Recent Developments in the Law Regarding Debt Consolidation Services

Consumers looking to debt consolidation services as a way to avoid filing bankruptcy need to consider some of the "hidden" dangers inherent in such services before making the decision to consolidate debt. Three recent judicial decisions in California, Washington and Connecticut illustrate some of these concerns.

In Simmons v. Daly, Murphy & Sinnot Law Center, 2003 WL 21267184 (Conn. Super. May 15, 2003), plaintiff Simmons sued the defendant debt consolidation service she had retained to reduce her overall debt. Simmons had seen a television advertisement for the debt consolidation service offered by the Law Center, and called the telephone number shown. The Law Center assured Simmons that it would negotiate a settlement with her creditors, whereby those creditors would accept an amount less than their claims against her. The Law Center stated that as its fee for its services it would charge Simmons nearly a third of the amount by which it was able to reduce her creditors' claims. The contract Simmons signed with the Law Center authorized electronic transfers directly from her checking account to the Law Center. In a period of approximately five months, the Law Center received over $2,300 from Simmons' account. Then, in April 2001, Simmons was sued by one of her creditors. She realized she would have to file bankruptcy, and did so. The attorney Simmons hired to file her bankruptcy petition attempted to gain an accounting from the Law Center of the services they had performed for Simmons, but no accounting was ever provided. In fact, the court noted that there was no evidence that the Law Center had ever even contacted Simmons' creditors in an effort to negotiate reduced claims. The court held that the Law Center had engaged in deceptive acts or practices in violation of Connecticut's consumer fraud statute, and awarded damages to Simmons.

In two other recent decisions, Acorn v. Household International, Inc., 211 F.Supp.2d 1160 (N.D. Ca. 2002) and Luna v. Household Finance Corp. III, 236 F. Supp. 2d 1166 (W.D. Wash. 2002), courts held that certain terms of agreements signed by consumers who consolidated their debt into home loans were unconscionable and therefore unenforceable. In Acorn, plaintiffs -- a community organization of low and moderate-income families and individual customers of the bank -- sued the bank for fraud, deceit, negligent misrepresentation and

unjust enrichment. They alleged that the defendant bank engaged in predatory lending practices by targeting homeowners struggling with credit card debt, tricking them into consolidating their debt into high cost loans secured against their homes, and trapped them into their loans by "upselling" the loans to amounts so high in relation to the value of the customers' homes that they could not refinance with any of the bank's competitors. In Luna, plaintiffs alleged that the bank misled them into entering loans with interest rates higher than those initially promised, and sued the bank for violations of the Washington Consumer Protection Act, the Real Estate Settlement Practices Act, the Truth in Lending Act, the Homeowners Equity Protection Act, as well as common law fraud and emotional distress. In both Acorn and Luna, the bank moved to dismiss plaintiffs' claims on the basis of an arbitration provision contained in plaintiffs' loan agreement. Relying on that arbitration provision, the banks claimed that plaintiffs were prevented from suing in court. Both the California and Washington District courts ruled that the arbitration provision was fundamentally unfair to the consumers, and therefore unconscionable and unenforceable.

Luna, Acorn and Simmons all demonstrate some of the harms that can befall unwary consumers looking to consolidate their debts.