

No. D-1-GV-09-001570

STATE OF TEXAS,
Plaintiff,

v.

DEBT RELIEF USA, INC.,
Defendant.

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IN THE DISTRICT COURT OF

TRAVIS COUNTY, TEXAS

53rd JUDICIAL DISTRICT

PLAINTIFF'S ORIGINAL PETITION

TO THE HONORABLE JUDGE OF SAID COURT:

Plaintiff, STATE OF TEXAS, acting by and through the Attorney General of Texas, Greg Abbott, complains of DEBT RELIEF USA, INC. Defendant, or "Debt Relief," and for cause of action would respectfully show as follows:

DISCOVERY CONTROL PLAN

1. The discovery in this case is intended to be conducted under Level 2 pursuant to TEX. R. CIV. P. 190.3.

JURISDICTION

2. This action is brought by Attorney General Greg Abbott, through his Consumer Protection and Public Health Division, in the name of the State of Texas and in the public interest under the authority granted him by § 17.47 of the Texas Deceptive Trade Practices-Consumer Protection Act, TEX. BUS. & COM. CODE ANN. § 17.41 *et seq.* (Vernon 2002 & Supp. 2008) ("DTPA") upon the grounds that Defendant has engaged in false, deceptive, and misleading acts and practices in the course of trade and commerce as defined in, and declared unlawful by, §§ 17.46(a) and (b) of the DTPA.

NATURE OF DEFENDANT'S OPERATIONS

3. Defendant operates a for-profit debt settlement company. Debt settlement is a form of consumer debt relief, targeted to consumers with thousands of dollars of unsecured debt.

Consumers interested in debt settlement likely are also considering options such as traditional credit counseling, debt management plans, debt consolidation loans, and possibly bankruptcy.

4. Unlike those alternatives, debt settlement is an aggressive form of debt relief, in which consumers stop paying all of their unsecured debts, and save the money they would normally use to pay those debts. After several months, when the accounts are in default, the debt settlement company will contact the creditor and negotiate a lump-sum payoff of the debt, ideally at a highly reduced percentage. The consumer then uses the money that he/she has been saving to pay the lump-sum, and can then have the benefit of a significant portion of their original debt being forgiven.

5. Because of its theoretical potential for a quick turnaround and significant savings, debt settlement is often promoted emphasizing these facts. For example, Defendant Debt Relief prominently represents on its web site that consumers will be “. . . DEBT FREE in as little as 36 months.” Debt settlement companies may also disparage the alternative forms of debt relief in order to persuade consumers that settlement is the best option for them. In reality, the debt settlement company has no interest or ability to advise consumers on the best option for them, rather they are selling their program.

6. Because debt settlement only works if consumers are not making monthly payments on their unsecured debts (since creditors will not want to settle a debt if they are receiving monthly payments), there are inherent risks involved with participating in a debt settlement program, that can have catastrophic effects to the consumer. Specifically, consumers entering a debt settlement program may experience any, or all, of the following:

- A. Creditors will continue to assess interest, late fees, over-limit charges, and any other fees associated with the account. As a result, at the time that a settlement is reached, the consumer owes significantly more on their account, thus reducing the actual savings.

- B. Creditors are under no obligation to accept, or even entertain, a settlement offer. When this occurs, consumers are stuck with a vastly higher balance because of the interest and late fees that have accumulated on the debt. As a result, the consumer can end up in a far worse financial situation than when they entered the program.
- C. Because they are no longer receiving monthly payments, creditors will likely engage in collection activities which may include repeated phone calls and other correspondence. Over time, these activities can increase, especially as the consumer's account may get transferred to a collection agency.
- D. Once a consumer stops paying on their accounts, the creditor may file a lawsuit against the consumer for breaking their contract. Most debt settlement companies, including Defendant, cannot offer any assistance when a lawsuit is filed, and as a result the consumer can end up with multiple judgments against them.
- E. The consumer's credit reports will reflect the late charges and nonpayment of their unsecured debt. As a result, the consumer's credit score will drop while participating in the program, and the consumer may experience the long term effects of a low credit score, which can include difficulty in buying a house or car, obtaining insurance, or obtaining employment.
- F. The debt forgiveness that occurs as part of the settlement is taxable income.

7. Because debt settlement is generally a "for-profit" industry, companies charge their customers large fees. Fees are typically calculated as a percentage of the total debt the consumer brings into the program, are often collected in the first several months of the program, and are for the most part non-refundable. In addition, there may be monthly maintenance fees, enrollment fees, administrative fees, and back-end settlement fees. As a result, the high fees cut into the potential savings that a consumer can experience in the program. Moreover, these fees may be the tip of the iceberg for consumers - if they are sued and want an attorney they may have to pay a lawyer's legal fees, if they want to improve their credit after participating in the settlement program they may have to pay a credit repair firm's fees, and if they want tax advice regarding debt forgiveness, they may need to pay an accountant.

8. Because of the additional costs and negative effects of debt settlement, it is often difficult to say what a consumer's true cost is in a program, or what benefit they may really see. For example, a consumer with a \$10,000 unsecured debt may be told their debt can settle for \$4,000, or a 60% savings, but when the company's fees are added, along with whatever costs are associated with improving the damage caused by the settlement process, the consumer likely will spend far more than \$4,000 in resolving the debt. In addition, late fees and interest will likely increase the \$10,000 debt, such that a 60% settlement will actually be for much more than \$4,000. Add to this the risk that a creditor will not settle an account, and it becomes evident that debt settlement is a risky form of debt management, that requires clear disclosures to consumers so that they can make an informed decision.

DEFENDANT

9. Defendant Debt Relief USA, Inc. is a foreign corporation incorporated under the laws of Florida, but which is registered to do business in Texas and maintains its principle place of business in Texas at 16200 Addison Road, Suite 105, Addison, Texas 75001. On June 18, 2009, Defendant filed a voluntary petition for relief under Chapter 11 of the U.S. Bankruptcy Code. This suit however is exempt from the automatic stay pursuant to 11 U.S.C. 362(b)(4). On June 24, 2009, the case was converted to a Chapter 7 proceeding and Robert Newhouse was appointed as the Chapter 7 Trustee. Defendant Debt Relief USA, Inc. can be served with process through the Chapter 7 Trustee, Robert Newhouse, at 1412 Main St., Ste. 2400, Dallas, Texas 75202. A copy of this lawsuit has also been sent to counsel for the Trustee, Linda LaRue and John Paul Stanford, Quilling, Selander, Cummiskey & Lownds, P.C., 2001 Bryan St., Ste. 1800, Dallas, Texas 75202.

VENUE

10. Venue of this suit lies in Travis County, Texas pursuant to the DTPA §17.47(b), because Defendant has done business in Travis County, Texas.

PUBLIC INTEREST

11. Because Plaintiff STATE OF TEXAS has reason to believe that Defendant has engaged in and will continue to engage in the unlawful practices set forth below, Plaintiff STATE OF TEXAS has reason to believe that Defendant has caused and will cause adverse effects to consumers and to legitimate business enterprise which conducts its trade and commerce in a lawful manner in this State. Therefore, the Consumer Protection and Public Health Division of the Office of the Attorney General of Texas believes and is of the opinion that these proceedings are in the public interest and at least seven days prior to instituting this action informed Defendant in general of the alleged unlawful conduct.

TRADE AND COMMERCE

12. Defendant is engaged in trade and commerce as that term is defined by § 17.45(6) of the DTPA.

ACTS OF AGENTS

13. Whenever in this Petition it is alleged that Defendant did any act, it is meant that:
- A. Defendant performed or participated in the act; or
 - B. Defendant's officers, agents, or employees performed or participated in the act on behalf of and under the authority of the Defendant.

STATEMENT OF FACTS

Texas Finance Code

14. In 2005, the Texas Legislature amended Chapter 394 of the Finance Code to regulate "debt management services," which it defined as:

“(A) the receiving of money from a consumer for the purpose of distributing that money to or among one or more of the creditors of the consumer in full or partial payment of the consumer's obligations;

(B) arranging or assisting a consumer to arrange for the distribution of one or more payments to or among one or more creditors of the consumer in full or partial payment of the consumer's obligations; or

(C) exercising control, directly or indirectly, or arranging for the exercise of control over funds of a consumer for the purpose of distributing payments to or among one or more creditors of the consumer in full or partial payment of the consumer's obligations.”

TEX. FIN. CODE ANN. § 394.202(6). Debt management service providers are required in part to register (TEX. FIN. CODE ANN. § 394.204), maintain a surety bond (TEX. FIN. CODE ANN. § 394.206), and can only charge fees that are fair and reasonable (TEX. FIN. CODE ANN. § 394.210).

15. An agreement between a consumer and an unregistered debt management service provider is void (TEX. FIN. CODE ANN. § 394.215(a)) and a consumer is entitled to recover all fees paid under a void agreement along with costs and attorneys' fees (TEX. FIN. CODE ANN. § 394.215(b)).

Defendant's Debt Settlement Services

16. Defendant operates a for-profit debt settlement company in Texas and nationwide, including in Austin, Texas. Defendant requires consumers to make a monthly fixed payment into a bank account owned and maintained by Defendant directly. This payment includes Defendant's fees, and the consumers' savings or “set-aside” funds, that will be used to settle their debts. Defendant states in its contracts with consumers that it segregates a consumers' “set-aside” funds from Defendant's fees. Defendant however maintains control of the “set-aside” account, and requires consumers to sign a “Limited Power of Attorney” that authorizes Defendant to withdraw funds from the consumer's account to both pay Defendant's fees, and to forward payments directly to creditors.

17. For its services, Defendant charges a variety of fees. Defendant charges an Administration Fee, in the amount of 10% of the consumer's total debt. This fee must be paid before any money is saved to settle the consumer's debt, such that the first several monthly payments made under Defendant's program are only used to pay Defendant's fees. Each month, Defendant also charges a Monthly Maintenance Fee in the amount of \$29.95 or \$39.95 (depending on the consumer's debt load). Finally, in the event a debt does settle, Defendant charges a Negotiation Fee in the amount of 13% of the amount of debt saved on each settlement.

18. Defendant's debt settlement services are debt management services as defined by the Texas Finance Code. Defendant has failed to register its debt management services as required by the Texas Finance Code. As such, all contracts entered between consumers and Defendant are void, and consumers are entitled to receive a refund of all fees paid, costs, and attorneys' fees. In selling and maintaining its debt settlement program, Defendant has misrepresented its authority to collect fees, enroll consumers, and has in general misrepresented the legality of its program.

Consumer Complaints

19. Despite Defendant's failure to register, and thus its operating an inherently illegal business in Texas, thousands of consumers have enrolled in Defendant's debt settlement service. Consumers complaining to the Texas Attorney General have alleged that Defendant failed to perform any services as advertised, often resulting in creditors not being contacted, which in turn resulted in lawsuits filed against the consumers by their creditors. Other consumers have expressed confusion as to Defendants' fee structure, not understanding that the initial payments made to Defendant would not be saved for use in settling their debts, but rather were Defendant's fees. Still other consumers have complained that enrollment in Defendant's program resulted in aggressive collection efforts by creditors, and that consumers were unable to contact Defendant for assistance. Others have

complained that when they contacted creditors directly, they were able to settle accounts on their own, without any work done by Defendant. Despite this, Defendant still collected their 13% Negotiation Fee.

VIOLATIONS OF DTPA

21. Plaintiff, the State of Texas, incorporates and adopts by reference the allegations contained in each and every preceding paragraph of this petition.

22. Defendant, as alleged and detailed above, has in the course of trade and commerce engaged in false, misleading and deceptive acts and practices declared unlawful in § 17.46(a) and (b) of the DTPA. Such acts include:

- A. Engaging in false, misleading or deceptive acts or practices in violation of § 17.46(a) of the DTPA.
- B. Representing that goods or services have sponsorship, approval, characteristics, ingredients, uses, benefits, or quantities which they do not have or that a person has a sponsorship, approval, status, affiliation, or connection which he does not in violation of § 17.46(b)(5) of the DTPA.
- C. Representing that an agreement confers or involves rights, remedies, or obligations which it does not have or involve, or which are prohibited by law in violation of § 17.46(b)(12) of the DTPA. And,
- D. Failing to disclose information concerning goods or services which was known at the time of the transaction if such failure to disclose such information was intended to induce the consumer into a transaction which the consumer would not have entered into had the information been disclosed in violation of § 17.46(b)(24) of the DTPA.

PRAYER

23. By reason of the acts and practices described herein above, DEFENDANT has violated and will continue to violate the laws as herein alleged unless enjoined by this Honorable Court.

24. WHEREFORE, PREMISES CONSIDERED, Plaintiff prays that DEFENDANT be cited according to law to appear and answer herein; that after due notice and hearing a temporary injunction be issued; and that upon final hearing a permanent injunction be issued, restraining and enjoining DEFENDANT, its officers, agents, servants, employees and attorneys and any other person in active concert or participation with DEFENDANT, from engaging in the following acts or practices:

- A. Providing debt management services without registering and posting a bond as required by TEX. FIN. CODE CH. 394;
- B. Misrepresenting Defendant's authority to do business in Texas;
- C. Misrepresenting Defendant's services, or the costs of such services;
- D. Failing to clearly and conspicuously disclose, prior to enrolling consumers in its debt settlement program, all material terms and conditions, including the costs of such program, and the services Defendant provides;
- E. Failing to clearly and conspicuously disclose, prior to enrolling consumers in its debt settlement program, all potential negative effects of debt settlement, including but not limited to the accumulation of increased late fees and interest, increased collection efforts, the possibility that consumers will be sued, the inability of Defendant to provide legal, accounting, or tax advice, the fact that debt forgiveness is taxable income, and the negative effect of debt settlement on consumers' credit score.

25. Plaintiff further requests that upon final hearing this Court assess¹ such relief as the Court finds necessary to redress injury to consumers including, but not limited to, restitution of monies paid by consumers; and further order Defendant to pay to the State of Texas:

- A. Restitution of monies paid by consumers.
- B. Disgorgement of any ill-gotten gains.

¹ While bringing this lawsuit is exempted from the automatic stay by virtue of 11 U.S.C. 362(b)(4), the Texas Attorney General's Office understands that it may not seek to collect against the Debtor without returning to the Bankruptcy Court, as it intends to do.

- C. Civil penalties of up to \$20,000.00 per violation of the DTPA.
 - D. Pre-judgment and post-judgment interest on all awards of restitution, damages, or civil penalties, as provided by law. And,
 - E. All costs of Court, costs of investigation, and reasonable attorneys fees pursuant to TEX. GOVT. CODE ANN. § 402.006(c).
26. Plaintiff further prays for such other relief to which Plaintiff may be justly entitled.

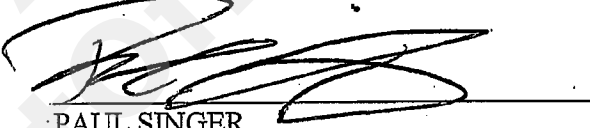
Respectfully submitted,

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