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ALERT

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Debt Settlement Law Progresses in California Legislature

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A proposed new law that would create extensive regulations governing the debt settlement industry in California is quietly working its way through the California legislature this spring. On June 2, 2009 the "Debt Settlement Services Act" (Assembly Bill 350) was approved by the state's Assembly and forwarded to the Senate for consideration. If enacted, the bill would take effect on January 11, 2011.

The proposed Act would dramatically change the debt settlement landscape in California, providing for registration and oversight of debt settlement companies by the Department of Corporations (DOC). The law would create new requirements that would have to be met before companies could enter into agreements with consumers to provide debt settlement services, including the obligation to prepare a financial analysis tailored for each consumer, a good-faith estimate of the fees, charges and estimated length of the program and numerous other specific contractual and disclosure provisions.

The new law would require contractual provisions allowing consumers to cancel the agreement and receive a full refund within five days after signing the debt settlement agreement.

Among the disclosures that would be required by the new law are the potential impact of the program on the consumer's credit rating or score, that the program may result in higher finance or other charges, the possibility of increased collection activity by creditors, that the program might not stop a creditor from filing or pursuing a lawsuit against a consumer, that the program could result in the creation of

taxable income, that specific results cannot be predicted or guaranteed, that the program requires the individual to meet certain savings goals in order to maximize settlement results, that the provider does not provide accounting or legal services and that a provider cannot force creditors to engage in negotiations or reach settlements.

The proposed legislation would set a fee cap of no more than twenty percent of the total debt brought into the program, including a limitation on setup fees of no more than five percent. All debt settlement fees would have to be spread over a period of at least half the length of the program, and the total fees plus the settlement amounts paid by the consumer could not exceed the principle amount of the consumer's debt.

License Application Requirements

Applicants would be required to submit:

- A licensing fee set by the Commissioner
- Evidence of a surety bond or minimum insurance coverage
- Proof that appropriate business entity documents have been filed with the Secretary of State or the county where the applicant operates
- Fingerprints and related information required by the California Department of Justice.

Applications may be denied if they are materially erroneous or incomplete; if an officer, director or owner of the appli-

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cant has been convicted of a crime, been subject to a civil judgment involving fraud, deceit, dishonesty or violations of state or federal securities laws; or if the required fees are not submitted.

Fee Structure Requirements and Limitations

The Act would require providers to disclose their fee structures in the application process. The provider must list the goods and services it provides along with the cost of all fees for such goods and services.

The Act also would impose limits on the fees that may be charged by providers. Fees would be capped at no more than twenty percent (20%) of the amount of debt as of the time an agreement is entered with a consumer, including a setup fee of no more than five percent (5%). The Act provides that fee payments must be spread over at least half of the program period.

Financial and Time Estimate Disclosure Requirements

The Act would prohibit a debt settlement provider from entering into an agreement with a consumer to engage in a debt settlement program until it has delivered a written financial analysis specific to the consumer, a good-faith estimate of the length of the time it will take to complete the program, and a statement of the total amount of debt owed to each creditor in the program. In addition, based on the completed written financial analysis, the provider must make a determination that the consumer is qualified for a debt settlement program and that the consumer can reasonably meet the requirements of the program.

Additional Required Disclosures to Consumers

Before engaging in the debt settlement program, the provider must make the following disclosures to consumers:

- The provider's name and business address
- That some programs are not suitable for some consumers
- That the program may affect credit rating and credit scores
- That the nonpayment of debt may lead creditors to increase finance charges and pursue litigation
- That a settlement may lead to taxable income
- That there are no specific results or guarantees
- That consumers are required to meet particular savings goals to increase settlement chances

- That providers do not provide accounting or legal advice, unless otherwise authorized or professionally licensed
- That providers do not receive compensation from any of the consumer's creditors, banks or third-party collection agencies
- That providers advocate on the consumer's behalf, but cannot control how creditors will respond and cannot force settlement
- That upon termination, no additional fees are due
- That the use of debt settlement services may not stop a creditor from filing or pursuing a lawsuit against a consumer
- That the consumer may owe fees upon signing an agreement whether or not any debts are reduced under the program
- The statement in its consumer agreements that "Complaints related to this agreement may be directed to the Department of Corporations by telephone and to its Internet Web site address."

Written Agreement Requirements

In addition to the required disclosure requirements, the Act provides that a written agreement between the provider and the consumer must be obtained, including the following provisions that must appear on the front page:

- The total amount of the debt brought into the program
- The amount of any setup fee
- The amount of any monthly fee
- The estimated number of months for which a monthly fee is required by the agreement
- An estimate of the total amount of fees reasonably anticipated to be paid by the consumer over the term of the agreement, as applicable
- The total amount of fees that may be charged under the contract.

The agreement must also include:

- The consumer's right to terminate the agreement at any time
- The consumer's right to cancel the agreement and receive a full refund within the first five days after entering into the agreement
- Confirmation that the provider's power of attorney is limited to communicating with creditors for the purpose

of negotiating settlement offers and initiating fund transfers.

The Act would prohibit debt settlement agreements from:

- Modifying or limiting available forums and procedural rights that are otherwise available to the consumer by law, other than as permitted by the California Arbitration Act
- Restricting a consumer's remedies under the Act or any other law
- Limiting or releasing liability for failing to perform the agreement or violating the Act
- Indemnifying any person for liability arising under the agreement or the Act
- Requiring the consumer to be responsible for payment of the provider's attorney's fees.

Consumers' Right to Periodic Accountings

The proposed law would require providers to prepare and deliver an accounting to consumers in any of the following situations:

- upon settlement of a debt
- within five business days after a request is received from the consumer, but not more than once a month and
- upon cancellation or termination of the agreement.

The accounting requirement generally requires the provider to disclose the total amount and terms of any settlement as well as all fees and how they were calculated.

Document Retention Requirements

The Act would require debt settlement providers to maintain records for all consumers for three years after the consumer makes the final payment to the provider.

Prohibited Conduct

A debt settlement provider would be prohibited from doing, directly or indirectly, any of the following:

- Exercise or attempt to exercise a power of attorney after termination of the agreement by the consumer
- Initiate a transfer of funds to or from the consumer's financial institution, unless under specified conditions
- Settle a debt or cause a consumer to believe that a payment to a creditor is in settlement of a debt, unless under specified conditions

- Represent that it will do any of the following: furnish money to pay bills; that payment of a certain amount will guarantee satisfaction of a certain amount or range of indebtedness; prevent litigation, garnishment, attachment, repossession, foreclosure, eviction or loss of employment
- Represent that it is a non-profit entity unless it is properly organized as such
- Employ any unfair, unconscionable or deceptive acts or practices
- Fail to respond or research any complaint filed by a consumer within 20 days
- Require a consumer to participate in additional ancillary services
- Receive financial compensation based in excess of the fee caps
- Pay referral fees to creditors
- Purchase a debt or obligation of the consumer
- Unless through a separately licensed affiliate, receive a promissory note, postdated check, or lend money or provide credit to the consumer
- Obtain a mortgage or other security interest in connection with the services provided
- Require a consumer to deposit funds into a specific financial institution
- Disclose the identity or identifying information of the consumer, except as permitted by law, or upon demand by the commissioner, to the extent necessary to effectuate the program, or to the extent necessary to obtain cooperation of the creditor
- Charge the consumer for or provide other compensation not directly related to the debt settlement services
- Provide legal advice or services
- Advise consumers to stop making payments on accounts administered by the provider
- Hold consumers' funds in trust
- Include secured debt in any debt settlement services agreement
- Engage in any false, misleading, or deceptive advertising.

Web Site Requirements

The Act would require a provider to maintain an Internet Web site, and specifies a number of disclosures that must be placed on the home page or on a page clearly and conspicuously connected to the home page. To highlight a few mandates for the Web site, the provider must set

forth: its business address, telephone number, email address and license number; all of the disclosures stated above; the fee structure and the method of determining the amount of all fees; and the provider's termination policy, as specified in the Act.

A provider must also maintain a toll-free communication system that allows customers to speak to a debt specialist or customer service representative during ordinary business hours.

Enforcement Provisions

Any debt settlement provider that knowingly misrepresents or submits any false information, or otherwise violates the Act, would be guilty of a misdemeanor.

The Commissioner would be authorized to act on his or her own initiative or in response to a complaint.

The limitations period for any action brought under the Act would be three years after the latest of the consumer's last payment to the provider, or the date when the consumer discovered, or reasonably should have discovered, the facts leading to the claim. The limitations period is also tolled if the provider materially and willfully misrepresents information.

A complete copy of the proposed legislation, as well as the legislative bill analysis, can be obtained at:

Proposed Legislation

www.loeb.com/files/Uploads/Proposed_Legislation.pdf

Legislative Bill Analysis

www.loeb.com/files/Uploads/Legislative_Bill_Analysis.pdf

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