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NEW CALIFORNIA DEBT SETTLEMENT BILL WOULD LIMIT FEES TO NO MORE THAN 15% OF CONSUMER SAVINGS

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A new bill introduced in California would prohibit debt settlement providers from charging any fees in excess of 15% of the amount of consumers' savings as a result of any settlement.

The Debt Settlement Consumer Act (Senate Bill 708) was introduced in February 2011 by State Senator Ellen Corbett (R-San Mateo), who headed the California Senate Judiciary Committee that stopped a proposed regulation (Assembly Bill 350) last year that had drawn support from the debt settlement industry. The bill is supported by the Center For Responsible Lending and the Consumers Union.

Besides limiting the timing and percentage of the fees that may be charged, the proposed new law contains extensive new requirements for licensing and reporting, and would impose substantial penalties on individuals and companies that fail to comply with the Act.

Exemptions

The proposed bill would not be applicable to certain financial service providers, including banks, financial planners and investment advisers, as well as accountants, escrow companies and title insurers.

However, notably, there is no general exemption for attorneys that provide debt settlement services "incidental to the practice of law," as has been included in most debt settlement statutes in other states. Instead, the only



exemption applicable to attorneys in the proposed new law is limited to “providing information, advice, or legal representation with respect to filing a case or proceeding under Title 11 of the United States Code.”

Licensing Requirements

SB 708 would require that all debt settlement providers obtain a license from the California Department of Corporations (“DOC”). The proposed licensing provisions include the following:

- The payment of an investigation fee (up to \$1,000), an application fee (up to \$1,000) and a fee to cover fingerprint processing.
- Extensive disclosure requirements, including disclosure of any civil or criminal judgments or regulatory actions relating to financial fraud or misuse, or violation of consumer protection laws by the applicant or any of its officers, directors, owners, employees, agents or predecessor organizations.
- Disclosure of any common ownership with any person or entity that advertises debt settlement services, provides banking services to debt settlement consumers or contracts to provide debt settlement services.
- Submission of annual audited financial statements and an annual report.
- Maintenance of a minimum net worth of \$100,000, as evidenced by the financial statement.
- Payment of the registrant's pro rata share of all costs and expenses for the administration of the debt settlement act.
- Obtain a \$200,000 surety bond as security for any violations of the Act and any fees or assessments by the DOC.



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Examination of Books and Records

The bill would grant the DOC authority to examine the books and records of debt settlement providers at least once every two years. Debt settlement companies would be required to allow free access to the DOC to inspect its books and records at any time, and would have to retain their books and records for a minimum of five years.

The DOC would also have the power to issue subpoenas, examine witnesses and require the production of documents and other things in performing its examination duties. Violation of the retention requirement would result in a \$10,000 penalty for each year that records were not retained.

Annual Reporting

The Act would impose extensive annual reporting requirements on debt settlement providers. They would have to provide data going back the previous five years and reflecting a wide variety of statistical categories. Companies would have to report, for each year, the amount of debt enrolled, the amount of debt settled, the number of newly-enrolled California residents, the total number of California residents, the number of California residents that terminated the program, the number of California residents that completed the program, the total amount of fees collected, and the number of consumers acquired from lead generators.

Failure to submit the annual report on a timely basis would result in a penalty of \$100 a day up to ten days, and then would constitute grounds for suspension or revocation of the provider's license.



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Pre-Agreement and Disclosure Requirements

Before entering into a debt settlement program with a consumer under the proposed Act, a provider would first have to provide the consumer with the following:

1. An individualized financial analysis.
2. A good faith estimate of the length of the program, the amount of debt enrolled, the total estimated savings required to complete the program, and the monthly targeted amount estimated to be required to meet the program.
3. A written determination, supported by the financial analysis, that the consumer can reasonably meet the program's requirements, including the savings and fee requirements, that the program is suitable for the consumer and that the consumer would reasonably be expected to receive a tangible net benefit from the program.
4. A description of the services to be provided in the program, including a good faith estimate of the time when the provider will make a bonafide settlement offer to each creditor and an estimate of all fees to be charged, including an itemized list of the approximate dates or circumstances when each fee will be due.
5. Extensive disclosures, including that:
 - The provider will not send money to the consumer's creditors unless there is a settlement,
 - The consumer's debts can grow bigger before any settlement and that debt settlement services are not suitable for all consumers,



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- The use of the debt settlement service will likely adversely affect the consumer's creditworthiness,
- The service may result in the consumer being subject to collections or sued by creditors or debt collectors,
- The service may increase the amount of money the consumer owes due to the accrual of fees and interest,
- Not all creditors will accept a reduction in the balance, interest rate, or fees a consumer owes,
- The consumer may inquire about other means of dealing with debt, including, but not limited to, nonprofit credit counseling and bankruptcy,
- The consumer will remain legally obligated to make periodic or scheduled payments to creditors while participating in a debt settlement plan,
- The debt settlement provider will not make any periodic or scheduled payments to creditors on behalf of the consumer.

6. A "Consumer Notice and Rights Form" that would have to be signed by the consumer and the provider, including most of the disclosures that are described above as well as confirmation of the consumer's right to cancel the program at any time, and DOC contact information for the consumer to make any complaints about the debt settlement provider.

Written Agreement Requirements

The proposed law would require that a provider enter into a written agreement with a consumer before providing any services, or else any agreement would be void. The agreement would have to include the various disclosures and good faith estimates described above.



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In addition, debt settlement agreements would not be allowed to include any of the following provisions:

- Application of the law of any jurisdiction other than California.
- Modifying or limiting otherwise available forums or procedural rights, including the right to trial by jury, that are generally available to the individual under law other than as provided in this division. This apparently would prohibit the inclusion of arbitration agreements in debt settlement agreements.
- Restricting the individual's rights or remedies or the provider's obligations under this division or under another applicable law.
- Limiting or releasing the liability of any person for not performing the agreement or for violating this division.
- Indemnifying any person for liability arising under the agreement or this division.
- Requiring the consumer to be responsible for payment of any attorney's fees of the provider.
- Containing a hold harmless clause.
- Containing a confession of judgment clause.
- Containing an assignment of or order for payment of wages or other compensation for services.
- Containing an acceleration provision

General Provisions

Consistent with the Federal Trade Commission's Telemarketing Sales Rule ("TSR"), 16 CFR Part 310, the proposed Act would allow consumers to cancel their enrollment in a debt settlement program at any time without cost (other than to the extent the provider has previously earned any part of its fees). In addition, no other cancellation fee or penalty could be charged.



The provider would be obligated to provide timely notice to all creditors it had contacted on behalf of the consumer, and any limited powers of attorney would be immediately terminated.

The Act would also prohibit debt settlement providers from:

- Making any misrepresentations about any aspect of the program.
- Making any representations about the results that may be achieved by debt settlement, including about the percentage or dollar amount by which debt may be reduced or the amount a consumer may save, or the experience of its customers with respect to debt reduction.
- Advising, encouraging, or requiring consumers to stop making payments to any creditors.
- Soliciting or accepting any voluntary contributions from consumers.
- Acquiring a power of attorney conferring any power except the power to negotiate a proposed settlement of one or more debts to which the consumer will be offered the opportunity to assent.
- Purchasing a debt or obligation of the consumer or engage in the practice or business of debt collection.
- Requiring a consumer to deposit his or her funds into a specific financial institution.
- Charging the consumer for or provide credit or other insurance, or charge the consumer for coupons for goods or services, membership in a club, educational services or materials, access to computers or the Internet, or any other ancillary product or service, or represent or imply to a person participating in or considering



debt settlement that purchase of any ancillary goods or services is required.

- Employing any unfair, unconscionable, or deceptive act or practice.
- Entering into any contract with one or more unconscionable terms.
- Making any loans or offering credit to a consumer or solicit or accept any note, mortgage, or negotiable instrument other than a check.
- Taking any release or waiver of any obligation to be performed on the part of the debt settlement provider or any right or remedy of the consumer.
- Changing the mailing address on any of a consumer's creditor's statements.
- Receiving any cash, fee, gift, bonus, premium, reward, or other compensation from any person other than the consumer explicitly for the provision of debt settlement service to that consumer.
- Taking any confession of judgment or power of attorney to confess judgment against the consumer or appear as the consumer or on behalf of the consumer in any judicial proceedings.
- Offering or providing any gifts or bonuses to consumers for signing a debt settlement service contract or for referring another potential customer or customers.
- Seeking or obtaining a consumer's signature on an agreement that contains any blank spaces to be filled in later.
- Disclosing to anyone the name or any personal information of a consumer for whom the debt settlement provider has provided or is providing debt settlement services, without the prior consent of the consumer, other than to a consumer's own creditors or the debt settlement provider's agents, affiliates, or contractors for the purpose of providing debt settlement services.



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- Structuring a program or settlement plan that would cause negative amortization of a consumer's debt or debts.
- Representing that debt settlement will prevent wage garnishment, litigation, debt collection efforts, attachment, repossession, or other adverse consequences, or advise a consumer to ignore any such activity.

Mandatory Reports To Consumers

Under the proposed Act, providers would be required to make reports to consumers at least every six months, and more often based on specific events, including when a settlement is achieved, upon a consumer request and upon a consumer termination.

The reports would require details such as all settlements completed, all fees paid, each remaining debt, the principal amount of each debt and the current amount of each debt. For settlements, the provider would have to report the total amount and terms of the settlement, the amount of the debt when the consumer entered the program, the amount of the debt when the creditor agreed to the settlement and the fee (and how it was calculated) for the settled debt.

Limitations on Settlement Fees

The bill would restrict debt settlement providers from charging more than 15% of the amount saved as a result of any settlement, based on the difference between the principal amount of the debt at the time of enrollment and the amount negotiated by the provider and paid by the consumer to the creditor as full and final settlement of the consumer's obligation.



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The bill would prohibit debt settlement providers from charging any fees unless they first have a signed written agreement with the consumer that complies with the provisions described above. In addition, before any fee may be charged, the debt settlement provider must provide documentation of the settlement agreement to the consumer, and the funds to settle the debt must have been paid in full to the creditor. No fee may be charged if the total fees, settlements and unsettled debt exceeds the principal amount of the debt at the time of enrollment.

The proposed Act would allow debt settlement providers to request or require consumers to deposit funds into a financial institution both for the settlement of debt as well as for the payment of the provider's fees on similar terms as those that are allowed by the TSR.

Enforcement and Penalties For Violations

The Act would provide for enforcement by the DOC, the California Attorney General and by consumers, who are authorized to bring civil actions arising from violations of the Act.

If a provider charges an unauthorized fee, the agreement would be voided and the provider would have to refund all fees paid within five days after receiving notice of the violation. Consumers could bring a civil action against the provider within four years, and recover statutory damages of \$1,000 to \$5,000 per violation, compensatory damages and attorney's fees.

Violations would also be enforceable by the Attorney General, who could bring a civil or criminal action. Criminal violations would be punishable by up to \$10,000 for each violation and/or up to one year in jail. The AG could



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seek damages, civil penalties up to \$10,000 per violation (including against anyone who aids in a violation) and injunctive relief, including restitution and disgorgement, and obtain attorney's fees in a civil action for violations of the Act.

Michael Thurman and Michael Mallow defend debt settlement companies and other businesses in litigation, regulatory investigations and enforcement actions, and consumer class actions.

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