

CONSUMER PROTECTION AND DEBTORS:
THE DEBT ADJUSTING ACT AND
THE CONSUMER ECONOMIC PROTECTION ACT

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I. BACKGROUND: THE ATTORNEY GENERAL'S CONSUMER PROTECTION DIVISION

The Consumer Protection Division of the Attorney General's Office was first created in 1969 by then-Attorney General Robert Morgan to address, among other practices, deceptive advertising practices and fraudulent business activities. Currently, Attorney General Cooper has empowered the Consumer Protection Division to exercise his statutory and common law authority in the areas of consumer protection, antitrust, nonprofits, and utilities. By enforcing the law, the Division strives to protect North Carolina consumers from fraud, deception, price fixing, price gouging, restraints of trade, commercial invasions of privacy, and other unfair and deceptive business practices.

The primary responsibilities of the Division are: (1) the handling of consumer complaints; (2) investigating and prosecuting violations of the antitrust and consumer protection laws; (3) educating North Carolinians about their rights as consumers; (4) providing information during policy debates on matters affecting North Carolina consumers, both at the state and federal levels; and (5) representing the consuming public before the North Carolina Utilities Commission.

The Division consists of 13 attorneys who specialize in different legal areas, approximately 13 consumer specialists, and additional support staff. On an annual basis, the Division handles approximately 20,000 written complaints, and responds to approximately 100,000 phone inquiries from consumers, attorneys, businesses, and others requesting assistance or information about North Carolina's antitrust and consumer protection laws.

Most written complaints to the Division are from consumers about various business practices, but some are from businesses complaining about competitors. Once a complaint is received, the Division forwards the complaint to the business being complained of, together with a letter requesting a response. This process, sometimes coupled with informal mediation, secures a satisfactory resolution of the majority of complaints received by the Division.

The Division maintains a record of all complaints filed as one means of identifying illegal practices and determining its investigative priorities. When the Attorney General has reason to believe that a business or person may be engaging in illegal activities in North Carolina in violation of state law, N.C. Gen. Stat. § 75-9 gives the Attorney General the power and duty to

investigate the affairs of the business or person to determine whether any violations have occurred. In carrying out these duties, the Attorney General has the power to compel testimony or production of documents by means of a civil investigative demand (“CID”), or investigative subpoena, pursuant to N.C. Gen. Stat. § 75-10. If an investigation reveals that a business or person has engaged in practices in violation of North Carolina’s antitrust or consumer protection laws, the Division may pursue formal legal action under N.C. Gen. Stat. § 75-15.

Most of the Division’s legal actions are brought under North Carolina’s unfair practices statute, N.C. Gen. Stat. § 75-1.1, which is modeled after Section 5 of the FTC Act, 15 U.S.C. § 45(a), and which prohibits unfair or deceptive practices in or affecting commerce. However, there are also specific consumer protection statutes that are enforced by the Division, such as those regulating certain business practices, such as telemarketing; debt collection; loan brokering; credit repair; the protection of consumers’ personal information; and numerous others. Some of these statutes are located in Chapter 75, titled “Monopolies, Trusts and Consumer Protection,” and in Chapter 66, titled “Commerce and Business,” but others are found throughout the General Statutes.

Lawsuits are filed in the name of the State of North Carolina *ex rel.* the Attorney General in order to represent all affected consumers throughout the State. Unlike private attorneys, the Attorney General cannot bring legal action on behalf of or in the name of individual consumers. In bringing an enforcement action, the Attorney General’s goal is to put a stop to unlawful business activities through injunctions, N.C. Gen. Stat. § 75-14, or consent agreements, and, if possible, to obtain restitution for consumer victims and disgorgement of ill-gotten gains. The Attorney General may also seek cancellation of contracts, as well as civil penalties of up to \$5,000 per violation of the unfair practices statute. N.C. Gen. Stat. §§ 75-15.1, 75-15.2.

In determining the Division’s enforcement priorities, there are no ironclad rules, but the Attorney General gives careful consideration to a number of factors, including, among others: (1) number of complaints; (2) number of victims; (3) harm per victim; (4) likelihood of repetition or continuation of illegal conduct; (5) past history of the violator; (6) certainty of legal violation; (7) violator’s intent; (8) precedent-setting value or impact; and (9) likelihood and effectiveness of private remedies or federal action. While there is no “magic” application of these factors, as a general matter, the more factors involved, the more likely enforcement activity will ensue.

II. DEBT RELIEF SERVICES AND NORTH CAROLINA’S DEBT ADJUSTING ACT

Debt relief services have proliferated in recent years as the economy has declined and greater numbers of consumers hold debts they cannot pay. Consumers who are overwhelmed with debt have a number of options for possible relief. These include bankruptcy, credit counseling, debt management plans, and debt settlement. All of these options purport to offer reasonable solutions for the financially-distressed consumer. Unfortunately, so-called “debt settlement” services often exploit the consumer, leaving the consumer deeper in debt and in a worse legal situation.

A. Traditional Credit Counseling Services

Nonprofit consumer credit counseling services have been present in most major cities in North Carolina and around the country since the 1960's. They provide counseling and credit education services to financially strapped consumers and, through debt management plans, offer an alternative to bankruptcy. Debt management plans (“DMPs”) are monthly payment plans for the repayment of credit card and other unsecured debt, enabling consumers to repay the full amount owed to their creditors. It is estimated that there are approximately one million consumers currently in debt management programs nationally.

Credit counseling has gained further importance with the enactment of the 2005 revisions to the Bankruptcy Code. Section 109(h) of the Code requires a debtor who wishes to file under Chapter 7 to provide certification that he or she has received assistance in preparing a budget analysis and information about credit counseling from an approved credit-counseling agency. In addition, section 727(a)(11) establishes the completion of an instructional course concerning personal financial management as a prerequisite to obtaining a discharge. Under bankruptcy requirements, the counseling agency must be non-profit and approved by the Office of the U.S. Trustee or the district bankruptcy administrator. The traditional community-based counseling services are providing bankruptcy counseling, but new organizations have appeared to meet the need and have been approved to conduct specialized bankruptcy-related counseling.

These are some of the common attributes of the traditional nonprofit credit counseling and debt management model:

1. They are usually locally based agencies with the acronym CCCS (Consumer Credit Counseling Service) and are certified by the National Foundation for Credit Counseling (NFCC).
2. They are often affiliated with family service agencies and supported by the United Way.
3. They also receive financial support from creditors through “fair share” contributions where creditors rebate a percentage of the consumer’s debt management payments back to the CCCS.
4. They offer individual, face to face credit counseling and budget assistance to consumers. This individually-tailored counseling may be the only service the consumer needs. The majority of consumers are not placed into more formal long-term debt management payment programs.
5. They also offer debt management plans where the agency collects monthly payments from consumers and then disburses the funds to creditors, often with some reductions in interest rates and waiving of delinquency fees.
6. They typically charge no fees or nominal fees for credit counseling and no more than \$40 per month to administer a debt management payment plan.

B. Profit Making “Nonprofit” National Debt Management Companies

In the 1990's a new form of credit counselor began to appear on the scene. With credit card debt and bankruptcies on the rise, entrepreneurs recognized that it was possible to make money by pitching debt management programs to financially strapped consumers. Through national television advertising and telemarketing, these companies were able to solicit consumers on a much larger scale. They were also able to economize by conducting their services by telephone and mail communications out of one national office instead of community offices, and by centralizing the collection of accounting functions of debt management programs.

Many states' laws allow only nonprofit organizations to offer debt management programs. Some creditors also authorized fair share payments only to nonprofit agencies. Therefore, most of these national companies declared themselves to be nonprofit and obtained 501(c)(3) status from the IRS. However, several major debt management companies, such as AmeriDebt and formerly, Cambridge Credit Counseling abused their nonprofit status by funneling their revenues to affiliated for-profit companies and paying their principal officers inflated salaries.

These are some of the common attributes of the nominally nonprofit national debt management companies:

1. They advertise nationally, with bold representations that they can consolidate bills, reduce consumers' monthly payments and reduce interest rates on credit cards.
2. They offer minimal individual credit counseling or budgeting assistance.
3. They use boiler room sales staffs to enroll consumers in debt management plans regardless of the consumer's individual needs. Telephone salespersons are paid commissions for signing consumers to a plan.
4. They charge up-front fees, averaging around \$400. The consumer's first monthly payment may be retained as a fee so that the consumer falls another month behind before any creditors are paid.
5. They charge monthly service fees in addition to the fair share payments they receive from creditors. Sometimes these fees are characterized as “voluntary contributions.”

In March, 2004, the Senate Permanent Committee on Investigations released a report entitled “Profiteering in a Non-Profit Industry: Abusive Practices in Credit Counseling.” The report focused on three of the then-largest national debt management firms, AmeriDebt/Debtworks, Ascend One/Amerix, and Cambridge Credit Counseling, and documented the abuses of the companies' nonprofit status. These abuses included: (1) making deceptive statements regarding their nonprofit nature, as the companies functioned as for-profit entities; (2) making misrepresentations about the benefits and likelihood of success consumers

could expect from their services; (3) false promises to provide counseling and educational services; (4) overstatements of the amount or percentage of interest charges a consumer might save; and (5) misrepresentations regarding their fees, including that they did not charge upfront fees or that fees were tax deductible.

As a result of closer scrutiny by the IRS, the Department of Justice's Executive Office of the U.S. Trustee (which examines credit counseling agencies seeking certification as approved providers of the required credit counseling under the Bankruptcy Code), and enhanced enforcement by the FTC and state attorneys general, many of the worst of the profiteering "non-profit" debt management companies have been closed down. Others, such as Cambridge, have significantly reformed their practices.

C. Debt Settlement and Negotiation

With the attrition in national credit counseling companies and the higher barriers to bankruptcy relief, a new form of service for debtors – debt settlement – has been heavily marketed. Debt settlers represent that they have expertise to negotiate with creditors to settle unsecured debts for no more than 50 cents on the dollar. They tend to disparage credit counseling and bankruptcy, and promote themselves as professional advocates for distressed debtors.

Consumers who enroll in a debt settlement program are required to deposit a certain amount of money each month in a separate bank account. The theory is that when the consumer accumulates sufficient funds, the settler can then offer lump sum discount settlements to the consumer's creditors. Consumers are typically advised to stop making direct payments to their creditors and to cease communicating with their creditors. The debt settlers claim that the more delinquent and stale the debt, the easier it is to settle.

There are of course, a number of problems with the standard debt settlement business model:

- A. Although most debt settlement companies claim they earn their fees when debts are settled, they typically charge significant set-up and monthly administrative fees before any debt negotiation takes place. As part of the contract, the debt settler obtains authorization to electronically debit its fees from the consumer's "reserve" account, so the consumer has little control over the collection of fees.
- B. Most creditors will not agree to cease contacting the debtor despite the intervention of a "professional" claiming to act on behalf of the debtor. The consumer receives little assistance or protection while this collection activity continues. If creditors take legal collection action against the debtor, he or she will have to seek out and pay for legal representation. National debt settlement firms do not have the legal training or particularized knowledge to advise consumers about the effects of judgments or the debtor's exemption rights under state law.

- C. With a cessation of payments by the consumer, interest and fees continue to accumulate on the consumer's debts, steadily increasing the amount of indebtedness.
- D. It can take two to three years for the debtor to accumulate sufficient funds to effectuate lump sum settlements. During this time, the debtor remains subject to regular collection efforts.
- E. Many insolvent debtors do not have the funds or the discipline to deposit regular payments into their accounts. Since the debt settler gets its fee first, there may not be sufficient funds accumulating to justify negotiation and settlement.
- F. Few debt settlement programs are ever completed. A report by a court-appointed receiver of one debt settlement company (National Consumer Council) revealed that only 1.4% of the consumers entering the program completed it.

D. Mortgage Loan Modification or Foreclosure Assistance Services

With the rapidly increasing volume of foreclosures in recent years, a cottage industry has developed to provide "assistance" to homeowners facing foreclosure. Using publicly available courthouse records, these loan modification companies or foreclosure "consultants" market their services to consumers who are seeking modifications of their mortgage loans or who have had foreclosure actions filed against them.

Like the debt settlers, the loan modification companies or foreclosure consultants represent that they have the professional expertise to negotiate with lenders. They claim to have contacts with mortgage lenders so that they have the ability to obtain forbearances or restructuring agreements to save the consumer's home. Consumers are usually required to cease communication with the lender and to let the consultant handle all creditor contacts.

Also, like debt settlers, loan modification companies or foreclosure consultants get their fee in advance. The standard fee is often the amount of one month's mortgage payment and the consumer may believe that this payment will be going to the mortgage company. Foreclosure consultants tend to accept anyone who can pay a fee even if there is no realistic possibility for the consumer to get a mortgage loan reinstated.

Often, all the purported loan modification company does is forward the consumer's documentation to the consumer's mortgage lender or servicer, and little else. Sometimes, the result of a loan modification or foreclosure assistance service is a referral of the consumer to a bankruptcy attorney to file a Chapter 13 plan, usually just before or after the foreclosure hearing. Another possible result, if the homeowner has enough equity, is a sale and lease-back agreement where the consumer transfers the house to an investor who then rents it to the consumer. The consumer may not understand that he or she has permanently deeded the house away. The investor can then access the equity with a new loan, leaving the original homeowner with little possibility of regaining ownership.

III. NORTH CAROLINA'S DEBT ADJUSTING LAW

A. State Law Restrictions on Debt Settlement and Foreclosure Assistance

In North Carolina, the business of “debt adjusting” is prohibited by a criminal statute, N.C. Gen. Stat. § 14-423, *et seq.* Effective January 1, 2006, the statute was amended to include debt settlement and foreclosure assistance services within the definition of debt adjusting if advance fees were collected. Engaging in, or offering to engage in, the business of debt adjusting is a misdemeanor. N.C. Gen. Stat. § 14-424.

The basic definition of debt adjusting is:

“...the entering into or making of a contract, express or implied, with a particular debtor whereby the debtor agrees to pay a certain amount of money periodically to the person engaged in the debt adjusting business and that person, for consideration, agrees to distribute, or distributes the same among certain specified creditors in accordance with a plan agreed on.”

The statute goes on to include acting “as an intermediary between a debtor and his creditors for the purpose of settling, compounding, or in any way altering the terms of payment of any debt of a debtor” and then distributing the debtor’s money to creditors.

Under the original statutory definition, the debt adjuster had to handle the debtor’s funds before they were paid over to creditors. Debt settlers formerly avoided the statute by having a third party payment processor or escrow agent handle the consumer’s funds pursuant to the terms of the contract between the debt settlement company and the consumer. To plug this loophole, the statute was amended in 2005 to specifically cover debt settlement and foreclosure assistance companies whether or not they handled the distribution of funds to creditors. The new section reads:

“Debt adjusting also includes the business or practice of debt settlement or foreclosure assistance whereby any person holds himself or herself out as acting for consideration as an intermediary between a debtor and the debtor’s creditors for the purpose of reducing, settling, or altering the terms of the payment of any debt of the debtor, whether or not the person distributes the debtor’s funds or property among the creditors, and receives a fee or other consideration for reducing, settling, or altering the terms of the payment of the debt in advance of the debt settlement having been completed or in advance of all the services agreed to having been rendered in full.”

N.C. Gen. Stat. § 14-423. At the time this law was passed, North Carolina was the first state in the country to expressly prohibit the charging of advance fees by debt settlement providers.

B. State Law Restrictions on Credit Counseling and Debt Management Services

The 2005 amendments also created exceptions to allow legitimate credit counseling agencies to charge some fees for administering debt management plans. Under the debt adjusting law as it existed in 2005, no one, whether a for-profit business or nonprofit consumer credit counseling service, could charge any consideration for debt management services. The CCCS agencies were formerly funded in large part by contributions from creditors paid as a percentage of the debtor's monthly payments under the plan. However, in recent years, the credit card banks have been reducing their contributions, making it very difficult for the CCCS agencies to operate. The CCCS agencies therefore sought legislation to allow them to charge fees under carefully prescribed conditions.

Under the 2005 amendment, an organization that "provides credit counseling, education, and debt management services" is exempt from the debt adjusting prohibition provided that it meets certain other requirements. The organization must, for example, (1) be certified by a recognized national accrediting organization; (2) provide individualized credit counseling and budgeting assistance without charge; (3) charge no more than "nominal consideration" to administer a debt management plan (defined as a maximum of \$40 to set up the plan and no more than \$40 in monthly service fees); and (4) not require the purchase of other goods or services as a condition of participating in a debt management plan. N.C. Gen. Stat. § 14-426(7).

The above conditions were designed to keep the bad actors out of North Carolina. Most of the problem national debt management companies charged more than \$40 as an enrollment fee and did not provide any bona fide credit counseling or budget assistance services. And the accreditation requirement is intended to screen out fly-by-night companies. Under the amendment, the Commissioner of Banks is given a limited role to approve the national accrediting organizations.

Another 2005 amendment created an exception for attorneys, since attorneys may negotiate debt settlements as part of representing clients. The exception is limited to attorneys licensed in North Carolina who are not employed by debt adjusting companies. N.C. Gen. Stat. § 14-426(6). However, numerous debt settlement providers and loan modification companies are now operating under the cover of law firms in an attempt to evade state and federal regulation (see the World Law case and others noted below).

North Carolina law does not cover purely credit counseling activities, as long as the counselor does not handle the consumer's debt payments and as long as there are no representations that a consumer's credit will be improved or repaired. In the latter situation, the Credit Repair Services Act, N.C. Gen. Stat. § 66-220, *et seq.* may apply. The definition of "credit repair business" under the Act includes providing advice or assistance on "improving, repairing or correcting a consumer's credit record." Credit repair businesses are required to obtain a \$10,000 bond and to provide specified contractual disclosures to consumers. Most importantly, the Credit Repair Services Act prohibits the charging or receipt of any money "prior to the full and complete performance of the services that the credit repair business has agreed to perform for or on behalf of the consumer." N.C. Gen. Stat. § 66-223.

C. Remedies Under State Law for Debt Adjusting Violations

Under the pre-2006 debt adjusting law, district attorneys had express authority to obtain injunctive relief and seek the appointment of receivers for illegal debt adjusting companies. A 2005 amendment extended authority to the Attorney General to bring actions “to enjoin, as an unfair trade practice, the continuation of any debt adjusting business or the offering of any debt adjusting services.” N.C. Gen. Stat. § 14-425. Although the debt adjusting law is a criminal statute, an aggrieved consumer should be able to bring an action for treble damages under N.C. Gen. Stat. § 75-1.1, alleging that a violation of N.C.G.S. § 14-424 is a *per se* unfair trade practice.

IV. FEDERAL LAW REGULATING DEBT SETTLEMENT AND FORECLOSURE ASSISTANCE

A. Prohibitions on Debt Relief Services Providers

In 2010, in response to growing concerns about the abuses of debt settlement businesses, the Federal Trade Commission promulgated amendments to the existing federal Telemarketing Sales Rule (“TSR”) which regulates telemarketing sales. These 2010 amendments expressly and broadly regulate the solicitation and sales of “debt relief services” which are 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.” 16 C.F.R. § 310.2(m).

The federal rule, like North Carolina law, prohibits debt relief services providers from collecting advance or upfront fees for debt settlement services. Instead, a fee may be charged and collected only after a debt is actually settled. 16 C.F.R. § 310.4(5)(i). In addition, before a fee can be collected, at least one payment must be made to the creditor, and the fee must be proportional to the overall fee, so that it relates only to the debt that has been settled.

In addition, the federal rule requires that debt relief services providers make certain required disclosures to consumers, such as the cost of the program, how long it will take to obtain the expected results, and how much must be saved before offers will be made to creditors. 16 C.F.R. § 310.3(a)(1)(viii). Further, debt relief services providers are prohibited from making misrepresentations regarding any material aspect of the service. 16 C.F.R. § 310.3(a)(2)(x).

The effective date of the advance fee prohibition in the federal rule was October 27, 2010.

B. Prohibitions on Mortgage Assistance Relief Services

Similarly, in an effort to protect distressed homeowners from mortgage loan modification scams that have sprung up during the mortgage crisis, the Federal Trade Commission promulgated a rule that bans providers of mortgage foreclosure rescue and loan modification services from collecting any advance fees. *See* Mortgage Assistance Relief Services Rule (“MARS”), 12 C.F.R. 1015, § 1015.5. Under the Rule, providers may only collect fees after homeowners have a written offer from their lender or servicer that the homeowner decides is acceptable. In addition, the Rule requires mortgage relief companies to disclose key information to consumers, including the amount of the company’s fee, and that consumers can stop doing business with the company at any time, and if they reject an offer made by their lender or servicer, they don’t have to pay the company’s fee. 12 C.F.R. §§ 1015.4, 1015.5. The Rule also prohibits mortgage relief companies from making any false or misleading claims about their services, and bars companies from telling consumers to stop communicating with their lenders or servicers. 12 C.F.R. § 1015.3.

Application to Attorneys: Attorneys may be exempt from the Rule, but only if they meet certain conditions: (1) they must be engaged in the practice of law; (2) they must be licensed in the state where the consumer or the dwelling is located; (3) they must comply with state laws and regulations governing attorney conduct related to the Rule; and (4) to be exempt from the advance fee ban, attorneys must place any fees collected in a client trust account and abide by state laws and regulations governing such accounts. 12 C.F.R. § 1015.7.

V. NORTH CAROLINA ENFORCEMENT

The North Carolina Attorney General’s Office has been active in bringing enforcement cases against debt settlement companies and loan modification companies that have violated N.C. Gen. Stat. § 14-423 or have engaged in unfair and deceptive trade practices in violation of N.C. Gen. Stat. § 75-1.1.

A. World Law Case

The most recent enforcement action by the Attorney General, which was brought jointly with the North Carolina State Bar, was filed on May 22, 2013, against a national debt settlement business operating as “World Law Group” which purports to be a law firm with attorneys in some 47 states, including North Carolina. *State of North Carolina, ex rel. Roy Cooper, Attorney General and The North Carolina State Bar v. Swift Rock Financial, Inc. d/b/a World Law Debt, a/k/a World Law Group; Orion Processing, LLC, d/b/a World Law Processing; and Derin Scott* (Wake County 13 CVS 007161). A copy of the State’s Complaint is attached as **Exhibit A**.

The Defendants’ Practices. As alleged by the Attorney General and the State Bar in the Complaint, World Law is a national debt settlement company based in Austin, Texas. World Law directly targets financially-distressed consumers through grossly deceptive direct mail solicitations, television advertisements, Internet advertisements, and telemarketing. When consumers contact the defendants in response to the deceptive advertising, they reach sales agents located in Texas, New Jersey, and California, among other locations. These sales agents

tell consumers that the defendants are a “law firm” with “local attorneys” in 47 states, including in North Carolina. The defendants tell consumers that they will contact their creditors on their behalf and negotiate reduced settlements of their debts for less than 50 cents on the dollar; that consumers’ monthly payments to their creditors will be greatly reduced; that their creditors will stop harassing them; and that consumers’ debts will be eliminated in 2-4 years, without having to file for bankruptcy.

If a consumer signs up, the World Law defendants instruct consumers that, because they are a “law firm,” consumers should let World Law “handle everything.” Consumers are placed on a payment plan, under which their bank accounts are debited every month. What consumers are not told is that World Law charges extraordinarily high fees, from 20-40 percent of consumers’ credit card debt, and that World Law will collect a substantial portion of its fees upfront, before money can be accumulated to pay creditors. As a result, instead of helping consumers, consumers become even more behind, their debts increase, creditor harassment increases, and consumers are placed at greater risk of being sued by their creditors.

In its investigation, the Attorney General obtained payment records from a third party payment processor, Global Client Solutions, LLC. The records show that to date, more than 800 North Carolina consumers have paid at least \$4.1 million to World Law, and that World Law has paid out less than 13% of consumers’ money, or a little over \$500,000, to creditors, while retaining more than \$2.6 million in consumers’ funds for their own fees.

The Defendants’ Court Filings. In their contracts and representations to consumers, World Law represents that a “local attorney” will be available to represent them. However, if consumers are sued, World Law prepares frivolous and baseless form pleadings for consumers to file *pro se* with the district court and provides no representation for consumers. Typically, persons purporting to be “legal assistants” with World Law e-mail these pleadings to consumers, with instructions to the consumers to file them with the district court. These pleadings are not prepared by members of the North Carolina Bar. Further, to date, with the possible exception of one attorney who has been licensed in Texas, the Attorney General, the State Bar, and creditors’ attorneys have been unable to identify any actual attorney who has prepared these pleadings or who is affiliated with World Law. Examples of form pleadings prepared by World Law, which are virtually identical in every case, include:

- Answer to Complaint and Affidavit;
- Affidavit in Reply to Plaintiff’s Motion for Summary Judgment;
- Responses to Discovery

Among other baseless claims, the pleadings state that the debtor never opened the credit card account at issue – even though the consumer had contacted World Law to settle the debt – or state that the plaintiff-creditor and its attorneys are “under investigation by state and federal authorities for robo-signing.” Based upon what consumers have told the Attorney General’s Office, creditors’ attorneys, and the courts, the consumers often have little understanding of the documents they are filing, and of the proceedings. To date, World Law has prepared pleadings in more than 115 active cases currently pending in North Carolina district courts. Because of the pervasiveness of World Law’s *pro se* filings, at least one district court, Hon. Meredith A.

Shuford of Cleveland County, in an order issued on April 25, 2013, found that the pleadings were filed in bad faith and granted the plaintiff-creditor's motion for sanctions. The order found that the pleadings were interposed for an improper purpose, caused unnecessary delay, and needlessly increased costs, and ordered the consumer-debtor to pay \$500.00 in sanctions in addition to any costs or attorney's fees already awarded. A copy of Judge Shuford's order is attached as **Exhibit B**.

In addition, in support of their Complaint, the Attorney General and State Bar submitted the affidavit of creditors' attorney Michael Stein of the law firm Bernhardt & Strawser, who describes World Law's court filings in great detail. Mr. Stein's affidavit, together with examples of World Law's filings in North Carolina courts, is attached as **Exhibit C**.

Preliminary Injunction Order. On May 24, 2013, Hon. Howard E. Manning, Jr. entered a Temporary Restraining Order against World Law; and on June 4, 2013, Hon. G. Bryan Collins, Jr. entered a Preliminary Injunction Order against World Law. Among other prohibitions, the Order enjoins World Law from:

- (1) Advertising, soliciting, or offering debt settlement or negotiation services to North Carolina consumers;
- (2) Entering into contracts with any North Carolina consumers for the performance of debt settlement services or any legal services;
- (3) "Preparing or providing legal pleadings, including but not limited to answers, discovery responses, affidavits, or motions, to or for use by consumers in North Carolina, including pleadings provided to the consumer for *pro se* filing or use; or providing any legal advice to consumers in North Carolina, including instructions on filing any pleadings or other documents with a court or tribunal, or instructions to consumers on appearing before a court or other tribunal, including statements to make to such court or tribunal;"
- (4) "Communicating with any court, tribunal, or creditor as an attorney or other representative of the legal interests of a North Carolina consumer debtor whether identified as an attorney, a paralegal, or any other title or designation;" and
- (5) Collecting any fees directly or indirectly from any North Carolina consumers.

In addition, the Order requires World Law to notify every North Carolina customer that the World Law defendants will no longer provide any legal services, including pleadings or instructions for appearing in court, and that the customer should consult with a North Carolina licensed attorney if they want legal services or advice concerning their legal rights and remedies with respect to any claims by creditors. A copy of the Preliminary Injunction Order issued against the World Law defendants is attached as **Exhibit D**. Also, on June 4, 2013, the Court issued a separate preliminary injunction order against defendant Global Client Solutions, LLC,

which is an unrelated payment processor, enjoining Global from disbursing any further payments received from North Carolina consumers to World Law.

B. Additional Debt Settlement Cases

Since 2006, the Attorney General has brought actions against or reached consent agreements with seven other debt settlement companies and one debt management company, including the following:

(1) *State of North Carolina ex rel. Roy Cooper, Attorney General v. Advantage Debt Solutions, Inc. and Anthony Krynski* (Wake County 13 CV 005840). In April 2013, the State brought an enforcement action against Charlotte-based ADS and its principal Anthony Krynski, alleging that the defendants engaged in illegal debt settlement services and in unfair and deceptive practices. The State has alleged that, as of July 2012, the defendants had collected approximately \$1,000,000 from out-of-state consumers, out of which the defendants had retained over \$640,000 for their purported services, and \$140,000 from North Carolina consumers out of which the defendants had retained over \$70,000. The Court entered preliminary injunction orders against the defendants on May 6, 2013, enjoining them from engaging in further debt settlement activities and from collecting any fees for such services.

(2) *Consumer Financial Protection Bureau et al. v. Payday Loan Debt Solution, Inc., et al.*, No. 1:12-cv-24410, (S.D. Fl.). In December 2012, the Attorney General joined the Consumer Financial Protection Bureau and the States of Hawaii, New Mexico, North Dakota, and Wisconsin, in an action against a Florida-based debt settlement company that charged illegal advance fees to settle payday loan debts for consumers. Pursuant to a consent judgment entered on December 20, 2012, Payday Loan Debt Solution, Inc. (“PLDS”) agreed to pay restitution of \$100,000, to be paid to consumers who were charged advance fees, but who received no debt-settlement services from PLDS. In addition, the order required PLDS to pay \$5,000.00 in civil penalties and prohibited PLDS from engaging in any further unlawful debt settlement activities.

(3) *State of North Carolina ex rel. Roy Cooper, Attorney General v. Consumer Law Group, P.A., Michael L. Metzner, American Debt Negotiators, Inc., Ran David Barnea and Daniel Post* (Wake County 10 CV 016777). In October 2010, the State sued Consumer Law Group, a debt settlement company based in Boca Raton, Florida. CLG used deceptive Internet and radio solicitations indicating that it was a government-sponsored program offering “stimulus” relief and purported to be a law firm that could settle consumers’ unsecured debts for pennies on the dollar. In reality, CLG charged large upfront fees ranging from 10 to 20% of consumers’ unsecured debts. The defendants agreed to a consent preliminary injunction in October 2010, prohibiting them from soliciting any new North Carolina customers and barring them from charging any further advance fees to existing North Carolina customers. The defendants filed a motion to dismiss, on the grounds that the defendants were attorneys and purportedly exempt from North Carolina law. The court heard the defendants’ motion in March 2011 and denied the motion. In January 2012, the court entered a Consent Judgment, under which the defendants agreed to a permanent injunction barring them from debt settlement activity in North Carolina, and requiring them to pay \$600,000 in restitution to North Carolina consumers, \$50,000 to the State for attorneys’ fees, costs, and consumer protection purposes, and

to forego the collection of an additional \$588,000 in debt settlement fees from North Carolina consumers that did not constitute upfront fees.

(4) *State of North Carolina v. Hess Kennedy Chartered, LLC, The Consumer Law Center, LLC, Laura L. Hess and Edward Cherry* (Wake County 08 CV 2310). In February 2008, the Attorney General filed suit against the Florida-based defendants, who purported to reduce consumers' debts through a debt settlement program that was purportedly administered by attorneys. In reality, consumers paid thousands of dollars in advance fees for debt settlement services, rarely saw their debts settled, and there were no attorneys that were performing the services. The court issued a temporary restraining order and a preliminary injunction against the defendants in February 2008. In July 2008, the defendant companies were placed under receivership pursuant to an order issued by the Broward County (Fla.) Circuit Court, following an emergency motion by the Florida Attorney General. In December 2008, the North Carolina court entered a Consent Judgment permanently barring the defendants from engaging in any debt settlement services in North Carolina and ordering the defendants to pay the State \$75,000 for its attorneys' fees and costs, out of which \$30,000 was paid to in restitution to consumers who filed complaints with the Division. Subsequently, the Florida receiver issued pro rata refunds of 30% of the total upfront fees consumers paid, and issued refunds totaling \$316,000 to North Carolina consumers. In addition, in an order issued by the Florida Supreme Court on January 15, 2009, Florida attorney Laura Hess, who had participated in and lent her name to the scheme, was disbarred for five years.

(5) *State of North Carolina v. Ascendone Corporation, Careone Services, Inc., Freedompoint Financial Corporation, 3C Inc., and Bernardo Dancel* (Wake County 10 CV 018483). The State filed this complaint in November 2010, as part of a multi-state action brought by 21 states against a debt management conglomerate, which the states contended had engaged in deceptive practices by, among other practices, holding itself out as a non-profit debt management company, when, in fact, all services were performed by a for-profit affiliate, and representing that consumers would receive credit counseling services, when they did not. The defendants agreed to an injunction prohibiting these deceptive practices and agreed to comply with all state laws regulating debt management services. North Carolina's share of the settlement was \$169,400.

(6) *U.S. Debt Relief, Inc.* – USDR was a debt settlement company that relocated from Florida to Asheville. The company mailed deceptive solicitations to consumers indicating that it was part of a “federal stimulus relief” program to help consumers get out of debt. The Attorney General's office received several complaints, and the Asheville BBB also contacted the Attorney General regarding complaints it received about USDR. In October 2010, USDR modified its practices in response to the federal rule and ceased collecting advance fees for debt settlement services. USDR entered into a settlement agreement with the Attorney General in May 2011, under which USDR provided refunds of advance fees charged to North Carolina consumers in the amount of \$39,000, paid \$5,000 for attorneys fees' and costs, and agreed to permanent injunctive relief.

(7) *Morgan Drexen* – Morgan Drexen, a California based debt settlement company, purported to offer consumers debt settlement services that would be performed by an attorney in

their state and charged substantial advance fees for their services. Instead, consumers rarely talked with an attorney, and attorneys did not perform the debt settlement services. In May 2009, Morgan Drexen entered into a settlement agreement under which it agreed to cease doing business in North Carolina, except to continue performing services for existing customers, and to offer full refunds to all North Carolina consumers seeking refunds.

(8) *State of North Carolina ex rel. Roy Cooper, Attorney General v. Commercial Credit Counseling Services, Inc.*, (Wake County 06 CV 14672). CCCS was a New Jersey-based firm that provided debt settlement services to small businesses. The State alleged that CCC misrepresented the cost of its services and claimed that it collected fees only if it negotiated savings on its clients' debts. In fact, CCCS charged a multiplicity of fees, including substantial "liquidated damages" if the client withdrew from the program. A settlement agreement was reached in January 2008, under which CCCS agreed not to enroll individual North Carolina customers; to restrictions on its fees charged to North Carolina customers; to provide conspicuous and specific disclosures to North Carolina customers regarding its fees; and to pay the State \$150,000 for attorneys' fees, costs, and consumer protection purposes.

C. Loan Modification Cases

Since 2006, the Attorney General has filed 16 enforcement actions against mortgage loan modification or foreclosure assistance companies.

VI. THE CONSUMER ECONOMIC PROTECTION ACT OF 2009

A. Background

As noted by a 2009 study by the Federal Trade Commission ("FTC"), the most significant change in the debt collection business in recent years has been the advent and growth of debt buying. "Debt buying" generally refers to the sale of debt – which is often charged-off or delinquent – by creditors or other debt owners to buyers that then attempt to collect the debt or sell it to other buyers. A March 2009 report by The Nilson Report estimated that debt buyers in 2008 purchased \$72.3 billion in consumer debt, including credit card, medical, utility, auto, and mortgage debt. Of that total, \$55.5 billion, or 76.8% was credit card debt bought directly from issuers. In a January 2013 study, the FTC found that, on average, debt buyers paid 4 cents per dollar of the debt's face value. Not surprisingly, older debt sold for a significantly lower price than newer debt. The FTC study further found that debt buying can reduce the losses that creditors incur in providing credit. Debt buying, however, may raise significant consumer protection concerns. *The Structure and Practices of the Debt Buying Industry*, Federal Trade Commission Report (Jan. 2013), available at <http://www.ftc.gov/os/2013/01/debtbuyingreport.pdf>.

Experiences in North Carolina. In North Carolina, prior to 2009, tens of thousands of cases were filed in district courts each year by debt buyers. Unlike most debt collection agencies, many debt buyers opt to file lawsuits as their primary collection option, rather than first engaging in traditional collection activity. In the experience of consumer advocates, attorneys,

and the courts, a number of problems (which were not unique to North Carolina) were observed in connection with these lawsuits:

- Many of the debts were old, and some may have been previously paid, or were not owed by the person being sued;
- Debt buyers sometimes had minimal or no documentation of ownership of the debt, or of the amount of the underlying debt;
- Debtors did not know how to assert defenses or seek discovery;
- The vast majority of the cases resulted in default judgments; and
- Debt buyers typically aggressively collected on the judgments.

B. The Debt Buying Provisions of CEPA

In an effort to address these growing concerns about the practices of debt buyers, in 2009 the North Carolina General Assembly enacted the Consumer Economic Protection Act (“CEPA”) (S974). A copy of the Act is attached as **Exhibit E**. North Carolina was the first state in the country to adopt laws specifically addressing debt collection litigation by debt buyers. Since 2009, Maryland has adopted court rules with similar requirements to CEPA, and similar legislation or court rules are being considered by state and local governments across the country, as well as being examined or recommended by federal agencies, including the FTC and the Consumer Financial Protection Bureau (“CFPB”). The key changes and requirements of CEPA are:

- (1) Debt buyers are required to be licensed as collection agencies.

CEPA adopted amendments to North Carolina’s unfair debt collection laws, and primarily to Article 70 of Chapter 58, which regulates collection agencies. Collection agencies are regulated by the North Carolina Department of Insurance, and must receive a permit from NCDOI, as well as a bond, to operate in the State. N.C. Gen. Stat. § 50-70-1, *et seq.* CEPA clarified that debt buyers are included within the definition of collection agencies, and therefore are subject to licensing and oversight by NCDOI. A “debt buyer” is defined as:

“a person or entity that is engaged in the business of purchasing delinquent or charged-off consumer loans or consumer credit accounts, or other delinquent consumer debt for collection purposes, whether it collects the debt itself or hires a third party for collection or an attorney-at-law for litigation in order to collect such debt.” N.C. Gen. Stat. § 58-70-15(b)(4).

- (2) Debt buyers cannot file a lawsuit or otherwise attempt to collect on a debt without valid documentation of ownership and reasonable verification of the amount of the debt.

A debt buyer cannot attempt to collect on a debt, or file suit, unless the debt buyer has valid documentation that it is the owner of the debt, and “reasonable verification” of the amount of the debt. N.C. Gen. Stat. § 58-70-115(5).

(3) Debt buyers are prohibited from any collection on time-barred debts.

A debt buyer is prohibited from bringing suit or initiating an arbitration proceeding, or otherwise attempting to collect on a debt, when the debt buyer knows, “or reasonably should know, that such collection is barred by the applicable statute of limitations.” N.C. Gen. Stat. § 58-70-115(4).

(4) Debt buyers must give 30-day advance notice before filing suit.

A debt buyer cannot bring suit or initiate an arbitration proceeding against a debtor without first giving the debtor written notice of the intent to file a legal action at least 30 days in advance of filing. The written notice must include:

- The name, address, and telephone number of the debt buyer;
- The name of the original creditor;
- The debtor’s original account number;
- A copy of the contract or other document evidencing the consumer debt; and
- An itemized accounting of all amounts claimed to be owed.

N.C. Gen. Stat. § 58-70-115(6).

(5) Evidence must be attached to the complaint proving the existence of the debt and the debt buyer’s ownership of the debt.

In any action filed by a debt buyer, N.C. Gen. Stat. § 58-70-150 requires that the following materials must be attached to the complaint:

- *A copy of the contract or other writing evidencing the original debt, which must contain a signature of the defendant. If no such signed writing evidencing the original debt ever existed, then copies of documents generated when the credit card was actually used must be attached.*
- *A copy of the assignment or other writing establishing that the plaintiff is the owner of the debt. If the debt has been assigned more than once, then each assignment or other writing evidencing transfer of ownership must be attached to establish an unbroken chain of ownership. Each assignment or other writing evidencing transfer of ownership must contain the original account number of the debt purchased and must clearly show the debtor’s name associated with that account number. Each assignment or other writing evidencing transfer of ownership must*

contain the original account number of the debt purchased and must clearly show the debtor's name associated with that account number.

(6) Prerequisites to entering a default or summary judgment in cases initiated by debt buyers.

Prior to entry of a default or summary judgment against a debtor in a complaint initiated by a debt buyer, the plaintiff must file evidence to establish "the amount and nature of the debt." N.C. Gen. Stat. § 58-70-155(a).

N.C. Gen. Stat. § 58-70-155(b) provides that "the only evidence sufficient to establish the amount and nature of the debt shall be properly authenticated business records that satisfy the requirements of Rule 803(6) of the North Carolina Rules of Evidence. The authenticated business records shall include at least all of the following items:"

- The original account number.
- The original creditor.
- The amount of the original debt.
- An itemization of charges and fees claimed to be owed.
- The original charge-off balance, or, if the balance has not been charged off, an explanation of how the balance was calculated.
- An itemization of post charge-off additions.
- The date of last payment.
- The amount of interest and the basis for the interest charged.

(7) No attorney fee award without proof of signed contract and unbroken chain of assignment.

CEPA amends N.C. Gen. Stat. § 6-21.2 to provide that attorneys' fees for services rendered to a debt buyer may not be awarded unless the following are provided to the court:

- A copy of the contract or other writing evidencing the original debt, which must contain a signature of the defendant. If no such signed writing evidencing the debt ever existed, then copies of documents generated when the credit card was actually used must be attached.
- A copy of the assignment of other writing establishing that the plaintiff is the owner of the debt. If the debt has been assigned more than once, then each assignment or other writing evidencing transfer of ownership must be attached to establish an unbroken chain of ownership. Each assignment or other writing evidencing transfer of ownership must contain the original account number of the debt purchased and must clearly show the debtor's name associated with that account number.

C. Additional Provisions of CEPA

CEPA increased the monetary penalties for a collection agency's violation of the statute. Under current law, a collection agency, including a debt buyer, that engages in any prohibited practice is liable to a debtor for actual damages, as well as for penalties of not less than \$500.00 or greater than \$4,000.00. In addition, a violation of the any of the above provisions of CEPA, or of any other provision of the prohibited practices part of Article 70, constitutes an unfair and deceptive practice in violation of N.C. Gen. Stat. § 75-1.1. N.C. Gen. Stat. § 58-70-130.