

## YOUR MONEY

# Debt Relief Can Cause Headaches of Its Own

Your Money

By JANE BIRNBAUM FEB. 9, 2008

It wasn't supposed to work this way.

Credit card companies have long seduced customers with “buy now, pay later,” hoping they would pay at least a minimum amount month after month but never pay off their debts. Now, though, with the economy slowing and houses no longer easy sources of cash, a growing number of consumers cannot pay even the minimums.

In December, revolving debt — an estimated 95 percent from credit cards — reached a record high of \$943.5 billion, according to the Federal Reserve. The annual growth rate of this debt increased steadily in 2007, reaching 9.3 percent in the last quarter, up from 5.4 percent in the first quarter.

The amount of debt that is delinquent — in which minimum payments are late but the accounts are still open — also appears to be on the rise. The Federal Reserve found that 4.34 percent of the credit card portfolios of the 100 largest banks that issue cards was delinquent in the third quarter of last year, up from 4.07 percent in the previous quarter. Charge-offs — accounts closed for nonpayment — also grew in that period, and banks expect charge-offs to keep rising in 2008.

“It's not that card debt is unmanageable for everyone,” Adam J. Levitin, a credit expert and an associate professor of law at Georgetown University, wrote in an

e-mail message. “Rather, it is unmanageable for some (and a growing group, it seems).”

What can borrowers do to extricate themselves?

If belt-tightening suffices, one option is a debt management repayment plan in which interest rates, but not balances, are reduced.

Ronald J. Mann, a law professor at Columbia University and a credit expert, describes credit industry practices as intended to enslave borrowers in a “sweat box.” He recommends a Chapter 7 bankruptcy that wipes out most credit card debt.

Many consumers, however, are loath to file for bankruptcy protection, said Mark S. Zuckerberg, a bankruptcy lawyer in Indianapolis. And others may find that they cannot qualify for a Chapter 7.

Then there is debt settlement, when a debtor and creditor agree that payment of a negotiated, reduced balance will be payment in full. Debt settlement generally works best when consumers can offer a lump sum, the experts said. But consumers may face taxes on the amount the creditor has forgiven.

“Done correctly, it can absolutely help people,” said Cyndi Geerdes, an associate professor at the University of Illinois law school who also runs a consumer debt clinic.

Consumers can arrange debt settlement themselves, and many Web sites offer advice. Consumers can also hire a lawyer or use debt settlement companies, many of which advertise online and on television. The experts agree, however, that “buyer beware” is the best advice when considering debt settlement companies.

A thousand such companies exist nationwide, up from about 300 a couple of years ago, estimated David Leuthold, vice president of the Association of Settlement Companies, which has 70 members and is based in Madison, Wis.

Deanne Loonin, a senior lawyer with the National Consumer Law Center in Boston, has investigated them. “It’s possible there are honest ones,” she said, “but I assume they aren’t until proven otherwise.”

Travis Plunkett, legislative director of the Consumer Federation of America in Washington, said distressed borrowers who cannot produce lump sums to settle with creditors were the most vulnerable to dishonest companies. In some cases, these companies tell consumers to stop paying monthly minimums, explaining that they will negotiate a settlement when borrowers have saved enough. Meanwhile, they take hefty monthly fees directly from clients' bank accounts.

Creditors will not negotiate reduced balances with consumers who are still making monthly payments. But when they stop paying, total balances swell with fees and interest rates. And depending on the law in states where debtors live, creditors can attach wages and property to satisfy the new total owed.

"Many debt settlement companies never explain these risks clearly," said Joseph A. Mullaney, a consumer affairs lawyer in Voorhees, N.J.

According to Ms. Geerdes, whether a creditor takes legal steps depends on its analysis of each debtor.

Mr. Leuthold said his association's members served consumers who had already stopped making payments and had no better options. And his members must pledge to inform clients of risks and spell them out in contracts, he said.

David Johnson, senior vice president of ByDesign Financial Solutions, a nonprofit charity in Commerce, Calif., says he advises consumers to avoid companies that charge large fees upfront or through payments.

"It certainly would seem likely that there would be less incentive to push to settle quickly," Mr. Johnson wrote in an e-mail message. He recommended that consumers look for services that charge after settlement, about 20 percent of the amount of the negotiated reduction in balance.

Desperate consumers may turn to debt settlement, Mr. Mullaney says, because "they usually want to pay their debt" but are also "intrigued with the proposition of getting out of it without the dishonor of declaring bankruptcy and with the prospect of compromising the actual principal that they owe."

And company employees can be smooth talkers, said Susan Block-Lieb, a law

professor at Fordham University and a consumer affairs expert. “You’ve got these really convincing, calm people with a really complicated formula, who are saying, ‘Don’t worry.’ ”

Katherine Taylor, the maiden name of a white-collar worker in Austin, Tex., who did not want to be further identified because she is a supervisor, said she realized last summer that she and her husband would soon be unable to make monthly minimums on their \$59,000 in credit card debt. After seeing a television advertisement, Ms. Taylor said she typed “Christian debt settlement” into her computer. “I wanted an agency with high ethics,” she explained.

On the first phone call with one based in Austin, she agreed to let the company take \$676 from her bank account for five months, then \$416 for the next 13. “I was told that if I stopped making payments and saved up almost \$24,000 on my own, in 48 months I would be free and clear and my credit score would improve,” Ms. Taylor said.

Late last year, unable to reach the settlement company by phone and getting constant calls from collectors, Ms. Taylor contacted a local Better Business Bureau office. She was advised to close her bank account immediately and file a complaint.

Offered a partial refund by the service, she is considering her options.

Mr. Mullaney himself was a victim of a debt settlement company. He was determined, he said, to avoid bankruptcy, a black mark for lawyers. But after starting practice in 2003, he said he realized that he would not be able to afford both student loan payments and the minimums on his \$33,500 in credit card debt. He searched online for a debt settlement company run by a lawyer, and by phone closely questioned one based in Anaheim, Calif.

As instructed, Mr. Mullaney stopped paying his credit cards, started paying monthly fees and saved aggressively, he recalled. But without warning, three of Mr. Mullaney’s four creditors took legal action. “Finally, the cloud of irrational belief in the concept disappeared, and I realized the scam I’d fallen for,” he said.

On Oct. 17, 2005, the last day before changes in federal bankruptcy law made it

harder to obtain a Chapter 7, Mr. Mullaney filed for bankruptcy protection and eliminated his credit card debt. “I’ve found redemption, through using my legal degree and what I’ve gone through, in counseling others who sit before me ashamed and in tears,” he said.

Marc S. Stern, a bankruptcy lawyer in Seattle, said most consumers should not negotiate for themselves. “It’s too emotional, and a lawyer can say things about clients that they never will, like he’s a deadbeat and you’re never going to get any more from him,” Mr. Stern said.

Experts agreed that deals may be struck with many original creditors for 50 to 80 cents on the dollar, while debt buyers, who paid 20 cents or less on the dollar, may settle for a lower amount.

Debt settlement companies are regulated by state attorneys general and the Federal Trade Commission, but they are rarely prosecuted. To improve regulation of this interstate business, the Uniform Law Commission, sponsored by state governments and based in Chicago, is promoting a model law that covers credit counseling and debt management companies. It was in force in four states last year, and an estimated five state legislatures will vote on it this year, said Michael Kerr, the commission’s legislative director.

Mr. Leuthold says his association welcomes regulation but has reservations about the model law, including its volume. “Some say it is long and complicated, 80 pages, and a lot of states don’t want that level of detail,” he said.

Until the states or Congress act, credit card holders are “naked in the world,” said Elizabeth Warren, a law professor at Harvard and a bankruptcy expert. “Unscrupulous debt counselors have built their business models around taking advantage of desperate people.”

A version of this article appears in print on , on page C1 of the New York edition with the headline: Debt Relief Can Cause Headaches Of Its Own.