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Debt Settlement: A Beast of Burden Without Any Reins

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Debt Settlement

A BEAST OF BURDEN WITHOUT ANY REINS

INTRODUCTION

At a recent debt-settlement industry conference, the speakers' stage was decorated to look like a boxing ring.[1] This backdrop was meant to symbolize the industry's need to fight back against its perceived opposition: lawmakers, regulators, and consumer-advocacy groups that want to put debt-settlement companies out of business. At first glance, the backlash against the debt-settlement industry is perplexing, since the industry bills itself as a better alternative to bankruptcy for consumers struggling with unsecured debt.

Irrespective of the conflict, the industry has been rapidly growing. One estimate places the total number of debt-settlement companies at two-thousand—up from eighty or one hundred just six years ago.[2] Industry advertising is much more prevalent and mainstream, and debt-settlement advertisements frequently appear on the front pages of New York City commuter newspapers. Remarkably, one major account-systems provider recently announced that it had aggregated over $3 billion in consumer debt-settlement accounts.[3]

Despite this growth, few outside the industry fully understand debt settlement as a service or its relationship to consumer-protection law. This note attempts to fill this void by providing a comprehensive examination of the debt-settlement industry and the legal issues it implicates. It begins with a brief history of debt-relief services targeting consumers. Part II provides a detailed explanation of the debt-settlement business model—its potential benefits and its fundamental problems

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1 David Streitfeld, *The Debt Settlement Industry Is Busy, But It's a Bit Nervous, Too*, N.Y. TIMES (June 9, 2009), http://www.nytimes.com/2009/06/10/business/10debt.html.

2 Pamela Yip, *Debt Settlers Attract Customers, Scrutiny: Credit Solutions CEO Defends Ethics Amid Regulator Suits*, DALLAS MORNING NEWS, May 30, 2009, at 1D.

3 Press Release, Persolvo Data Sys., Persolvo Data Systems Achieves $3 Billion Milestone (Sept. 9, 2009), *available at* http://persolvodatasystems.com/pr/Persolvo_$3_Billion_Dollar_Milestone_Wade-Torkelson.pdf.

that harm debt-settlement clients. Part III explains why past efforts, at both the federal and state level, have been inadequate to regulate this harm. Part IV discusses current regulatory proposals in federal law and uniform state law. It also examines the Federal Trade Commission's recent rule amendments that address the harms caused by debt settlement. Finally, Part V argues that the Federal Trade Commission (FTC) is the ideal venue for regulating the debt-settlement industry. This part also addresses the shortcomings of current FTC regulation. Although the FTC recently amended its regulations—wisely banning debt-settlement companies from collecting upfront fees—the amendments' efficacy is severely limited by the absence of a private cause of action accessible to individual consumers. Administering these regulations is necessary to both rein in the industry and to ensure that debt-settlement services successfully assist consumers with the burdens of unsecured debt.

I. A BRIEF HISTORY OF DEBT-RELIEF SERVICES

Debt-relief services have a long history in business and regulation. Early in the twentieth century, debt adjusters began operating as the first generation of this consumer service.[4] Also known as debt consolidators, debt adjusters are for-profit services that attempt to persuade creditors to accept a less-than-full payment and discharge the remainder of a debtor's obligations.[5] If an agreement is reached, the debt adjuster collects a monthly payment from the debtor and distributes it to the creditor in accordance with the agreement.[6]

Myriad problems existed within this particular business model. Debt adjusters often charged usurious rates assessed prior to creditor payment and created unreasonable payment plans.[7] Complaints of deceptive advertising and outright fraud were also numerous.[8] Consumers unable to timely pay creditors often found themselves in worse financial conditions after

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4 Leslie E. Linfield, *Uniform Debt Management Services Act: Regulating Two Related—Yet Distinct—Industries*, AM. BANKR. INST. J., Apr. 2009, at 50, 51. For much of this background on the history of debt-relief services, see UNIF. DEBT MGMT. SERVS. ACT, prefatory note (Nat'l Conference of Comm'rs on Unif. State Laws 2005).

5 Linfield, *supra* note 4, at 51.

6 *Id.*

7 Carla Stone Witzel, *The New Uniform Debt-Management Services Act*, 60 CONSUMER FIN. L.Q. REP. 650, 651 (2006).

8 Linfield, *supra* note 4, at 51.

working with debt adjusters.[9] In response, by 1970, most states had banned for-profit debt adjusters,[10] and a majority of the remaining states had passed strict regulatory measures.[11]

Despite this regulatory movement, many of these statutes exempted nonprofit organizations from debt-adjusting prohibitions, triggering the second generation of debt-relief services.[12] In the 1960s, a trade association of credit-card-issuing businesses developed credit-counseling agencies for the express purpose of reducing consumer bankruptcy filings.[13] These counseling agencies negotiate a debt-management plan (DMP) between debtors and creditors for full payment of the debt, albeit on modified terms.[14] A counselor first determines if a modified plan is appropriate by examining the debtor's financial information and then negotiating with existing unsecured creditors for modifications (such as reduced interest rates, lowered late fees, and time extensions for repayment).[15] Once a DMP is set, the counselor takes monthly payments from the debtor and disburses pro-rata payments to creditors.[16] Funded predominantly by participating creditors, these credit-counseling agencies also provide educational and financial-literacy counseling as a part of the overall debt-management plan.[17]

As the amount of unsecured debt grew through the 1980s and 1990s, so did the credit-counseling industry—creating the third generation of debt-relief services.[18] Competing trade associations organized around aggressive marketing strategies and cost cutting.[19] These new agencies pushed for debt-management plans at the expense of educational initiatives and

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[9] Witzel, *supra* note 7, at 651.

[10] *Id.*; *see, e.g.*, N.Y. GEN. BUS. LAW §§ 455-457 (McKinney 2009). New York called debt adjusting "budget planning," defined as

> the making of a contract . . . with a particular debtor whereby . . . the debtor agrees to pay a sum or sums of money in any manner or form and the person or entity engaged in the business of budget planning distributes . . . the same among certain specified creditors in accordance with a plan agreed upon.

Id. § 455(1).

[11] Linfield, *supra* note 4, at 51.

[12] *Id.* New York explicitly exempted from its ban what it called "budget planning" not-for-profit entities. GEN. BUS. LAW § 455(4).

[13] Telemarketing Sales Rule, 74 Fed. Reg. 41,988, 41,995 (Aug. 19, 2009).

[14] *Id.*

[15] *Id.*

[16] Linfield, *supra* note 4, at 51.

[17] Telemarketing Sales Rule, 74 Fed. Reg. at 41,990.

[18] Linfield, *supra* note 4, at 51.

[19] *Id.*

individualized counseling.[20] As the market grew, creditors became less willing to fund these agencies, and higher fees were levied on the debtor.[21] Critics charge that credit-counseling agencies now provide no social utility and operate simply as deceptive debt collectors on behalf of creditors.[22] Many critics also allege illegal financial improprieties related to the agencies' required use of nonprofit status.[23] Due to the exemption of nonprofits from debt-adjuster laws, this industry remains largely unregulated.[24] Nevertheless, the FTC and state attorneys general (AGs) have pursued many enforcement actions against credit-counseling agencies for violations of state and federal consumer-protection laws.[25]

II. DEBT-SETTLEMENT COMPANIES

A. *The Business Model*

Debt settlement, the fourth generation of debt-relief services, differs significantly from credit counseling.[26] Because the end result of a debt-settlement program is less-than-full payment of a debtor's obligations, the service can also be thought of as a reappearance or reformulation of first-generation debt adjusters.[27] Indeed, one of the main industry trade associations describes a business familiar to consumer law professionals:

> By definition, debt settlement is the process by which a company negotiates with a consumer's unsecured creditors over time for a reduction in principal, which is usually less than the current balance owed. History shows us that an offer from creditors, collection

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[20] *Id.*

[21] Telemarketing Sales Rule, 74 Fed. Reg. at 41,991.

[22] Witzel, *supra* note 7, at 652.

[23] *See* PERMANENT SUBCOMM. ON INVESTIGATIONS, COMM. ON HOMELAND SEC. & GOVERNMENTAL AFFAIRS, U.S. SENATE, PROFITEERING IN A NON-PROFIT INDUSTRY: ABUSIVE PRACTICES IN CREDIT COUNSELING, S. REP. NO. 109-55 (2005). Specifically, fraud and nonenforcement were identified as major issues.

[24] Witzel, *supra* note 7, at 652.

[25] For an extensive sample of enforcement actions, see Telemarketing Sales Rule, 74 Fed. Reg. at 41,991-92 nn.51-59. Generally, the FTC Act and state unfair-and-deceptive-practices laws were used. For a discussion of these laws as they relate to the debt-settlement industry, see *infra* text accompanying notes 80-122.

[26] Linfield, *supra* note 4, at 51.

[27] *Id.* This comparison is not made as a conclusive argument in favor of regulation. Debt adjusters, as discussed above, were not banned because they sought less than full payment to creditors but because diverse, industry-wide abuse was identified.

> agencies, debt buyers, and attorneys can range from as little as 5% of the outstanding claim to as much as 90% of the outstanding claim. . . . The process of debt settlement is, in theory, simple. A financially troubled consumer resolves an outstanding account, alleviating the consumer of that financial responsibility. The bank liquidates an account, saving the account from total loss.[28]

Debt settlement, however, is unique. Unlike debt adjusters, the company creates a contract and payment plan prior to contacting or negotiating with any creditors.[29] The debtor makes payments to a savings or escrow account, and once a target amount is achieved (often calculated based on a percentage of the total debt owed), the settlement company contacts the creditor and offers a sum that can be immediately paid from that account.[30] Debt-settlement companies encourage saving enough money to effectuate settlements in escrow as quickly as possible,[31] and typically, payment plans aim for achieving this amount in twenty-four to thirty-six months.[32]

Inherent in this business model is "the ability of the debt settlement provider to time a consumer's delinquency and rate of savings to coincide with a creditor's or debt collector's incentive to settle."[33] Generally, the industry has determined that creditors become much more willing to settle for lower payments once an account is more than 120 days in delinquency.[34] Consequently, debt-settlement companies instruct clients to stop payments, default on accounts, and cease communication with creditors.[35] To achieve this superficial divorce of debtor from creditor, debt-settlement companies often accept power of attorney to cease communication, instruct creditors to only contact the settlement company, or change billing addresses to route all creditor mail to the settlement company.[36]

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[28] U.S. ORGS. OF BANKR. ALTS., INC., DEBT SETTLEMENT: DEBT RELIEF: A GROWING NECESSITY FOR MANY CONSUMERS 6 (2008) [hereinafter GROWING NECESSITY], *available at* http://www.ftc.gov/os/comments/debtsettlementworkshop/536796-00022.htm.

[29] Linfield, *supra* note 4, at 51.

[30] *Id.*

[31] ASS'N OF SETTLEMENT COS., TASC GENERAL RESPONSE TO QUESTION CARDS FROM FTC WORKSHOP 8 (2008) [hereinafter TASC RESPONSE].

[32] *See Consumer Protection in the Debt Collection and Debt Management Industries: Hearing on A. 7268 Before the Comm. on Consumer Affairs & Prot.*, 2009 Leg., 2 (N.Y. 2009) (testimony of Johnson M. Tyler) [hereinafter Tyler Testimony].

[33] Telemarketing Sales Rule, 74 Fed. Reg. 41,988, 41,993 (Aug. 19, 2009).

[34] GROWING NECESSITY, *supra* note 28, at 7.

[35] Telemarketing Sales Rule, 74 Fed. Reg. at 41,994; UNIF. DEBT MGMT. SERVS. ACT prefatory note 3 (Nat'l Conference of Comm'rs on Unif. State Laws 2005).

[36] Telemarketing Sales Rule, 74 Fed. Reg. at 41,994.

Debt-settlement companies frequently calculate fees using one of two methods: the settlement savings-fee method or the flat-fee method.[37] The former bases most of the fee on a percentage of the savings realized by the debtor, while the latter is based on a percentage of the total debt managed by the settlement company.[38] Additionally, enrollment fees and monthly maintenance fees are often calculated and charged separately.[39] The FTC found that regardless of how fees are calculated, most companies charge using a "front-end fee model" that requires a debtor to pay a bulk of the fee within the first few months of enrollment, "whether or not any settlements have been attempted or achieved."[40] Some companies also require a debtor to pay all or almost all fees before any funds are released to creditors as a settlement.[41]

B. The Good

Demand for debt-relief services is high, yet "traditional [debt-management plans] have become less available to consumers who increasingly have insufficient income to repay their debts under such plans."[42] Completion of a debt-settlement program can potentially reduce the debt owed by a consumer who is otherwise ineligible for debt management or liquidation bankruptcy.[43] A hypothetical debt situation is helpful in understanding the potential benefit of debt-

[37] *See* TASC RESPONSE, *supra* note 31, at 2; *see also* GROWING NECESSITY, *supra* note 28, at 12.

[38] TASC RESPONSE, *supra* note 31, at 2.

[39] GROWING NECESSITY, *supra* note 28, at 13.

[40] Telemarketing Sales Rule, 74 Fed. Reg. at 41,994. The FTC also describes two alternative fee structures—one in which the entire fee is collected during the first half of the enrollment period and one in which the bulk of the fee is not paid until the program is complete. *Id*.

[41] *Id.*

[42] *Id.* at 41,993; CAREONE CREDIT COUNSELING, BETWEEN FINANCIAL BALANCE AND BANKRUPTCY: BETTER OPTIONS FOR CONSUMERS STRUGGLING TO MANAGE UNSECURED DEBT 5 (2008), *available at* http://www.ftc.gov/os/comments/debtsettlementworkshop/536796-00035.pdf (estimating that, every year, "more than six million consumers interested in the traditional DMP either opt for another solution or do not meet the repayment criteria").

[43] Debt-management plans frequently require a debtor to show a sufficient ability to pay, something that many debtors cannot do. *See* CAREONE CREDIT COUNSELING, *supra* note 42, at 4. Similarly, recent amendments to the bankruptcy code make liquidation bankruptcy more difficult to obtain because of added eligibility requirements, which also increases filing expenses. *See generally* Andrew P. MacArthur, *Pay to Play: The Poor's Problems in the BAPCPA*, 25 EMORY BANKR. DEV. J. 407 (2008).

settlement services. A debtor that owed $10,000 in total debt might be charged a fee of 18% under the flat-fee model (or $1800).[44] That debtor may be charged a $300 initiation fee and a $60-per-month service fee for the entire, say, thirty-six-month program, resulting in service fees of $2460.[45] Combined with the flat fee, the debt-settlement-program fees total $4260. Assume that the settlement company is able to negotiate a 40% settlement of the total debt in this situation—a number that debt-settlement companies claim is possible.[46] In this scenario, the debtor will have paid $4000 to settle the actual debt and an additional $4260 in fees—a total of $8260. The debtor saved close to 20% on the total $10,000 debt owed, and the entire program lasted only three years. This is a best-case scenario.

C. The Bad

The best-case scenario is not necessarily the norm. State attorneys general report a two-fold increase in the number of complaints against debt-settlement companies in 2009.[47] Major news outlets—including ABC's *Nightline* and *World News Saturday*, and CBS's *The Early Show*—have recently run features critical of the debt-settlement industry and warning consumers of its drawbacks.[48] In 2008, debt settlement was listed in Better Business Bureau as one of the top-ten business scams.[49] Two prominent New York legal-services organizations advise against using debt-settlement programs entirely; one bluntly stated, "[d]ebt settlement companies are a rip-off."[50] Debt settlement often results in unforeseen harm for consumers.

One major concern is the success rate within the industry. A voluntary study conducted by an industry trade

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[44] *See* TASC RESPONSE, *supra* note 31, at 2. This hypothetical uses numbers that two leading trade associations provided to the FTC. *Id.*

[45] GROWING NECESSITY, *supra* note 28, at 13. For illustrative purposes, I have chosen potential fees on the higher side of ranges provided by debt-settlement companies.

[46] *Id.* at 6.

[47] David Streitfeld, *Debt Settlers Offer Promises But Little Help*, N.Y. TIMES (Apr. 20, 2009), http://www.nytimes.com/2009/04/20/business/20settle.html.

[48] *See, e.g.*, *The Early Show* (CBS television broadcast May 12, 2009); *Nightline* (ABC television broadcast July 25, 2009); *World News Saturday* (ABC television broadcast Aug. 22, 2009).

[49] Linfield, *supra* note 4, at 51.

[50] Peter Dellinger, *Debt Settlement Scams*, EMPIRE JUST. CENTER (Aug. 13, 2009), http://www.empirejustice.org/issue-areas/consumer-community-development/credit-cards/debt-settlement-scams.html; Tyler Testimony, *supra* note 32, at 2.

association found only a 35% to 60% debtor "completion rate."[51] Even worse, a National Consumer Law Center report stated that only 1.4% of consumers completed a debt-settlement program after enrolling.[52] Similarly, New York Attorney General Andrew Cuomo reported that one debt-settlement company promised a 60% reduction in debt yet only achieved those results for 1% of enrolled consumers.[53] In one suit brought by the State of Texas against a debt-settlement company, the State alleged that the company's own internal data showed that fewer than 20% of individual accounts reached a settlement of any amount.[54]

The FTC describes the problems with debt-settlement services as two-fold: (1) "the marketing and advertising" of debt-settlement programs and (2) their fundamental soundness for consumers.[55] Speaking to the former, debt-settlement companies advertise heavily on television, radio, and the internet.[56] A common strategy is to highlight the long-term consequences of bankruptcy and present debt settlement as a better alternative.[57] Specific outcomes are frequently touted:

> Common claims in the ads . . . include representations that debt settlement companies will obtain for consumers who enroll in a debt settlement plan any of the following results: a reduction of their debts by 50%; elimination of debt in 12-36 months; cessation of harassing calls from debt collectors and collection lawsuits; and expert assistance from debt settlement providers who have special relationships with creditors and knowledge about available techniques to induce settlement. Debt settlement companies also frequently represent that there is a high likelihood (sometimes even a "guarantee") of success.[58]

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[51] ASS'N OF SETTLEMENT COS., STUDY ON THE DEBT SETTLEMENT INDUSTRY 1 (2007). The study accepted companies' self-reported completion rates, which had been calculated using different standards. *See* Telemarketing Sales Rule, 74 Fed. Reg. 41,988, 41,995 n.104 (Aug. 19, 2009). The FTC was highly critical of this methodology. *Id.*

[52] DEANNE LOONIN, NAT'L CONSUMER LAW CTR., AN INVESTIGATION OF DEBT SETTLEMENT COMPANIES: AN UNSETTLING BUSINESS FOR CONSUMERS 5 (2005) [hereinafter UNSETTLING BUSINESS].

[53] Press Release, N.Y. Att'y Gen., Attorney General Cuomo Sues Debt Settlement Companies for Deceiving and Harming Consumers (May 19, 2009), *available at* http://www.ag.ny.gov/media_center/2009/may/may19b_09.html.

[54] Streitfeld, *supra* note 47.

[55] Telemarketing Sales Rule, 74 Fed. Reg. at 41,995 (internal citations omitted).

[56] Suzanne Ziegler, *New Law Tightens Rules for Debt Firms*, STAR TRIB. (Minn.) (June 7, 2009), http://www.startribune.com/business/47061237.html.

[57] *See, e.g.*, Streitfeld, *supra* note 1.

[58] Telemarketing Sales Rule, 74 Fed. Reg. at 41,995.

In light of the industry's low completion rates, these claims are dubious at best.[59] Touting guaranteed specific reduction percentages and completion dates without concern for individual circumstances or overall success rates is reckless and deceptive. Indeed, even the executive director of a debt-settlement trade association commented, "the main concern is consumers are being misled through false advertising."[60]

More troubling are the fundamental flaws in the nature of debt-settlement services. Debt-settlement companies claim to maintain strong relationships with creditors[61] and market their experience with creditor settlement procedures as a benefit.[62] But it is not clear that creditors are even receptive to working with debt-settlement companies. One executive of the American Bankers Association—the professional association representing the banking industry—described debt-settlement companies as "very harmful to both creditor and consumer."[63] Another American Bankers Association senior representative stated that creditors want to work with customers "without the significant negative consequences to the consumer that flow from the insertion of the debt-settlement company into the relationship."[64] In fact, many consumer advocates recommend contacting creditors directly to negotiate reductions as a better alternative to debt-settlement programs.[65]

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[59] *Id.*

[60] John Pacenti, *McCollum: Consumers Better Off Avoiding Debt Settlement Firms*, MIAMI DAILY BUS. REV., Oct. 20, 2008, at 1.

[61] Telemarketing Sales Rule, 74 Fed. Reg. at 41,995.

[62] UNSETTLING BUSINESS, *supra* note 52, at 10. One debt-settlement trade association went so far as to state,

> It is common for debt settlement company representatives to have a relationship with specific contacts at creditor offices or collection agencies that they work with in the negotiation process. Some creditors and collection agencies have developed, or are in the process of developing, specific departments that work exclusively with debt settlement companies. For these creditors and collection agencies, working with debt settlement companies allows them to handle a large quantity of accounts with a limited amount of manpower, minimizing the costs associated with collection activity and maximizing liquidation percentages.

GROWING NECESSITY, *supra* note 28, at 8.

[63] Streitfeld, *supra* note 47 (internal quotation marks omitted).

[64] Pacenti, *supra* note 60, at 1.

[65] *See, e.g.*, Sandra Block, *When Settling Debt, Watch out for Scam Artists Waiting to Pounce*, USA TODAY, July 21, 2009, at B3; Tara Siegel Bernard, *Weighing the Options with Credit Card Debt*, N.Y. TIMES (May 16, 2009), http://www.nytimes.com/2009/05/16/your-money/credit-and-debit-cards/16counsel.html; David Streitfeld, *Credit Bailout: Issuers Slashing Card Balances*, N.Y. TIMES (June 16, 2009), http://www.

Moreover, debt-settlement companies encourage debtor default—either explicitly or implicitly—a strategy that is unavoidably harmful to consumers.[66] The industry openly admits that delinquency aids the negotiation process.[67] But payment default has a profoundly negative impact on the debtor more generally: "creditors often impose additional finance charges, delinquency fees and may undertake collection activity, including litigation."[68] This response is not surprising; creditors may go months without receiving payment or any communication on behalf of a debtor's account after the debtor enrolls in a settlement program. Payment neglect may even accelerate the collection process.[69] Indeed, one FTC enforcement action against a consortium of debt-settlement companies revealed that 5679 collection lawsuits were filed against the companies' approximately 18,116 clients during a one-year period.[70] Compounding the problem, many clients are unaware that they are subject to traditional collection measures once enrolled in debt-settlement programs, and debt-settlement companies provide no assistance with the consequences.[71]

Additionally, debt-settlement programs are financially infeasible for their target population of debtors:

> Debt settlement companies have described the ideal debt settlement customer as someone who is suffering from a hardship of some kind and having difficulty making payments . . . and cannot afford to pay their debts. Some companies will work only with insolvent customers, defined in some cases to mean consumers who are unemployed. Others require that the consumer be in a hardship situation. One company states that its program is appropriate for consumers with little or no ability to pay their debts and facing possible bankruptcy. "It is not for people who are gainfully employed or have high credit ratings." Another company strongly discourages people with good credit.[72]

Indeed, of the three debt-settlement clients described in a recent New York Assembly committee hearing on the problems

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nytimes.com/2009/06/16/your-money/credit-and-debit-cards/16credit.html; Susan Tompor, *Be Wary of Offers to Settle Debt*, BELLEVILLE NEWS DEMOCRAT, May 28, 2009.

66 UNSETTLING BUSINESS, *supra* note 52, at 5; Linfield, *supra* note 4, at 60.

67 GROWING NECESSITY, *supra* note 28, at 7.

68 Linfield, *supra* note 4, at 51.

69 Telemarketing Sales Rule, 74 Fed. Reg. 41,988, 41,994 n.86 (Aug. 19, 2009).

70 *Id.* at 41,996 n.109 (citing Complaint, Fed. Trade Comm'n v. Connelly, No. SA CV 06-701 DOC RNBx (C.D. Cal. Aug. 3, 2006)).

71 UNSETTLING BUSINESS, *supra* note 52, at 6.

72 *Id.* at 4.

within the industry, not one was employed.[73] Monthly charges—which include money to be put in escrow and service fees—often exceed a client's ability to pay.[74] High monthly payments are only exacerbated by the front-end fee model—now an industry standard.[75] Many settlement companies claim to have a screening process to ensure that clients can afford the given monthly payments.[76] But it is hard to accept this assertion given the extremely low success rate, the industry's stated preference for indigent clients, and the available examples of common payment schedules.[77] Further, for many indigent clients, their only income and assets are exempt from collection under applicable state and federal laws—a fact that debt-settlement companies would undoubtedly discover under any financial audit.[78] The economically infeasible nature of debt-settlement programs seriously undermines their utility for both debtors and creditors.

III. EXISTING REGULATION AND ENFORCEMENT

Commonly used regulatory and enforcement schemes are ill equipped to address the problems within the debt-settlement industry. Current laws were not designed with reference to debt settlement and do not attack the industry's fundamental problems.[79]

A. FTC Action

FTC action has been a frequent method of enforcement. Responding to consumer complaints, the FTC targets debt-settlement companies for deceptive and misleading

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[73] Tyler Testimony, *supra* note 32, at 2-3.

[74] UNSETTLING BUSINESS, *supra* note 52, at 4.

[75] Telemarketing Sales Rule, 74 Fed. Reg. 41,994 (Aug. 19, 2009).

[76] GROWING NECESSITY, *supra* note 28, at 7.

[77] *See* UNSETTLING BUSINESS, *supra* note 52, at 4. One example is a $300-per-month plan set for a woman whose only source of income was Social Security. Tyler Testimony, *supra* note 32, at 2.

[78] *See* Tyler Testimony, *supra* note 32, at 3; *see also* UNSETTLING BUSINESS, *supra* note 52, at 4.

[79] Although the FTC has now passed rule amendments specifically addressing the debt-settlement industry (most of which became effective on September 27, 2010), the discussion here is limited to longer-standing regulatory sources under which enforcement actions have originated. Telemarketing Sales Rule; Final Rule, 75 Fed. Reg. 48,458 (Aug. 10, 2010) (to be codified at 16 C.F.R. pt. 310).

advertising.[80] Since 2001, the FTC has filed seven actions, some of which involved multiple companies and individuals.[81] Most commonly, the FTC alleges violations of the Federal Trade Commission Act (FTC Act).[82] The FTC Act is broadly worded, providing that "[u]nfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are . . . unlawful."[83] Consequently, FTC actions under this law have alleged violations such as misrepresented fees, undisclosed fees, falsely promised success rates, and failure to warn of negative consequences.[84]

FTC actions against debt-settlement companies have been successful in limited circumstances. For example, one settlement agreement stipulated that an individual defendant, the ex-CEO of a debt-settlement company that allegedly violated the FTC Act, could no longer engage in telemarketing or debt negotiation.[85] Similarly, a different settlement agreement obtained by the FTC for alleged FTC Act violations permanently banned an individual defendant and a corporate defendant from engaging in debt-negotiation services of any kind.[86] The FTC has also recovered substantial monetary refunds through settlements.[87]

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[80] *See* Telemarketing Sales Rule, 74 Fed. Reg. at 41,996; *see also* ROBERT J. HOBBS, FAIR DEBT COLLECTION 624-25 (6th ed. 2008).

[81] *See* Telemarketing Sales Rule, 74 Fed. Reg. at 41,996.

[82] 15 U.S.C. §§ 41-58 (2006). *See, e.g.*, Complaint, Fed. Trade Comm'n v. Connelly, No. SA CV 06-701 (C.D. Cal. Aug. 3, 2006); Complaint, Fed. Trade Comm'n v. Nat'l Consumer Council, No. SA CV 04-0474 (C.D. Cal. Apr. 23, 2004); Complaint, Fed. Trade Comm'n v. Debt Set, Inc., No. 07 CV 00558 (D. Co. Mar. 20, 2007).

[83] 15 U.S.C. § 45(a)(1).

[84] *See, e.g.*, Press Release, Fed. Trade Comm'n, 'Debt Meltdown Program' Marketers Settle with FTC; Charged with Failing to Deliver Promised Debt Reduction Services (Aug. 5, 2008), *available at* http://www.ftc.gov/opa/2008/08/edge.shtm; Press Release, Fed. Trade Comm'n, Debt-Negotiation Defendants Agree to Settle FTC Charges in Nationwide Operation That Led Many into Financial Ruin (Sept. 25, 2008), *available at* http://www.ftc.gov/opa/2008/09/nss.shtm; Press Release, Fed. Trade Comm'n, Debt Reduction Companies Settle with FTC (Feb. 14, 2008), *available at* http://www.ftc.gov/opa/2008/02/debtreduct.shtm.

[85] Settlement Agreement and Stipulated Final Order as to Defendant Dennis Connelly at 6, Fed. Trade Comm'n v. Connelly, No. SA CV 06-701 (C.D. Cal. Sept. 25, 2008).

[86] Stipulated Final Judgment and Order for Permanent Injunction Against Defendants Todd A. Baker and Debt Resolution Specialists, Inc. at 8-9, Fed. Trade Comm'n v. Innovative Sys. Tech., Inc., No. CV 04-0728 (C.D. Cal. July 13, 2005).

[87] *See, e.g.*, Press Release, Fed. Trade Comm'n, Debt Services Operations Settle FTC Charges (Mar. 30, 2005), *available at* http://www.ftc.gov/opa/2005/03/creditcouncel.shtm. Here an FTC settlement agreement with NCC required corporate defendants to pay $1 million and three individual defendants to pay $3.5 million, after the FTC had recovered $24 million in funds held in corporate trust accounts. *Id.*

Despite these successes, the FTC is not able to address the full extent of abuse in the debt-settlement industry. As an agency, the FTC is tasked with numerous categories of consumer protection involving many statutes—resulting in limited resources for any one issue.[88] Indeed, while the FTC has identified abuse in the industry widespread enough to justify increased regulation,[89] it has only brought seven enforcement actions since 2001[90]—despite its broad discretion under the FTC Act to determine what actually constitutes consumer harm.[91] Additionally, the FTC Act, under which the FTC has achieved most of its settlements, disallows private causes of action.[92] This means that individuals who are harmed by violations of the Act are "encouraged to complain to the Commission, [but their] complaints give them no formal standing before the Commission or the courts."[93] Thus, recognizing its internal limitations, the FTC itself has advocated the creation of private causes of action for consumer matters.[94] Finally, while FTC enforcement has been able to selectively shutter debt-settlement companies for employing deceitful advertising, the FTC Act does not address the fundamental problems of the industry—namely, untenable fee structures, and harmful delays between client payments and services rendered.[95]

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[88] Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 95 (2008).

[89] *See* Telemarketing Sales Rule; Final Rule, 75 Fed. Reg. 48,458 (Aug. 10, 2010) (to be codified at 16 C.F.R. pt. 310).

[90] *See* Telemarketing Sales Rule, 74 Fed. Reg. 41,994, 41,996 (Aug. 19, 2009).

[91] Victor E. Schwartz & Cary Silverman, *Common-Sense Construction of Consumer Protection Acts*, 54 U. KAN. L. REV. 1, 8-9 (2005).

[92] PETER C. WARD, FEDERAL TRADE COMMISSION LAW PRACTICE AND PROCEDURE § 3.04 (Law Journal Press 2010).

[93] *Id*.

[94] William A. Lovett, *State Deceptive Trade Practice Legislation*, 46 TUL. L. REV. 724, 729 n.10 (1972) ("FTC enforcement effort against deceptive trade practices suffers from crucial and probably inherent limitations. . . . [T]he federal effort is modestly staffed, far removed from most local communities, and, consequently, must be concentrated against national media advertising with only occasional test cases against smaller scale law violators. In recent years . . . the FTC itself [has] strongly endorsed and emphasized the need for . . . viable private remedies for consumers.").

[95] On at least one occasion, the FTC brought an action for FTC Act violations based on failure to disclose the potential harmful effects of discontinuing payment to one's original creditors. Press Release, Fed. Trade Comm'n, Fraudulent "Debt Negotiators" Settle FTC Charges (July 19, 2005), *available at* http://www.ftc.gov/opa/2005/07/briggsbaker.shtm. But this allegation still does not address the fundamental problems of the debt-settlement model. A company could easily comply with the law by using contractual fine print and simultaneously do nothing to protect

B. State Attorneys General

Like the FTC, state attorneys general also frequently target debt-settlement companies in civil actions.[96] Often, AGs allege unfair or deceptive acts and practices committed by debt-settlement companies in violation of state consumer law.[97] For example, in May 2009, New York Attorney General Andrew Cuomo filed suit against two debt-settlement companies alleging deceptive business practices and false advertising.[98] The suits followed subpoenas issued by the AG to fourteen debt-settlement companies requesting information about fee structures, completion rates, and services rendered.[99] One of these cases has already been decided, levying a civil penalty of $198,100 against Nationwide Asset Services, Inc. for defrauding 1981 consumers.[100] The court also ordered a complete refund to 180 consumers and enjoined the company from doing further business in New York unless it provided a $500,000 performance bond.[101]

Although these AG actions can be financially effective for select consumers, they provide only short-term solutions that

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clients from the permanently damaging actions of creditors once payments and communication cease.

96 Telemarketing Sales Rule, 74 Fed. Reg. 41,988, 41,997 (Aug. 19, 2009).

97 *Id.* at 41,996. For an extensive list of AG enforcement actions from around the country, see *id.* at 41,997 nn.132-33. For a discussion of state deceptive-acts laws, also called "little FTC Acts," see Schwartz & Silverman, *supra* note 91, at 15. AGs also frequently target debt-settlement companies for violations of more narrowly written debt-management statutes. Telemarketing Sales Rule, 74 Fed. Reg. at 41,997 n.134. State laws specifically targeting debt-management services are discussed at length *infra* Part IV.B. And because New York has not yet passed this type of legislation, a description of its enforcement is not relevant here.

98 Verified Complaint, Cuomo v. CSA-Credit Solutions of Am., No. 401225/2009 (N.Y. Sup. Ct. May 19, 2009); Verified Petition, Cuomo v. Nationwide Asset Servs., Inc., No. 2009-5710 (N.Y. Sup. Ct. May 20, 2009). Both complaints alleged that defendants Nationwide Asset Services and Credit Solutions of America Inc. (CSA) engaged in fraud, deceptive business acts, and false advertising in violation of New York law; only the CSA complaint alleged violations of New York's credit-services law. These particular New York statutes are discussed *infra* Part III.B in the context of private causes of action.

99 Press Release, N.Y. Att'y Gen., Attorney General Cuomo Announces Nationwide Investigation into Debt Settlement Industry (May 7, 2009), *available at* http://www.oag.state.ny.us/media_center/2009/may/may7a_09.html.

100 Press Release, N.Y. Att'y Gen., Attorney General Cuomo Obtains Court Order Barring Debt Settlement Company that Ripped Off Thousands of New York Consumers from Operating in NYS Unless It Meets Strict Requirements (Oct. 15, 2009), *available at* http://www.oag.state.ny.us/media_center/2009/oct/oct15b_09.html. According to the AG's office, the "court found that the majority of . . . customers were promised a 25 to 40 percent reduction in their outstanding debt but never saw such reductions. Only one-third of one percent of consumers received such savings." *Id.*

101 *Id*.

are limited in ways similar to FTC actions. The New York AG's office does not prosecute directly on behalf of individual consumers; there must be a widespread need for it to proceed.[102] The result is that lone consumers may not be able to use the AG to enforce their legal rights. Further, these New York cases are based on laws that address only general fraudulent and deceptive practices by debt-settlement companies. Accordingly, a debt-settlement company can easily comply with basic disclosure requirements while simultaneously collecting upfront fees that far exceed the value of services rendered. Similarly, AG actions fail to address the industry's fundamental problems because they are brought under state laws with limited breadth. Like the FTC, AGs cannot target infeasible fee structures or delays in services that cause creditors to pursue debtors for payment defaults while under a debt-settlement program. Absent false or misleading statements, the AG is unable to act against debt-settlement companies.

C. Private Enforcement

Private causes of action also target debt-settlement companies with varied but less-than-sufficient success. The Federal Credit Repair Organizations Act (CROA) is one statute that allows individuals to assert violations by debt-settlement companies.[103] The CROA provides that "credit repair organizations" may not receive money or valuable consideration in advance of performing agreed-upon services.[104] A credit-repair organization is defined as any person or entity that provides services for the express or implied purpose of either (1) "improving any consumer's credit record, credit history, or credit rating" or (2) "providing advice or assistance to any consumer with regard to" such services.[105] In passing the CROA, Congress desired to ensure that consumers had

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[102] Indeed, in the two cases against debt-settlement companies, 18,000 New York residents had enrolled with one company, while 1981 had enrolled with another one, illustrating the size of cases taken by the AG. David Streitfeld, *New York Accuses 2 Debt Settlement Firms of Fraud*, N.Y. TIMES (May 20, 2009), http://www.nytimes.com/2009/05/20/business/20debt.html.

[103] 15 U.S.C. §§ 1679-1679j (2006). *See, e.g.*, Complaint, Yunker v. Rise Above Debt Relief LLC, No. 09-CV-1204-01 (D. Kan. June 30, 2009); Complaint, Boyken v. Am. Debt Arbitration, No. 6:07-cv-06348 (W.D.N.Y. July 16, 2007); Complaint, Cortese v. Edge Solutions, Inc., No. CV-04 0956 (E.D.N.Y. Mar. 5, 2004).

[104] 15 U.S.C. § 1679b(b).

[105] *Id.* § 1679a(3). Nonprofit organizations and a particular debtor's original creditors are explicitly exempted from the statute's provisions. *Id.*

necessary information when purchasing such services, and to protect the public from unfair and deceptive business practices in the industry.[106]

Debt-settlement fee structures would violate the CROA's ban on upfront fees because no debt-settlement company begins negotiations with creditors until all or a substantial portion of fees have been collected.[107] But in the limited cases on the issue, courts have refused to find that debt-settlement services alone fulfill the CROA's definition of a credit-repair organization.[108] Absent a showing that the company, at a minimum, advertised or engaged in specific credit-related issues, courts are unwilling to declare that debt-settlement companies are credit-repair organizations. In *Plattner v. Edge Solutions*, *Inc.*, for example, an Illinois district court held that a debt-settlement company administering a credit-repair program was not a credit-repair organization because the company had "ma[de] clear that participation in [its] program [would] likely result in damage to the participant's credit" and "that the participant's credit is outside the scope of the program."[109] Thus, the court concluded, the company "did not represent or even imply that [its] program was designed to improve the participant's credit as required for [it] to be a credit repair organization."[110] Indeed, the debt-settlement companies that the courts have deemed credit-repair organizations have aimed, explicitly or implicitly, to improve their clients' credit rating.[111] In light of this case law, a debt-settlement company can easily avoid CROA liability by tailoring its representations while still retaining harmful aspects of its business model.

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[106] *Id.* § 1679(b).

[107] Telemarketing Sales Rule, 74 Fed. Reg. 41,994 (Aug. 19, 2009).

[108] *See* HOBBS, *supra* note 80, at 624-25.

[109] Plattner v. Edge Solutions, Inc., 422 F. Supp. 2d 969, 974 (N.D. Ill. 2006). The court stated that "[w]hether a company is a credit repair organization under the CROA depends on the representations made." *Id.*

[110] *Id.*

[111] *See, e.g.*, Reynolds v. Credit Solutions, Inc., 541 F. Supp. 2d 1248, 1254-57 (N.D. Ala. 2008) (finding that a debt-settlement program that advertised credit improvement met the CROA's definition of credit-repair organization), *vacated on other grounds*, Picard v. Credit Solutions, Inc., 564 F.3d 1249 (11th Cir. 2009); Cortese v. Edge Solutions, Inc., No. 04-0956, 2007 WL 2782750, at *6-7 (E.D.N.Y. Sept. 24, 2007) (holding that a debt-settlement company was a credit-repair organization because it advertised and rendered a supplemental program explicitly designed to repair credit following the traditional settlement program).

CROA's legislative history also does not support the statute's application to the debt-settlement industry. A U.S. House of Representatives report accompanying the CROA's passage states that "[t]he credit repair business involves the marketing of credit repair services to consumers whose consumer reports contain adverse information that interferes with their ability to obtain credit."[112] More succinctly, "credit repair organizations . . . help consumers eliminate adverse information from consumer reports."[113] Debt-settlement companies, however, do not purport to perform this function. Rather, these companies exist to eliminate outstanding debt on their clients' behalf. Absent material representations about improving credit worthiness, debt settlement does not fall within Congress's purpose in enacting the CROA.[114] Although the CROA may be useful for certain consumers, it is inadequate as regulation of the industry as a whole.

Many states have enacted CROA analogs that provide an additional private cause of action for debt-settlement clients.[115] For instance, New York's CROA analog applies to "credit services businesses"—defined identically to the federal CROA's credit-repair organizations.[116] The New York law imposes specific disclosure requirements on credit-services companies and

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[112] Hillis v. Equifax Consumer Servs., Inc., 237 F.R.D. 491, 513 (N.D. Ga. 2006) (quoting H.R. REP. NO. 103-486, at 57 (1994)).

[113] *Id.* (quoting S. REP. NO. 103-2009, at 7 (1993)).

[114] For an extensive discussion of the CROA's legislative history, see *id*. As the district court noted in *Hillis*,

> To utilize an analogy from the sport of golf, a [credit-repair organization] is like a person who offers to improve a golfer's score after a round is over by reviewing and making changes to the golfer's score card or by telling the golfer how he can make changes to his score card. By contrast, a person who offers to give a golfer swing tips to improve his score the next time he heads out on the course is not a [credit-repair organization].

Id. at 514. The *Hillis* court was not discussing debt-settlement companies, but the distinction between editing a scorecard and performing differently in the future is relevant. Congress intended the CROA to regulate the former while debt settlement is a service much more like the latter.

[115] For a comprehensive discussion of various state credit-repair laws and their scope, see CHI CHI WU & ELIZABETH DE ARMOND, FAIR CREDIT REPORTING § 15.3 (6th ed. 2006).

[116] N.Y. GEN. BUS. LAW §§ 458-a to 458-k (McKinney 2009) (defining a credit service business as person who provides "a service for the express or implied purpose of improving a consumer's credit record, history, or rating or providing advice or assistance to a consumer with regard to the consumer's credit record history or rating in return for the payment of a fee"); *see also* 15 U.S.C. § 1679a(3) (2006) (codification of the federal CROA). New York law, like the federal CROA, exempts nonprofits and original creditors from regulation. GEN. BUS. § 458-b.

prohibits them from accepting fees before performing services.[117] Given the New York CROA's similarity to its federal counterpart, courts are likely to interpret its definitional scope similarly: debt settlement qua debt settlement is not a credit-services business.[118] Indeed, state credit-repair laws "generally cover the same variety of organizations as the [federal CROA]."[119] Just as the federal CROA does not adequately regulate the debt-settlement industry, it is unlikely that courts will read state analogs to do so.

Additionally, New York's deceptive-acts-and-practices law provides a private cause of action that may also apply to the debt-settlement industry.[120] Section 349 states very simply and broadly that "[d]eceptive acts and practices in the conduct of any business, trade or commerce or in the furnishing of any service in this state are hereby declared unlawful."[121] Modeled on the FTC Act provision discussed above,[122] New York courts have interpreted section 349 using FTC Act case law and legislative history.[123] Since the FTC has been relatively successful in the few actions it has brought against debt-settlement companies, similarly situated plaintiffs in New York may be successful in section 349 actions. At least one suit brought under section 349 against a debt-settlement company, for example, settled out of court. The complaint, filed in the Western District of New York, alleged numerous section 349 violations for a debt-settlement company's statements about

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[117] GEN. BUS. §§ 458-d, 458-e.

[118] Although plaintiff Cortese pleaded violations of section 458, the court denied the defendant's motion for summary judgment on procedural grounds without discussing the merits of the plaintiff's state-law claims. Cortese v. Edge Solutions, Inc., No. 04-0956, 2007 WL 2782750, at *1 n.1 (E.D.N.Y. Sept. 24, 2007). *Cortese*, therefore, provides no insight into how it would apply section 458 to a debt-settlement company.

[119] WU & DE ARMOND, *supra* note 115, at § 15.3.2. But New York credit-repair law does explicitly exempt "[a]ny person admitted to practice law in this state where the person renders services within the course and scope of his or her practice as an attorney at law." GEN. BUS. § 458-b(1)(b). There is no similar exemption under the federal CROA. This New York exemption would be relevant in a situation where a law firm provides debt-settlement services (and, thus, might claim exemption from the New York law). While the intended scope of the exemption is unclear, one could argue that debt settlement is not "within the course and scope" of law practice and should therefore not be exempted.

[120] *See* GEN. BUS. § 349.

[121] *Id.* § 349(a).

[122] 15 U.S.C. § 45 (2006). Indeed, these state laws are known as "little FTC Acts." Schwartz & Silverman, *supra* note 91, at 15 (quoting J.R. Franke & D.A. Ballam, *New Applications of Consumer Protection Law: Judicial Activism or Legislative Directive?*, 32 SANTA CLARA L. REV. 347, 357 (1992)).

[123] State *ex rel.* Lefkowitz v. Colo. State Christian Coll. of Church of Inner Power, Inc., 346 N.Y.S.2d 482, 487 (N.Y. Sup. Ct. 1973).

the time required for services to be rendered and the success rates of its program.[124]

Nonetheless, section 349 has many of the same limitations as its federal counterpart. While section 349 may benefit certain individuals, like the FTC Act, it addresses only deceptive behavior. In enacting section 349, the New York legislature did not intend to address debt-settlement companies; indeed, its passage predates the rapid expansion of debt-settlement usage. Consequently, section 349 does not address the core problems of the debt-settlement industry. Section 349 provides consumers with only a limited resource and contributes little to the needed comprehensive regulatory framework.

IV. PROPOSED SOLUTIONS

Public concerns about the debt-settlement industry have not escaped the attention of regulators and legislators—federal and state alike. This section provides a detailed explanation of recent legislative efforts, as well as rule amendments passed by the FTC to regulate the debt-settlement industry.

A. Congressional Efforts

The U.S. House of Representatives has proposed a few different measures to address the deleterious effects of debt settlement. In 2003, the House proposed a resolution that mandated significant advertising and contract disclosures, and prohibited upfront fees.[125] The bill also banned debt-settlement companies from advising clients to discontinue payments owed to their original creditors.[126] The bill was referred to committee in late 2003, and has not been voted on or reintroduced since.[127]

More recently, the House introduced a bill that would give the FTC expedited rulemaking powers to regulate debt-

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[124] Complaint at 10, Boyken v. Am. Debt Arbitration, No. 6:07-cv-06348 (W.D.N.Y. July 16, 2007).

[125] Debt Counseling, Debt Consolidation, and Debt Settlement Practices Improvement Act of 2003, H.R. 3331, 108th Cong. (1st Sess. 2003).

[126] *Id.* § 1003(c)(1).

[127] *See* H.R. 3331 Bill Summary & Status, LIBRARY OF CONG., http://thomas.loc.gov (follow "Try the Advanced Search" link; then select "108" under "Select Congress"; then select "Bill Number" in the drop-down menu under "Enter Search"; then enter "H.R. 3331" in text search box; then follow "search hyperlink"; then follow "All Congressional Actions" hyperlink) (last visited Feb. 10, 2011); *see also Library of Congress*, THOMAS ONLINE DATABASE, http://thomas.loc.gov (last visited Feb. 1, 2011).

settlement companies.[128] Specifically, the bill directs the FTC to consider banning upfront fees and requiring certain disclosures by the debt-settlement industry.[129] No action has been taken on this bill since June 3, 2009,[130] likely due, in part, to the FTC's broader independent efforts and Congress's proposals for institutional change. As discussed below, the FTC independently passed amended rules creating regulations pertaining to "debt relief services"[131]—entirely supplanting the need for the House's expedited rulemaking.

Additionally, Congress recently passed the Dodd-Frank Wall Street Reform and Consumer Protection Act, which created the Bureau of Consumer Financial Protection.[132] The bureau is tasked with regulating all financial products and services, which are defined to explicitly include debt-settlement services.[133] That Congress specifically tasked a new federal agency with regulating the debt-settlement industry suggests that it is unlikely to pursue further legislation.

B. Uniform State Laws

Although congressional action is frozen, state legislatures have recognized the need to tackle the problems of the debt-settlement industry. As discussed above, states have commonly regulated debt-relief services in the past through piecemeal legislation.[134] Recently, however, the National Conference of Commissioners on Uniform State Laws (NCCUSL) began an effort to reverse this trend.[135] In 2005, the NCCUSL approved for dissemination a final version of the Uniform Debt-Management Services Act (UDMSA).[136] In brief,

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[128] Consumer Credit and Debt Protection Act, H.R. 2309, 111th Cong. (1st Sess. 2009).

[129] *Id.* § 2(b).

[130] *See* H.R. 2309 Bill Summary & Status, LIBRARY OF CONG., http://thomas.loc.gov (follow "Try the Advanced Search" link; then select "111" under "Select Congress"; then select "Bill Number" in the drop-down menu under "Enter Search"; then enter "H.R. 2309" in text search box; then follow "search hyperlink"; then follow "All Congressional Actions" hyperlink) (last visited Feb. 10, 2011).

[131] Telemarketing Sales Rule, 74 Fed. Reg. 41,988, 41,988 (Aug. 19, 2009).

[132] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1011, 124 Stat. 1376 (2010) (to be codified at 15 U.S.C. § 5491).

[133] *Id.* § 1002(15)(A)(viii)(II).

[134] *See supra* Part I.

[135] For a full background and history of the NCCUSL, see generally James J. White, *Ex Proprio Vigore*, 89 MICH. L. REV. 2096 (1991).

[136] Jeffrey S. Tenenbaum & Jonathan L. Pompan, *Proposed Uniform Debt-Management Services Act to Effect Major Changes in the Law*, 123 BANK. L.J. 502, 502 (2006).

the UDMSA purports to regulate debt-management services, including both credit-counseling agencies and debt-settlement companies.[137] Of course, the UDMSA is not law at promulgation; state legislatures must adopt and enact its provisions.[138] But a handful of states have enacted the UDMSA so far.[139]

At its foundation, the UDMSA prohibits companies and individuals from providing "debt management services" without registering at the state level.[140] Debt-management services are defined "as an intermediary between an individual and one or more creditors for the individual for the purpose of obtaining concessions."[141] The comments to this subsection clarify that debt-management services encompass any intermediary that attempts to change the terms of a debt contract—even when the intermediary does not have control over an individual's escrow funds—and explicitly mention debt-settlement companies.[142] The UDMSA exempts specific entities from its coverage.[143] The UDMSA also includes alternative language that allows states to decide whether to allow for-profit companies.[144] For example, a state could enact UDMSA language banning all for-profit debt-settlement services; or it could opt for language allowing *only* for-profit debt-settlement services and prohibiting for-profit credit counseling.[145]

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[137] *Id*.

[138] White, *supra* note 135, at 2096.

[139] *E.g.* COLO. REV. STAT. ANN. § 12-14.5-201 (West 2010); DEL. CODE ANN. TIT. 6 § 2401A (West 2010); KAN. STAT. ANN. § 50-1116 (West 2010); MINN. STAT. ANN. § 332A.02 (West 2010); 63 PA. CONS. STAT. ANN. § 2401 (West 2010); R.I. GEN. LAWS ANN. § 19-14.8-1 (West 2010); S.C. CODE ANN. § 37-7-101 (2010); UTAH CODE ANN. § 13-42-101 (West 2010). The UDMSA has also been proposed in New York. The bill adopting the UDMSA regulations was introduced in the New York Assembly and was referred to the Consumer Affairs and Protection Committee on March 27, 2009. The committee held a hearing on May 8, 2009. N.Y. Assemb., A. 7268, 2009 Leg. (N.Y. 2009). But no action has since been taken on the bill.

[140] UNIF. DEBT MGMT. SERVS. ACT § 4(a) (Nat'l Conference of Comm'rs on Unif. State Laws 2005). Registration is made with a state agency designated or created by a state for administering the UDMSA. *Id.* § 2(1). Approval of registration in one state shall be accepted as valid in another state so long as the information is substantially similar or more comprehensive than that required by the second state. *Id.* § 12(1).

[141] *Id.* § 2(9).

[142] *Id.* § 2 cmt. 8. The UDMSA is also explicitly intended to cover credit-counseling agencies. In fact, when originally written in 2003, the UDMSA only covered credit-counseling agencies. Debt-settlement companies were not included until a NCCUSL decision in 2004. *Id.* at 4 (prefatory note).

[143] For example, judicial officers and banks are specifically exempted. *Id.* § 3.

[144] *Id.* § 4(d).

[145] *Id.*; *see also* Tenenbaum & Pompan, *supra* note 136, at 506. For example, the version proposed by the New York legislature, *see supra* note 139, would require any

Once registered, the UDMSA imposes significant regulation on a debt-settlement company. One drafter described UDMSA regulations as "four pillars" that respond to recognized past abuse by "(1) safeguarding the debtor's money; (2) disclosing the credit counselor's relationship with and payment by creditors; (3) requiring adequate financial education; and, perhaps most importantly, (4) requiring credit counselors to determine that a [debt-management plan] is suitable for the debtor before enrolling the debtor in [the plan]."[146]

The UDMSA purports to accomplish the first goal—safeguarding a debtor's money—in several ways. First, it requires registered companies to provide extensive biographical information.[147] This requirement is intended to prevent highway banditry and to lower enforcement costs by allowing a state administrator to easily locate companies. Additionally, the UDMSA mandates that registered companies have a bond, certificate of insurance, or letter of credit in an amount deemed sufficient to cover potential payments of damages—which protects against company insolvency.[148] Trust accounts (also known as escrow accounts) must conform to specific guidelines: notably, money in a trust must be promptly returned to the individual upon cancellation of a service program.[149] Finally, the UDMSA specifically limits the fees that a debt-settlement company may charge.[150] Service fees are not to exceed $50 monthly; set-up fees are not to exceed $400 monthly; and debt-

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debt-management company—including debt-settlement companies—to be nonprofit before registering and conducting business in New York. N.Y. Assemb., A. 7268, 2009 Leg. Sess. § 579-C (N.Y. 2009). The specific language, borrowed directly from the UDMSA, provides that no company may register unless it is (1) organized and properly running as a not-for-profit under the law of the state in which it was formed, and (2) exempt from taxation under Section 501 of the Internal Revenue Code. *Id.* Despite this for-profit ban, however, the New York bill as proposed does not alter the UDMSA's general fee-cap provisions. *Id.* § 584-B. Indeed, New York specifically uses the UDMSA's language providing for a maximum initial fee of $400, a maximum monthly fee of $50, and a maximum of 30% of the amount saved on any settled debt. *Id.*

[146] Witzel, *supra* note 7, at 653. Disclosing details of any relationship with creditors is more relevant to credit counselors that are employed or paid by creditors. As previously noted, debt-settlement companies do not have a history of opaque relationships with creditors; in fact, creditors often disapprove of the debt-settlement industry. *See supra* Part II.C. As such, this particular type of regulation will not be discussed here.

[147] UNIF. DEBT MGMT. SERVS. ACT § 6 (Nat'l Conference of Comm'rs on Unif. State Laws 2005).

[148] *Id.* §§ 13, 14.

[149] *Id.* § 22(h).

[150] *Id.* § 23.

settlement companies may only charge up to 30% of the amount saved on a settled debt.[151]

The UDMSA goal of "requiring adequate financial education" speaks to disclosure as well as education. Prior to performing debt-management services, debt-settlement companies must provide an itemized list of services and charges, as well as a list of predicted settlement outcomes with each creditor.[152] In addition, the UDMSA requires that these companies disclose the adverse consequences of participating in their programs. Companies must inform clients that the service may adversely affect their credit scores.[153] They also must advise clients that there may be better alternatives like bankruptcy and that any settled debt may be taxable as income.[154] Supplementing these disclosure requirements, a debt-settlement company is required to provide prospective clients with "reasonable education about the management of personal finance."[155] According to the comment accompanying this subsection, education may be a "group class" or an "electronic educational program," but it "must be substantially more than an explanation of the benefits of a plan."[156] Noting that financial-literacy education is becoming more commonplace, the UDMSA comments also explain that the state administrator may promulgate more detailed rules for education as standards for effective financial literacy develop.[157]

Finally, the UDMSA regulations require a debt-management service to determine that a particular plan is suitable for an individual before the individual enrolls in the

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[151] *Id.* The numbers presented here are absolute-maximum amounts allowed under the UDMSA. Actual fee structures are based on the amount of debt under contract in various ways. For example, a debt-settlement company may only charge a set-up fee "in an amount not exceeding the lesser of $400 and four percent of the debt in the plan at the inception of the plan." *Id.* § 23(d)(2)(A). The UDMSA also requires that debt-settlement contracts provide cancellation within three days of creation with no obligation and cancellation upon notice by the individual at anytime with the right to a refund of unexpended funds. *Id.* §§ 19, 20. This protects a debtor's money by allowing cancellation of a contract without liability for further payments.

[152] *Id.* § 17(a), (c). Prediction of settlement outcomes need not be particular as to an amount. The UDMSA creates four categories in which a creditor must be predicatively placed by a debt-settlement company: (1) those that will participate and grant concessions, (2) those that will participate but not grant concessions, (3) those that will not participate, and (4) all others. *Id.* § 17(c)(3).

[153] *Id.* § 17(d).

[154] *Id.*

[155] *Id.* § 17(b)(1).

[156] *Id.* § 17 cmt. 2.

[157] *Id.*

service's plan.[158] For a prospective client of a debt-settlement company, suitability "means at a minimum that the individual does not have the ability to satisfy creditors out of current income within a reasonable time even if the creditors were to reduce finance charges and fees for late payment, default, and delinquency."[159] A debt-settlement company must also determine that an individual will be able to fulfill the payment schedule of the chosen settlement plan.[160]

To enforce the UDMSA regulations, the UDMSA gives the state administrator power to order a cease and desist, to order payment of restitution, and to prosecute a civil action independently or on an individual's behalf.[161] In addition to public enforcement, an individual may bring a civil action to recover compensatory damages, punitive damages, and reasonable attorney's fees.[162]

C. FTC Rulemaking

Apart from federal and state legislation, the FTC has recently adopted rule changes targeting the debt-settlement industry.[163] This rulemaking amended the current Telemarketing Sales Rule (TSR) to bring more aspects of debt-relief services within the regulations.[164] Generally, the TSR regulates various business practices of companies engaged in telemarketing.[165] Telemarketing is defined as (1) soliciting the sale of goods or services using a telephone and (2) making more than one interstate phone call.[166] Previously, the TSR applied only to outbound calls made by debt-relief services.[167] But the new rule encompasses inbound calls as well, bringing "virtually all debt relief telemarketing transactions" within the TSR's

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[158] *Id.* § 17(b)(3)(B).

[159] *Id.* § 17 cmt. 4.

[160] *Id.* § 17(b)(3)(B).

[161] *Id.* § 33. The state administrator is the agency or entity chosen by the state to enforce the UDMSA. *Id.* § 2(1).

[162] *Id.* § 35.

[163] Telemarketing Sales Rule; Final Rule, 75 Fed. Reg. 48,458 (Aug. 10, 2010) (to be codified at 16 C.F.R. pt. 310). The deadline to submit written comments in response to this rule's requisite notice of proposed rulemaking was October 9, 2009. Telemarketing Sales Rule, 74 Fed. Reg. 41,988 (Aug. 19, 2009).

[164] *See* Telemarketing Sales Rule; Final Rule, 75 Fed. Reg. at 48,458.

[165] *Id.*

[166] *Id.*

[167] *Id.* at 48,501-02.

coverage.[168] At the outset, it is important to understand that the statute authorizing the FTC to implement the TSR (and thus, this proposed rulemaking) creates a federal private cause of action for injunctive relief or damages, provided that the amount in controversy exceeds $50,000.[169]

Under the new rule, a debt-relief service is defined broadly and is intended to cover debt-settlement services.[170] Specifically, a debt-relief service is defined as

> any program or service represented, directly or by implication, to renegotiate, settle, or in any way alter the terms of payment or other terms of the debt between a person and one or more unsecured creditors or debt collectors, including, but not limited to, a reduction in the balance, interest rate, or fees owed by a person to an unsecured creditor or debt collector.[171]

In promulgating this new rule, the FTC sought to regulate all procedures sold to consumers, and it added the word "program" to ensure this wide breadth.[172]

The new FTC rule also subjects debt-settlement companies to mandatory disclosure, an important aspect of regulation for the FTC. Under one general set of provisions, debt-settlement companies must disclose (1) the total costs of services; (2) all "material restrictions, limitations, or conditions to purchase, receive, or use the goods or services"; and (3) the seller's refund policy.[173] The rule also mandates disclosure of the time required to achieve resolution—including the specific time when a settlement company will tender settlements to creditors—and the amount of money that must accumulate

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[168] *Id.* As an initial matter, these amendments are subject to the jurisdictional limitations of the TSR and the FTC Act. One noteworthy limitation is that all nonprofit entities are exempted from these regulations. *Id.* at 48,465-66. The FTC acknowledged concerns that many abusive debt-relief services might remain unregulated because they are technically nonprofits. *Id.* at 48,465. It concluded, however, that it lacks authority under the TSR's governing statute to regulate nonprofit entities. *Id.* at 48,465-66.

[169] 15 U.S.C. § 6104 (2006). The statute also provides a civil cause of action for any state attorney general. *Id.* § 6103.

[170] Telemarketing Sales Rule; Final Rule, 75 Fed. Reg. at 48,516-17. The last clause of the definition, however, limits the definitional scope to unsecured creditors or debt collectors operating with unsecured debt. This was done intentionally to exclude mortgage loan-modification plans. The FTC noted that there are problems with fraudulent mortgage-relief companies that are similar to debt-settlement operations but that need to be regulated in different ways for various reasons. *Id.*

[171] *Id.* at 48,516-17.

[172] *Id.* at 48,466 n.123.

[173] *Id.* at 48,517.

before settlement is offered.[174] Additionally, the new rule requires that debt-settlement companies advise clients of certain risks—namely, that creditors may pursue collection efforts (including litigation) during the debt-settlement program, and that participating in a settlement program will likely result in an adverse credit rating and may increase the total amount of debt owed.[175]

Much beyond disclosure, the FTC also adopted a solution to the unsound practice of charging upfront fees. The new rule prohibits requesting or receiving payment for any debt-relief service unless the company has "renegotiated, settled, reduced, or otherwise altered the terms of at least one debt pursuant to a settlement agreement."[176] This upfront-fee ban applies to all debt-relief services—including debt-settlement companies, which, as explained above, hold a client's funds in escrow until enough have accumulated to offer a settlement. The rule states that the FTC "does not intend that the advance fee ban be interpreted to prohibit a consumer from using legitimate escrow services . . . to save money in anticipation of settlement,"[177] though this language does seem to explicitly prohibit collecting any part of a flat fee prior to settling a debt.[178]

Less clear, however, are other fees often charged by debt-settlement companies—namely, service fees, initiation fees, and other account-maintenance or administrative-type fees. Companies charge these fees before any debt has been settled, but one could argue that this practice does not violate the ban on upfront fees because these other fees are required to facilitate escrow services for the client until enough funds have accumulated. The FTC has concluded, however, that all upfront fees charges by debt-relief providers are an abusive business practice.[179]

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[174] *Id.* at 48,518.

[175] *Id.*

[176] *Id.* at 48,519.

[177] Telemarketing Sales Rule, 74 Fed. Reg. 41,988 (Aug. 19, 2009).

[178] *See supra* Part II. A flat-fee model charges a percentage of the total debt and is typically collected—entirely or in part—before any settlement is achieved.

[179] Telemarketing Sales Rule, 74 Fed. Reg. at 42,006. To determine if a practice is abusive, the FTC uses a three-prong unfairness test. A practice is unfair if "1) the conduct at issue causes substantial injury to consumers; 2) the harm resulting from the conduct is not outweighed by any countervailing benefits; and 3) the harm is not reasonably avoidable." *Id.* at 42,005.

V. THE IDEAL REGULATION

To determine ideal regulation of the debt-settlement industry, one must answer two questions: (1) where should regulation originate,[180] and (2) what particulars should the regulation include?

A. *Source of Regulation*

To the first question, we have seen potential regulation originate from uniform state law, federal law, and federal-agency regulation. Congress's recent actions in regulating debt-relief services show that it is likely to stay out of the issue.[181] As a practical matter, then, it is appropriate here to analyze the benefits of uniform state law and federal-agency regulation.

The NCCUSL is known as a private legislature because it cannot pass binding laws; it can only suggest passage to traditional legislatures.[182] It has also been called an elite legislature because its members are chosen by state governors based on their expertise and sophistication in a particular area of law.[183] As one commentator has noted, NCCUSL "[c]ommissioners are likely to draft laws that are clearer, better understood, and with more insight" than state legislatures.[184]

Even if true, however, these factors may not warrant placing regulation of the debt-settlement industry in the NCCUSL's hands. One problem is that the NCCUSL coordinates and embraces interest-group activities, injecting bias into uniform laws.[185] The NCCUSL invites interest-group advisers and self-interested American Bar Association committees to participate in drafting the laws.[186] As a result,

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[180] Implicit in the question is, to whom should the power of enforcement be given?

[181] As noted *supra* text accompanying notes 125-27, Congress failed to act on comprehensive regulation in 2003; it proposed expedited rulemaking powers for the FTC in 2009; and recently, it created a new federal agency tasked with consumer protection. *See supra* text accompanying notes 132-33. It is highly unlikely, then, that Congress will now be a venue for regulation.

[182] Alan Schwartz & Robert E. Scott, *The Political Economy of Private Legislatures*, 143 U. PA. L. REV. 595, 596 (1995).

[183] *See* White, *supra* note 135, at 2132.

[184] *Id.* Indeed, it is also argued that because its product must be approved by fifty state legislatures, NCCUSL is forced to engage in a much more careful deliberative process. Edward J. Janger, *Predicting When the Uniform Law Process Will Fail: Article 9, Capture and the Race to the Bottom*, 83 IOWA L. REV. 569, 583 (1998).

[185] *See* Larry E. Ribstein & Bruce H. Kobayashi, *An Economic Analysis of Uniform State Laws*, 25 J. LEGAL STUD. 131, 142-43 (1996).

[186] *Id.*

"the drafting process may be biased towards business rather than consumer groups."[187] Unbalanced lobbying efforts also result when the burdens of a proposed law fall on a small, concentrated group while its benefits are distributed among a large, diffuse group.[188] In this context, "the small and concentrated group can use its own resources . . . to acquire rules favorable to itself and possibly detrimental to the larger, diffuse group."[189] Besides producing a biased law, interest-group involvement may hinder the ultimate ratification of uniform laws. At the state level, interest-group opposition "can prevent widespread adoption of an efficient NCCUSL proposal."[190]

The UDMSA—and, indeed, any NCCUSL regulation of the debt-services industry—is prone to these exact problems. Debt-management-services providers bear the costs and burdens of the regulation, while the benefits go to the diffuse population of debt-holding consumers nationwide. Naturally, this dynamic creates strong incentives for the debt-settlement industry to participate in drafting the UDMSA. It likewise creates very little incentive for the individual consumer to participate, even though that consumer is within the population that benefits.

NCCUSL proposals are also prone to negative results when interest groups mount equal lobbying campaigns in competition with each other. Often, active interest-group competition results when a legislative proposal would substantially change the status quo.[191] The NCCUSL generally reacts to coequal lobbying with a conservative stance—adopting "no new rules at all" or "vague rules that appear to accomplish something, but in fact do not."[192] Thus, if consumer interests were equally represented in the lobbying and drafting process, the UDMSA regulations would likely do little to effect meaningful change in the debt-settlement industry.

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[187] *Id.* at 143. Consumers and consumer-oriented groups may also be much better equipped to pressure public legislatures than the NCCUSL, given the latter's procedural inclusion of interest groups. *Id.* at 142-43. Similarly, public legislatures have institutional tools that foster production of diverse and reliable information whereas private legislatures do not. *See* Schwartz & Scott, *supra* note 182, at 630.

[188] Janger, *supra* note 184, at 584-85; Ribstein & Kobayashi, *supra* note 185, at 143.

[189] Janger, *supra* note 184, at 585.

[190] Ribstein & Kobayashi, *supra* note 186, at 143.

[191] *See* Schwartz & Scott, *supra* note 183, at 636.

[192] *Id.* at 637.

In any event, the NCCUSL has a low rate of adoption in state legislatures.[193] Opposition to adopting a uniform law makes failure the likely result, regardless of how proficient the proposal may be.[194] The UDMSA, though already enacted in some states, would face sharp opposition from an acutely interested industry if it imposed anything considered a constraint on business.[195] The goal of uniform laws is uniformity; thus, uniform laws should not be proposed if there is a risk of failure.[196] Since the UDMSA is either likely to be ineffective at regulating the debt-settlement industry or prone to failure at the state level, uniform state laws are not the ideal means of regulation in this context.

The FTC, by contrast, avoids both of these problems. As an agency with a relatively broad mandate of authority, the FTC is free of "interest group capture."[197] Moreover, the FTC's rules have uniform applicability.[198] Unlike the UDMSA, FTC rulemaking would create complete national coverage and

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[193] As of 1991, "[o]f the more than 200 uniform acts, 107 have been adopted by fewer than ten states; 77 of those have not made the grade in even five states, and a number of uniform acts have earned zero adoptions." White, *supra* note 135, at 2103.

[194] *See id.* at 2132. As one commentator has written,

> The pull to make the law technically better is an engine of modest horsepower. Going up even the smallest incline . . . it is soon unable to move forward. When there is only a modest incline and no opposition, as in the case of laws concerning procedural issues in the courts, this engine can carry its load to the destination, but only in such circumstances.

Id.

[195] It is difficult to ascertain the extent of the debt-settlement industry's direct involvement in the UDMSA's drafting. But speaking to the general idea that the industry is acutely aware and interested in any potential regulation, the FTC held a public workshop on September 25, 2008, for which it received thirty-five public comments from debt-settlement companies and trade associations. All these comments are available at http://www.ftc.gov/os/comments/debtsettlementworkshop/index.shtm. There is no reason to believe that the industry as a whole was and is any less interested in the UDMSA.

[196] *See* Janger, *supra* note 184, at 593 (arguing that, when certain circumstances indicate that the uniform law process is likely to fail, the "NCCUSL should decline to regulate the area and leave the question to federal law or nonuniform state law").

[197] *See* Sidney M. Milkis, *The Federal Trade Commission and Consumer Protection: Regulatory Change and Administrative Pragmatism*, 72 ANTITRUST L.J. 911, 938 (2005). In Milkis's view, although the FTC was not institutionally or historically designed to avoid capture, it has become the agency's biggest strength. *Id.* at 911-13. He supports this thesis with three case studies on consumer-protection actions, including one examining the Telemarketing Sales Rule. *Id.* at 927.

[198] *See* Telemarketing Sales Rule, 74 Fed. Reg. 41,989 (Aug. 19, 2009).

uniformity.[199] And uniformity may prompt less industry opposition. Since many debt-settlement companies operate nationally, a uniform rule provides "the advantage[] of having to comply with only one law."[200]

Despite these strengths, however, there is a legitimate concern that the FTC lacks the ability to effectively enforce its own consumer-protection regulations. The agency has a relatively small budget and is charged with overseeing a large number of businesses and transactions.[201] Of particular concern, "the sheer number of actions the FTC can bring in any given year is insignificant compared to the nature and scope of the consumer protection problems plaguing consumers and honest businesses in the United States."[202] As a result, most defrauded consumers thus have no recourse after filing a complaint with the FTC.[203]

There is an easy solution to this problem: a private cause of action. A private cause of action was expressly considered and ultimately rejected when the FTC Act was originally passed in 1914.[204] Lawmakers recognized that, because the FTC Act was purposefully broad, a private cause of action would destroy predictability, be abused by plaintiffs' attorneys, and burden the court system.[205] While "the FTC was composed of a body of experts and economists who could create policy in a reasoned, orderly, and forward-looking fashion . . .

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[199] *See* Mark E. Budnitz, Martina Rojo & Julia Marlowe, *Deceptive Claims for Prepaid Telephone Cards and the Need for Regulation*, 19 LOY. CONSUMER L. REV. 1, 14 (2006).

[200] *Id.* Budnitz argues that the best approach to regulating prepaid telephone cards is through federal legislation giving the FTC rulemaking authority. Congress has already given the FTC authority to regulate the debt-settlement industry, as seen in the FTC's recent rulemaking. Telemarketing Sales Rule; Final Rule, 75 Fed. Reg. 48,458 (Aug. 10, 2010) (to be codified at 16 C.F.R. pt. 310). But Budnitz's reasons for a federal approach remain relevant in this context.

[201] *See* Jeff Sovern, *Private Actions Under the Deceptive Trade Practices Act: Reconsidering the FTC Act as Rule Model*, 52 OHIO ST. L.J. 437, 442 (1991).

[202] Robert M. Langer, *Point: State Attorneys General Should Have Broad Powers to Enforce a Federal Telemarketing Fraud Law*, 5 ANTITRUST 36, 36 (1991).

[203] Guernsey v. Rich Plan of the Midwest, 408 F. Supp. 582, 586 (N.D. Ind. 1976). The *Guernsey* court noted that

> [m]ost defrauded customers have no remedy at all because the Government cannot possibly act in more than a small fraction of all of the cases of deceit and overreaching against consumers. The [FTC] currently receives about 9,000 complaints a year and is only able to investigate one out of eight or nine of these, and, of the small fraction investigated, only one in ten results in a cease and desist order.

Id.

[204] Schwartz & Silverman, *supra* note 91, at 12.

[205] *Id.* at 13-14.

private lawsuits, on the other hand, create[] policy in a piecemeal and retroactive manner."[206] The Act has not been amended to include a private cause of action.[207]

The legislature's concerns were valid when the FTC Act was enacted and remain valid today. But the new FTC rules regulating the debt-settlement industry do not trigger these concerns. First, despite the breadth of the FTC Act, the new rules are specific, top-down provisions that are not subject to judicial discretion. In this context, a private cause of action would not create policy retroactively. To the contrary, banning specific actions by a debt-settlement company is an "orderly" and "forward-looking" policy.[208] And a private cause of action would be a much-needed means of enforcement. Moreover, there is little reason for concern that a private cause of action would be exploited by plaintiffs or overburden the judiciary. The vast majority of potential plaintiffs are low-income consumers whose access to legal representation is, at the very least, limited. Nor would a private cause of action compromise predictability because this regulation is built of narrow, specific provisions—unlike the FTC Act, which is broad and open to interpretation.[209]

The cause of action allowed under the FTC regulations is inadequate because it is preconditioned on an amount in controversy exceeding $50,000.[210] Losses to fraudulent debt-settlement companies are frequently no more than a few thousand dollars per case. Moreover, individual consumers cannot rely on the FTC to redress these losses. As discussed earlier in this note, the FTC does not excel at this level of enforcement.[211] An unrestrained private cause of action provided by FTC rulemaking is the best approach to regulate the debt-settlement industry. Although the FTC's recent rule amendments are a good start, consumer protection means nothing without enforcement. Without a private cause of

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[206] *Id.* at 15.

[207] *Id.* at 14.

[208] *Id.* at 15.

[209] Indeed, the FTC Act prohibits "unfair or deceptive acts or practices." 15 U.S.C. § 45(a)(1) (2006). A private cause of action would force courts to interpret this phrase on a case-by-case basis. Contrast this with the FTC's recent proposed rule, which prohibits receiving a fee before a particular debt is settled. Telemarketing Sales Rule, 74 Fed. Reg. 42,020 (Aug. 19, 2009). Issues of interpretation arise in any litigation, but even with a private cause of action, debt-settlement regulations would result in much more predictability and much less ambiguity than the FTC Act.

[210] 15 U.S.C. § 6104 (2006).

[211] *See supra* text accompanying notes 88-93.

action—one that does not impose a threshold amount in controversy—the new regulations will often go unenforced, substantially undermining their efficacy.

B. Particulars of Regulation

The second question remains: of what particulars should regulation be composed? Generally speaking, the UDMSA focuses on registering companies, mandating education, and imposing fee caps for debt settlement, whereas FTC rulemaking emphasizes banning upfront fees. Both proposed regulations include significant disclosure requirements.

Disclosure is a laudable characteristic of any business practice. In this context, however, it has limited value. Mandating disclosure often results in "creative compliance" by companies—that is, printed communications too complicated or convoluted for the average customer to understand.[212] Regardless of the information's clarity or value, consumers frequently do not read contracts.[213] Thus, requiring a company to "inform" consumers that debt settlement may adversely affect their credit scores, as the UDMSA does,[214] is window dressing that would benefit few consumers. In fact, many debt-settlement companies already disclose pertinent information—voluntarily or pursuant to state law—but consumers are uninformed nonetheless because they rarely read contracts.[215] Further, the FTC Act and its state analogs also prohibit companies' questionable representations, albeit with less clarity than would provisions tailored specifically to the debt-

[212] Debra Pogrund Stark & Jessica M. Choplin, *A License to Deceive: Enforcing Contractual Myths Despite Consumer Psychological Realities*, 5 N.Y.U. J.L. & BUS. 617, 660-61 (2009); *see generally* Matthew A. Edwards, *Empirical and Behavioral Critiques of Mandatory Disclosure: Socio-Economics and the Quest for Truth in Lending*, 14 CORNELL J.L. & PUB. POL'Y 199 (2005) (arguing that existing disclosure regimes—particularly the Truth in Lending Act—fail to reduce information asymmetries in the consumer-finance industry). Moreover, extensive disclosure requirements are worth little when potential debt-settlement clients are in stressful financial situations; "desperate consumers will tend to focus most on the representations made in the advertisements about how these services can relieve them of their debt worries." Letter from Consumer Fed'n of Am. to the Sec'y of the Fed. Trade Comm'n 10 (Oct. 16, 2009), *available at* http://www.ftc.gov/os/comments/tsrdebtrelief/543670-00161.pdf.

[213] *See* Stark & Choplin, *supra* note 212, at 655-56.

[214] UNIF. DEBT MGMT. SERVS. ACT, § 17(d)(3) (Nat'l Conference of Comm'rs on Unif. State Laws 2005).

[215] Letter from S. Brooklyn Legal Servs. to the Sec'y of the Fed. Trade Comm'n 7-8 (Oct. 26, 2009), *available at* http://www.ftc.gov/os/comments/tsrdebtrelief/543670-00216.pdf.

settlement industry.[216] Disclosure would provide benefits for certain consumers—possibly warranting inclusion—but it cannot be the gravitas of this regulation.

Debt-settlement services have an enormous potential for consumer financial harm. Damage results not only from high fees but also from high failure rates. Legal action by creditors and worsened credit scores are often unavoidable consequences of the service as it exists today. Since this potential harm is the central problem of the industry, it must be the focus of regulation.

Banning upfront fees is the proper solution to address these problems. Advance fees allow debt-settlement companies to benefit from client payment stagnation while taking no risk of their own. Even if a consumer is unable to save money in escrow (and thus does not proceed to benefit from the service), debt-settlement companies still profit from advance fees.[217] This delay is fundamentally problematic for consumers: it increases the risk of failure and creditor legal action while worsening credit worthiness and doing nothing to lessen debt. Debt-settlement companies seek this business because it is profitable. And they target consumers that cannot afford debt-settlement services in the first place.[218] As an unregulated service, debt-settlement companies can profit by contracting with anyone holding unsecured debt.

A ban on upfront fees provides these companies with a natural incentive to screen clients for potential success. Prohibiting advance fees increases the profit margin that exists in clients that could actually save enough money to effectuate a settlement. With an advance-fee bar in place, companies will voluntarily screen potential clients, limiting abusive

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[216] *See supra* Part III.

[217] *See* Letter from Nat'l Ass'n of Att'ys Gen. to the Sec'y of the Fed. Trade Comm'n 9 (Oct. 23, 2009) [hereinafter Letter to FTC], *available at* http://www.ftc.gov/os/comments/tsrdebtrelief/543670-00192.pdf (arguing that, without a ban on advance fees, "there is minimal incentive for debt relief companies charging up-front fees to perform services because they collect these substantial fees regardless of whether they negotiate anything for the consumer, succeed in settling any of the consumer's debts for a reduced amount, or take any action at all on behalf of the consumer").

[218] *See id.* (stating concern that "the current regulatory regime—in which collection of substantial up-front fees is not prohibited—is such that increasing numbers of unscrupulous operators will flock to this industry"). This comment also references a classified advertisement in a Portland, Oregon, newspaper that claimed, "This is truly the NEXT WAVE!! I'm sure you heard about it. Debt Settlement! . . . You can be part of it and make a fantastic residual income!!! You too can potentially earn a Million dollars in the next 12 months! Free Complete Training! No Fee To Become An Affiliate!" *Id.* at 9 n.14.

contracting.[219] It would also force companies to provide services quickly and efficiently—to work with a client's creditors earlier in the process to achieve an earlier payday. Banning upfront fees would increase overall success rates, minimize creditor action because of shortened default periods and ensure that consumers owe fees only once a benefit has been realized.

The industry claims that debt-settlement companies are unable to operate without upfront fees. It bases this claim on several arguments. First, the industry argues that the settlement process is continuous and ongoing, making advance payment a requirement for creditor communication, and that creditor communication is the relevant unit of work justifying compensation.[220] Second, debt-settlement companies have relatively large client-acquisition costs, which justify advance fees.[221] Finally, the industry warns that only large existing companies would be able to operate without upfront fees, meaning that the ban would harm competition.[222]

These objections are without merit. The hypothetical value of debt settlement is reducing a consumer's debt load by negotiating settlements with creditors. The value does not derive from general communication with creditors, nor does it derive from an expanded client base. Consumers are willing to pay fees to have their debts settled—not for a company to communicate with their creditors.[223] Every business has costs associated with its intended results. The entitlement to profit

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[219] Over the past decade, various state laws have attempted to rein in subprime and other predatory home-loan providers by banning upfront fees. *See* Daniel Immergluck, *Private Risk, Public Risk: Public Policy, Market Development, and the Mortgage Crisis*, 36 FORDHAM URB. L.J. 447, 470-71 (2009). Some studies suggest that antipredatory lending laws discouraged providers from offering the riskiest loans. *Id.* at 483-84; Comptroller of the Currency, *Economic Issues in Predatory Lending* 19-20 (OCC Working Paper July 30, 2003), *available at* http://www.occ.treas.gov/workingpaper.pdf. In the case of debt settlement, a ban on upfront fees would discourage companies from contracting with the riskiest clients (i.e., those most unable to complete a debt-settlement program and thus most likely to gain no benefit from debt settlement).

[220] Transcript of Federal Trade Commission Workshop: Consumer Protection and Debt Settlement Industry, at 189 (Sept. 25, 2008) [hereinafter FTC Transcript] (statement of Michael Mallow), *available at* http://www.ftc.gov/bcp/workshops/debtsettlement/OfficialTranscript.pdf ("I don't believe that in a debt settlement company the unit of work is the successful completion of the settlement and the satisfaction thereof."); *see also id.* at 113 (statement of Jack Craven).

[221] ASS'N OF SETTLEMENT COS., STUDY ON THE DEBT SETTLEMENT INDUSTRY 4-5 (2007) [hereinafter STUDY ON THE INDUSTRY], *available at* http://www.ftc.gov/os/comments/debtsettlementworkshop/536796-00014.pdf.

[222] FTC Transcript, *supra* note 220, at 187 (statement of Wesley Young).

[223] *See* Letter to FTC, *supra* note 217, at 10 ("[I]t is marketing, lead generation and referral costs that drive the debt settlement industry's zeal for up-front fees.").

comes from providing a service that has a client value greater than its provider costs. Debt-settlement companies deserve payment only after a client has received a benefit—that is, once a debt has been settled.

To be sure, the ban on advance fees could potentially constrain competition. The FTC noted that a "prohibition could increase the costs incurred by any legitimate providers of debt-relief services, make it impossible for some firms to continue to exist, and reduce the ability of new firms to enter the market."[224] A ban may necessitate "additional capitalization, in the form of borrowing or investment."[225] As a result, the industry claims, debt settlement will become more expensive and less accessible. But the industry is currently contracting with far more consumers than it can reasonably provide beneficial services for.[226] The ban on advance fees would eliminate predatory firms, allowing legitimate settlement providers to fairly compete in the market and price their services accurately. To the extent that constrained supply would increase the costs of debt-settlement services, these costs "would be unlikely to outweigh the consumer injury resulting from the current fee practice."[227] Banning upfront fees mitigates the most harmful aspect of debt settlement without creating unreasonable costs for the industry.

For precisely these reasons, banning upfront fees is more desirable than the UDMSA approach of imposing fee maximums. While a fee maximum would hypothetically save a client more money in escrow, since less would be taken for fees (much as banning advance fees would), it does not give the debt-settlement company any incentive to complete settlement services more efficiently. Fee maximums would not compel client screening because clients with no chance of completing companies' settlement programs would still be profitable. There is also no incentive to mitigate creditor intervention because

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[224] Telemarketing Sales Rule, 74 Fed. Reg. 41,988, 42,008 (Aug. 19, 2009).

[225] *Id*. Some form of capital reserve via bond or insurance is required under the UDMSA to protect against insolvency in the event of a judgment against the company. UNIF. DEBT MGMT. SERVS. ACT §§ 13, 14 (Nat'l Conference of Comm'rs on Unif. State Laws 2005). The UDMSA's registration requirement is largely intended to effectuate this mandated capitalization. Banning upfront fees might also force debt-settlement companies to maintain a reserve and may mitigate the need to impose registration requirements on debt-settlement companies.

[226] A voluntary study conducted by an industry trade association reported success rates only as high as 60%. STUDY ON THE INDUSTRY, *supra* note 221, at 1. This means that, at minimum, 40% of debt-settlement clients realize no benefits from the service.

[227] Telemarketing Sales Rule, 74 Fed. Reg. at 42,008.

these companies would collect fees—albeit at a more modest level—regardless of whether a client falls further into financial turmoil. The ban on upfront fees is the most advantageous approach to regulating the debt-settlement industry, and the FTC is wise to adopt it as its regulatory centerpiece instead of fee maximums or mere compelled disclosure.

CONCLUSION

The debt-settlement industry is likely to continue its rapid growth. But the existing regulation is insufficient to protect consumers from the harm caused by debt settlement. Neither the UDMSA nor the FTC's recent rulemaking are perfect, but each contains elements helpful in ensuring that debt-settlement programs provide financial benefits. Ultimately, the FTC's recent regulation banning upfront fees is a strong start. Still, the FTC must also provide for an unreserved private cause of action to guarantee proper enforcement. As it stands now, debt settlement is a beast that tramples consumer welfare. But with the proper reins, debt settlement can provide legitimate help to those facing the burden of unsecured debt.

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