



Debt Settlement Firms Adopt “Attorney Model” to Evade State & Federal Rules

Morgan Drexen Case Illustrates Harm to Consumers

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This paper discusses debt settlement firms’ increased use of affiliations with legal firms to circumvent state and federal restrictions on upfront fees and other unfair and deceptive practices.

What is Debt Settlement?

Debt settlement companies promise debt relief to families in financial distress with claims that they can settle debts for less than the amounts owed.

To enroll in a debt settlement program, consumers must stop paying their debts and are encouraged to cease contact with creditors. Consumers often grant a power of attorney to the debt settlement company to communicate with creditors on their behalf.

Companies typically calculate the fees consumers pay based on a percentage of their debt at the time of enrollment, not on any savings achieved through settlements.

FTC and state investigations have shown that, when advance fees are charged, less than 10 percent of consumers complete their debt settlement programs successfully. Industry data shows that, at most, less than one-third of enrollees paying advance fees have most of their debts settled, while more than 40 percent have no debts settled.

Federal Trade Commission Bans Advance Fees: In the past, debt settlement companies typically charged hefty fees upon enrollment, before settling any debts. This practice created heavy incentives for companies to sign up as many people as possible, collect fees, and not settle any debts. The high upfront fees also made it very difficult for consumers to afford continuing in the program, and most were forced to drop out before any debt was settled.

In light of these abuses and problems, the Federal Trade Commission (FTC) issued rules regulating debt relief in 2010. Among the most significant of these provisions is an “advance fee ban,” which allows firms to collect fees on accounts only when a settlement agreement has been reached and at least one settlement payment has been made by the consumer to the creditor.

Debt Settlement Companies Evade Ban through the Attorney Model: Following the issuance of the FTC rule, there has been a rise in various attorney-related debt settlement models, in an apparent effort to evade both the FTC’s advance fee ban,¹ and also state laws that often exempt attorneys from their debt settlement regulations.

Although the models differ across companies, in each, attorneys and non-attorneys are affiliated, but the attorneys are present only to provide a cover for collecting advance fees. In fact, the attorneys do not engage in any debt settlement activities; only non-attorneys perform any debt settlement work. Much has been written about how these models are being used to skirt the FTC’s advance fee ban.² The primary models of attorney model evasion are represented by Morgan Drexen and Legal Helpers Debt Resolution.³ Other companies include Allegro Law,

Consumer Law Group, Johnson Law Group, CareOne,⁴ Persels & Associates, whether on its own or in affiliation with CareOne, and World Law Group.⁵

State and Federal Agencies Protect Consumers from Attorney Model Schemes:

States Are Actively Enforcing Laws against the Debt Settlement Attorney Model

The States' Attorney Generals have been using their enforcement powers in an effort to crack down on the attorney model of debt settlement for several years. For example, in May 2011, West Virginia's Attorney General brought numerous counts against Morgan Drexen and associated individuals, challenging the attorney model, as well as Morgan Drexen's advertising and business practices.⁶

In March 2011, Lisa Madigan, the Illinois Attorney General, filed a civil complaint against Legal Helpers Debt Resolution LLC (LHDR), similarly charging that LHDR used its attorneys as a front to charge illegal upfront fees while providing no meaningful debt settlement services.⁷ LHDR settled with Illinois, agreeing to provide \$2.1 million in restitution to Illinois consumers, and not to accept any more Illinois customers.⁸ Oregon sued LHDR in November 2012 for financially abusing the elderly.⁹

Other States have also brought enforcement actions against attorney-model companies. For example, the Colorado Attorney General sued the Johnson Law Group for engaging in debt management in Colorado without a license and alleged that the firm outsources the debt management work to non-attorneys while promising that the work will be handled by attorneys.¹⁰ The Florida and North Carolina Attorneys General have taken action against the Consumer Law Group (CLG) with similar allegations.¹¹ CLG settled claims with North Carolina for \$1.2 million in customer relief and agreed not to conduct business in North Carolina.¹² The Oregon and North Carolina Attorneys General have sued the World Law Group for similar violations, and those cases are pending.¹³

The CFPB Takes Action against One of the Largest Abusers

On August 20, 2013, the Consumer Financial Protection Bureau filed a lawsuit against Morgan Drexen, alleging that it charges illegal upfront fees and deceives consumers, in violation of both the FTC rule and the Dodd-Frank Wall Street Reform and Consumer Protection Act.¹⁴ According to the Complaint, at least 22,000 consumers have enrolled in Morgan Drexen's program since the implementation of the FTC rule on October 27, 2010, and have been charged millions of dollars in up-front fees.¹⁵ The CFPB alleges that only a "tiny fraction" of enrollees has all of their debts settled, and most do not have any debts settled.¹⁶

As alleged in the Complaint, Morgan Drexen was founded in 2007 and began its "attorney model" of debt settlement in that year. After the FTC Advance Fee Ban took effect, Morgan Drexen devised a scheme to circumvent the rule, creating the "Dual Contract Model" so that consumers now sign two contracts simultaneously, "one purportedly for debt relief services and one purportedly for bankruptcy-related services."¹⁷ Morgan Drexen charges the up-front fee under the bankruptcy contract,¹⁸ even though no (or in rare cases, very limited) bankruptcy services are actually provided, per the contract.¹⁹ In this way, Morgan Drexen continues to charge up-front fees (typically \$1,500-\$2,000), despite the advance fee ban. The consumer does not begin to accumulate savings to be applied to settlements with creditors until after all of the up-front "bankruptcy" fees have been collected.²⁰

The Complaint also alleges that Morgan Drexen engaged in deceptive acts and practices by falsely representing that consumers are not charged up-front fees (Morgan Drexen's television

advertisements announce: “\$0 up-front fees” and “Best part – no up-front fees”) and that they will be debt free within months of enrolling in the program.²¹ Instead, few consumers are debt-free within months of enrolling, and the majority of consumers enrolled with Morgan Drexen have no debts settled or negotiated by Morgan Drexen or the affiliated attorneys.²²

Continuing Vigilance Needed: These cases demonstrate the efforts of some debt settlement companies to evade state laws and the FTC Rule, and to continue to engage in unlawful, unfair, and deceptive practices by promising unattainable results and charging harmful advance fees to vulnerable consumers. CRL commends the CFPB and the State Attorneys General who have taken enforcement actions against Morgan Drexen and other companies that employ the unfair, deceptive, and abusive attorney model of debt settlement. Continuing strong action and oversight by both federal and state policymakers is needed to end the use of this business model.

¹ The FTC has made clear that attorneys are not exempted from the Rule as a matter of course. *See, e.g.*, Telemarketing Sales Rule, 16 CFR Part 310, Fed Reg 75-153, at 48468 (Aug. 10, 2010) (“Based on the record in this proceeding, the Commission has concluded that an exemption from the amended rule for attorneys engaged in the telemarketing of debt relief services is not warranted.”), available at <http://www.ftc.gov/os/2010/07/100810tsrdebtrelietreatmentamendments.pdf>.

² *See, e.g.*, Elizabeth Ody, “Debt Firms Play ‘Whack-a-Mole to Skirt Fee Ban,” *Bloomberg News* (Sept. 29, 2011) (“Debt-settlement companies that offer to negotiate with creditors on behalf of consumers are switching tactics to skirt rules banning up-front fees by working with lawyers and charging retainers.”), available at <http://www.bloomberg.com/news/2011-09-30/debt-firms-play-whack-a-mole-to-skirt-fee-ban.html>; Connie Prater, “States, Feds Target Debt Settlement Legal Firms Over Upfront Fees: Despite Bans On Upfront Fees For Debt Relief, Some Law Firms Bypass Restrictions,” *Creditcards.com* (Apr. 12, 2012) (“Despite a 2010 federal rule that banned charging upfront fees for helping consumers to negotiate their way out of debt, law firms have now teamed up with debt settlement operators to get around restrictions – and to keep on charging hefty upfront fees.”), available at <http://www.creditcards.com/credit-card-news/debt-settlement-upfront-fees-banned-law-firms-1282.php>.

³ Morgan Drexen is a company consisting of non-lawyers that contracts with attorneys who serve as a front, but its own non-lawyer employees actually provide the debt settlement work and consumer contact, to the extent any is performed. Legal Helpers Debt Resolution is a company that includes attorneys, but which contracts out the debt settlement work to third-party non-lawyers, to the extent any is performed.

⁴ CareOne, a debt settlement and debt management firm based in Maryland, appears to offer debt settlements services itself in some states, while in other states it utilizes law firm Persels & Associates to get around state regulations or bans that do not apply to attorneys. CareOne indicates on its website that “it provides administrative, technology and paralegal services to Persels & Associates.” *See* <http://www.careonecredit.com/about-us/service-providers.aspx> (visited Oct. 2, 2013). Evidence from a 2011 lawsuit against Persels reveals that non-attorney employees of CareOne actually perform the debt negotiation (to the extent any is performed) in this relationship, such that the use of attorneys appears to be simply a front to allow for the collection of advance fees and/or for CareOne to do business in states where regulations prohibit or otherwise restrict it. *See In re Kinderknecht*, Case No. 09-13443 (Sept. 6, 2011) (Trustee’s Response to Defendants’ Joint Motion for Summary Judgment, Ex. G) (indicating that CareOne negotiators contact the creditors and negotiate a settlement, not Persels’ contract attorneys).

⁵ *See Cooper Takes On One of Nation’s Largest Debt Settlement Firms*, NCPoliticalNews.Com (May 23, 2013), available at <http://www.ncpoliticalnews.com/?p=1956>; *DOJ seeks \$10M in damages from Texas debt-relief company*, Chris Willis, KGW.com, available at <http://www.kgw.com/news/DOJ-seeks-10-M-in-damages-from-Texas-debt-relief-company-216089871.html>.

⁶ *West Virginia v. Morgan Drexen, Inc.*, Civ. Action No. 11-C-829 ¶¶ 30-31 (Complaint filed May 20, 2011), available at <http://getoutofdebt.org/wp-content/uploads/2011/05/MD-Filed-Complaint.pdf>. The Complaint explains that “The “enrollment lawyer, essentially, delegates all of his duties and activities to Morgan Drexen. The enrollment lawyer does not communicate with consumers, does not communicate with creditors, does not negotiate with creditors, and does not even bill consumers. All of these activities are performed by Morgan Drexen.” *Id.* ¶ 90. The sworn testimony of a West Virginia attorney hired by Morgan Drexen appears to confirm these allegations, as the attorney admits that Morgan Drexen negotiates settlements, not her, and that the client has already approved the settlement before the attorney even sees it. Sworn Statement of Rachelle D. McIntyre-Nicholson in *the Matter of the Investigation of Morgan Drexen Before the Attorney General of West Virginia* at 69:12-14; 75:12-14, 17-20; 81:23-82:1-11;98:14-17 (Dec. 22, 2010), available at <http://getoutofdebt.org/33172/morgan-drexen-case-exposes-issues-in-attorney-model-debt-settlement>. The Complaint further alleged that Morgan Drexen acquires customers through telemarketing robo-calls, and has collected advance fees totaling more than \$800,000 from West Virginia consumers. *Id.* ¶¶ 67, *Id.* ¶ 87 (detailing the fees that Morgan Drexen collects from West Virginia consumers: an engagement fee of 1% to more than 15% of the total debt enrolled, a monthly maintenance fee of \$50, settlement fees of 25% of difference between amount owed at settlement and the amount paid to settle the debt, as well as other fees).

⁷ The Complaint alleges that LHDR charges an initial flat retainer of \$500, a monthly maintenance fee of \$49, 5% of the savings of any settlement reduction of 65% or greater (with the retainer and monthly fee credited against this contingency fee), and under

the contract, the consumer also pays 15% of the total enrolled debt to a third party for “the implementation, management, and maintenance of a debt resolution plan.” *People v. Legal Helpers Debt Resolution, LLC*, Case No. 2011CH00286 ¶¶ 52-55 (Ill. Cir. Ct. 7th Jud. Cir. Mar. 2, 2011), available at http://cdn3.getoutofdebt.org/wp-content/uploads/FILED-COMPLAINT-2011CH00286-LEGAL-HELPERS_03-02-2011_08-51-32.pdf. For the first three months, all of the consumer’s payments are allocated to fees. *Id.* ¶ 57.

⁸ Press Release, “Madigan IDFPR Settle Lawsuit Over Consumer Debt Scam,” (July 9, 2012), available at http://www.illinoisattorneygeneral.gov/pressroom/2012_07/20120709.html.

⁹ Brent Hunsberger, “Oregon Sues Legal Helpers Debt Resolution and Chicago Law Firm for Financially Abusing Elderly,” *The Oregonian* (Nov. 28, 2012), available at http://www.oregonlive.com/finance/index.ssf/2012/11/oregon_sues_legal_helpers_debt.html.

¹⁰ See generally *Colorado v. The Johnson Law Group* (Apr. 13, 2011), available at http://www.coloradoattorneygeneral.gov/sites/default/files/press_releases/2011/04/28/jlg_plc_complaint.pdf. Apparently the Supreme Court of Florida suspended the law license of Clint Johnson, the lawyer behind the Johnson Law Group for misusing clients’ money. See “Lawyer Suspended After Alleged Misuse of Funds,” *wftv.com* (May 3, 2011), available at <http://www.wftv.com/news/news/lawyer-suspended-after-alleged-misuse-of-funds/nJfSq/>.

¹¹ *Florida v. Metzner, et al.*, Case No. 12-00762 (7th Jud. Cir.) (Complaint filed Jan. 10, 2012), available at <http://cdn2.getoutofdebt.org/wp-content/uploads/2012/02/2012-01-23-complaint.pdf>; *North Carolina v. The Consumer Law Group, P.A.*, Case No. 10CV016777 (N.C. Super. Ct.) (Complaint filed Oct. 1, 2010), available at <http://www.ncdoj.gov/getdoc/45fb2d1d-b63e-4045-b6c1-f06697c8ff6f/CLG-Complaint.aspx>.

¹² Press Release, “Bogus Law Firm Gives Up \$1.2 Million Taken From NC Consumers” (Jan. 24, 2012), available at [http://www.ncdoj.gov/News-and-Alerts/News-Releases-and-Advisories/Press-Releases/Bogus-law-firm-gives-up-\\$1-2-million-taken-from-NC.aspx](http://www.ncdoj.gov/News-and-Alerts/News-Releases-and-Advisories/Press-Releases/Bogus-law-firm-gives-up-$1-2-million-taken-from-NC.aspx). “Cooper contends that CLG deceived consumers by promising to reduce their debts by half and leave them debt-free without bankruptcy. In reality, CLG rarely worked out agreements to settle debts but kept substantial fees anyway. The company also misled consumers to believe that its program was government-affiliated, and claimed that its services were performed by attorneys when they were not.” *Id.*

¹³ *Oregon v. Swift Rock Financial Inc.*, Case No. 1303-09347 (Complaint filed July 1, 2013), available at <http://www.scribd.com/doc/168947670/State-of-Oregon-v-World-Law>; *North Carolina v. Swift Rock Financial, Inc.*, File No. 13-007161 (Complaint filed May 22, 2013), available at <http://www.ncdoj.gov/getattachment/2a9d323f-3bbd-4767-b0d0-282b119e96cd/World-Law-Group-Filed-Complaint.aspx>.

¹⁴ *CFPB v. Morgan Drexen, Inc.*, Case No. SACV13-01267 JST (JEMx) (C.D. Cal.) (Complaint filed Aug. 20, 2013), available at http://files.consumerfinance.gov/f/201308_cfpb_complaint_morgan-drexen.pdf.

¹⁵ Complaint ¶ 56.

¹⁶ *Id.* ¶ 59.

¹⁷ *Id.* ¶ 14.

¹⁸ *Id.* ¶¶ 11-13.

¹⁹ *Id.* ¶¶ 14, 31-40, 48-50, 60.

²⁰ *Id.* ¶¶ 51, 52.

²¹ *Id.* ¶¶ 19, 80-87, 91-97.

²² *Id.* ¶¶ 58-59, 84-87, 95-97