

DEBT CONSOLIDATION AND SETTLEMENT FIRMS: Governing Laws and Issues

J. Bennett Fox, Jr.

I. DEBT SETTLEMENT AND CONSOLIDATION FIRMS

Debt Settlement companies are among the many different kinds of services that claim to help consumers with debt problems.¹ They will purportedly negotiate with creditors to reduce the amount a consumer owes. Some debt settlement companies claim that they can arrange for debt to be paid off for less than the amount owed – for anywhere from 30 to 70 percent of the balance. While there are legitimate firms who settle debt, the Federal Trade Commission (“FTC”) has issued warnings regarding and number of issues and fraudulent activities related to debt settlement firms.

For example, contrary to any such guarantees or proclamations, there is no guarantee that debt settlement companies can persuade a credit card company to accept partial payment of a legitimate debt. Even where they can, a consumer must still put aside money for creditors each month. Additionally, it may actually be months – or even years – before the debt settlement company negotiates with a consumer’s credit card company to settle debts. Further, if payments are stopped in the meantime, the credit card company usually adds late fees and interest to the debt each month. In fact, these actions can cause a consumer’s original debt to double or triple.

II. FEDERAL AND TENNESSEE REGULATION OF DEBT SETTLEMENT FIRMS

Debt settlement and its regulation has been a prominent issue in recent years. In 2010, the Federal Trade Commission (FTC) established the Telemarketing Sales Rule which bans advance fees, requires disclosures, and prohibits misrepresentations by debt settlement companies. The rule also covers calls consumers make to these firms in response to debt relief advertising. Since October 2010, for-profit companies that sell debt relief services over the telephone may not charge a fee before they settle or reduce a customer’s credit card or other unsecured debt. Companies must disclose fundamental aspects of their services, such as how long it will take for consumers to see results, how much it will cost and the potential negative consequences from using debt relief services, before the consumer signs up for any service. Most recently, the FTC settled two actions charging debt settlement companies with deceptively and fraudulent practices.²

¹ See generally, the Federal Trade Commission’s web site: www.ftc.gov. Specifically, the publication “Facts for Consumers” at www.ftc.gov/bcp/edu/pubs/consumer/credit/cre02.shtm provides the general background information on debt settlement and consolidation firms relied upon in Section I.

² See FTC publication “FTC Settlements Put Debt Relief Operations Out of Business” at www.ftc.gov/opa/2011/05/amsdynamic.shtm.

A. The FTC Addresses Deceptive Practices

In one recent case, the FTC charged a debt settlement firm for calling consumers and claiming that they could negotiate with credit card issuers to substantially lower the consumers' credit card interest rates, using prerecorded "robocalls" with messages urging consumers to "press one" to speak with someone, falsely leading many consumers to believe that the calls came from the credit card company, charging consumers up to \$1,590, and promising a refund if they failed to save at least \$2,500 in interest savings.³ Instead of arranging for interest rate reductions, the companies merely advised consumers to pay down their credit card debts early to save money on interest. When refunds were requested, the companies either denied the requests or deducted a \$199 "nonrefundable fee" from the refund. In addition to various prohibitions, the US District Court for the Eastern District of Washington imposed an 8.1 million dollar judgment against the firm.

In another case, the FTC charged debt settlement firms with making false claims by offering debt relief services with an up-front fee of up to \$1,995.⁴ The defendants claimed to help consumers pay off their debts faster and promised a full refund if a consumer did not save a "guaranteed" amount. Under the settlement order from the US District Court for the Northern District of Illinois, the defendants were ordered to pay over 30 million dollars.

B. Tennessee's Uniform Debt-Management Services Act

The Uniform Debt-Management Services Act ("UDMSA") was issued by the National Conference of Commissioners on Uniform State Laws as means of providing uniform rules across the country for regulating debt settlement services and consumer credit counseling services.⁵ On July 1, 2010, Tennessee enacted the Uniform Debt-Management Services Act.⁶ The primary focus of the UDMSA is on three issues: registration of services, debtor agreements and enforcement.⁷

With respect to registration no service may enter into an agreement with any debtor without registering.⁸ Additionally, registration requires submission of detailed information concerning the service, including its: financial condition, principals, locations, forms, and business history in other jurisdictions.⁹ To register, a service must have an effective insurance policy against fraud, dishonesty, theft and the like and must

³ See FTC publication "At FTC's Request, Court Stops Deceptive Telemarketing Calls Pitching Credit Card Interest Rate Reduction" found at www.ftc.gov/opa/2010/05/ams.shtm.

⁴ See FTC publication "FTC Sues to Stop Robocalls With Deceptive Credit Card Interest-Rate Reductions" found at www.ftc.gov/opa/2009/12/robocall.shtm.

⁵ See Uniform Debt-Management Services Act (UDMSA) – Summary, found at www.udmsa.org/.

⁶ TENN. CODE ANN. § 47-18-5501, *et seq.*

⁷ See TENN. CODE ANN. § 47-18-5501, *et seq.* and Uniform Debt-Management Services Act (UDMSA) – Summary, found at www.udmsa.org/.

⁸ See TENN. CODE ANN. §§ 47-18-5503 to 47-18-5512.

⁹ See TENN. CODE ANN. § 47-18-5506.

DEBT CONSOLIDATION AND SETTLEMENT FIRMS: Governing Laws and Issues

J. Bennett Fox, Jr.

I. DEBT SETTLEMENT AND CONSOLIDATION FIRMS

Debt Settlement companies are among the many different kinds of services that claim to help consumers with debt problems.¹ They will purportedly negotiate with creditors to reduce the amount a consumer owes. Some debt settlement companies claim that they can arrange for debt to be paid off for less than the amount owed – for anywhere from 30 to 70 percent of the balance. While there are legitimate firms who settle debt, the Federal Trade Commission (“FTC”) has issued warnings regarding and number of issues and fraudulent activities related to debt settlement firms.

For example, contrary to any such guarantees or proclamations, there is no guarantee that debt settlement companies can persuade a credit card company to accept partial payment of a legitimate debt. Even where they can, a consumer must still put aside money for creditors each month. Additionally, it may actually be months – or even years – before the debt settlement company negotiates with a consumer’s credit card company to settle debts. Further, if payments are stopped in the meantime, the credit card company usually adds late fees and interest to the debt each month. In fact, these actions can cause a consumer’s original debt to double or triple.

II. FEDERAL AND TENNESSEE REGULATION OF DEBT SETTLEMENT FIRMS

Debt settlement and its regulation has been a prominent issue in recent years. In 2010, the Federal Trade Commission (FTC) established the Telemarketing Sales Rule which bans advance fees, requires disclosures, and prohibits misrepresentations by debt settlement companies. The rule also covers calls consumers make to these firms in response to debt relief advertising. Since October 2010, for-profit companies that sell debt relief services over the telephone may not charge a fee before they settle or reduce a customer’s credit card or other unsecured debt. Companies must disclose fundamental aspects of their services, such as how long it will take for consumers to see results, how much it will cost and the potential negative consequences from using debt relief services, before the consumer signs up for any service. Most recently, the FTC settled two actions charging debt settlement companies with deceptively and fraudulent practices.²

¹ See generally, the Federal Trade Commission’s web site: www.ftc.gov. Specifically, the publication “Facts for Consumers” at www.ftc.gov/bcp/edu/pubs/consumer/credit/cre02.shtm provides the general background information on debt settlement and consolidation firms relied upon in Section I.

² See FTC publication “FTC Settlements Put Debt Relief Operations Out of Business” at www.ftc.gov/opa/2011/05/amdynamic.shtm.

A. The FTC Addresses Deceptive Practices

In one recent case, the FTC charged a debt settlement firm for calling consumers and claiming that they could negotiate with credit card issuers to substantially lower the consumers' credit card interest rates, using prerecorded "robocalls" with messages urging consumers to "press one" to speak with someone, falsely leading many consumers to believe that the calls came from the credit card company, charging consumers up to \$1,590, and promising a refund if they failed to save at least \$2,500 in interest savings.³ Instead of arranging for interest rate reductions, the companies merely advised consumers to pay down their credit card debts early to save money on interest. When refunds were requested, the companies either denied the requests or deducted a \$199 "nonrefundable fee" from the refund. In addition to various prohibitions, the US District Court for the Eastern District of Washington imposed an 8.1 million dollar judgment against the firm.

In another case, the FTC charged debt settlement firms with making false claims by offering debt relief services with an up-front fee of up to \$1,995.⁴ The defendants claimed to help consumers pay off their debts faster and promised a full refund if a consumer did not save a "guaranteed" amount. Under the settlement order from the US District Court for the Northern District of Illinois, the defendants were ordered to pay over 30 million dollars.

B. Tennessee's Uniform Debt-Management Services Act

The Uniform Debt-Management Services Act ("UDMSA") was issued by the National Conference of Commissioners on Uniform State Laws as means of providing uniform rules across the country for regulating debt settlement services and consumer credit counseling services.⁵ On July 1, 2010, Tennessee enacted the Uniform Debt-Management Services Act.⁶ The primary focus of the UDMSA is on three issues: registration of services, debtor agreements and enforcement.⁷

With respect to registration no service may enter into an agreement with any debtor without registering.⁸ Additionally, registration requires submission of detailed information concerning the service, including its: financial condition, principals, locations, forms, and business history in other jurisdictions.⁹ To register, a service must have an effective insurance policy against fraud, dishonesty, theft and the like and must

³ See FTC publication "At FTC's Request, Court Stops Deceptive Telemarketing Calls Pitching Credit Card Interest Rate Reduction" found at www.ftc.gov/opa/2010/05/ams.shtm.

⁴ See FTC publication "FTC Sues to Stop Robocalls With Deceptive Credit Card Interest-Rate Reductions" found at www.ftc.gov/opa/2009/12/robocall.shtm.

⁵ See Uniform Debt-Management Services Act (UDMSA) – Summary, found at www.udmsa.org/.

⁶ TENN. CODE ANN. § 47-18-5501, *et seq.*

⁷ See TENN. CODE ANN. § 47-18-5501, *et seq.* and Uniform Debt-Management Services Act (UDMSA) – Summary, found at www.udmsa.org/.

⁸ See TENN. CODE ANN. §§ 47-18-5503 to 47-18-5512.

⁹ See TENN. CODE ANN. § 47-18-5506.

provide a security bond.¹⁰ A satisfactory application will result in a certificate to do business and a yearly renewal is required.¹¹

The second primary area of focus is on agreements. In order to enter into agreements with debtors, fees, services and the risks involved must be disclosed.¹² The service must offer counseling services from a certified counselor or certified debt specialist and a plan must be created in consultation by the counselor for debt-management service to commence.¹³ The contents of the agreements and fees that may be charged are set by the statute. Further, any payments for creditors received from a debtor must be kept in a trust account and there are strict accounting and reporting requirements respecting funds held.¹⁴

The third area of focus is enforcement, with the following specific acts on the part of a service being prohibited: misappropriation of funds in trust; settlement for more than 50% of a debt with a creditor without a debtor's consent; gifts or premiums to enter into an agreement; and representation that settlement has occurred without certification from a creditor.¹⁵ Enforcement occurs at two levels, the administrator and the individual level. The administrator has investigative powers, power to order an individual to cease and desist; power to assess a civil penalty, and the power to bring a civil action.¹⁶ An individual may bring a civil action for compensatory damages, including triple damages if a service obtains payments not authorized in the Uniform Act, and may seek punitive damages and attorney's fees.¹⁷

¹⁰ Id.

¹¹ See TENN. CODE ANN. § 47-18-5511.

¹² See TENN. CODE ANN. §§ 47-18-5517 and 47-18-5519.

¹³ See TENN. CODE ANN. § 47-18-5517.

¹⁴ See TENN. CODE ANN. § 47-18-5522.

¹⁵ See TENN. CODE ANN. § 47-18-5528.

¹⁶ See TENN. CODE ANN. § 47-18-5533.

¹⁷ See TENN. CODE ANN. § 47-18-5535.

