



U.S. Department of Justice

EXHIBIT 1

Executive Office of United States Trustees

Credit Counseling and Debtor Education Unit

441 G Street, N.W., Suite 6150
Washington, D.C. 20530
(202) 514-4100

December 18, 2013

VIA ELECTRONIC MAIL AND OVERNIGHT MAIL

Ms. Victoria Wright
Hummingbird Credit Counseling and Education, Inc.
3737 Glenwood Avenue
Suite 100
Raleigh, NC 27612
vwright@hbcece.org

Re: Hummingbird Credit Counseling and Education, Inc., Agency 1356
Removal from List of Approved Providers of a Personal Financial Management
Instructional Course
Denial of Application 0513-DE-02305R

Dear Ms. Wright:

Hummingbird Credit Counseling and Education, Inc., Agency 1356 ("Hummingbird"), is an approved provider of a personal financial management instructional course ("debtor education"), currently approved as of June 29, 2012. Hummingbird also timely submitted the above-referenced application (the "Application") seeking re-approval as a debtor education provider on May 17, 2013. The Application requested approval to offer debtor education via internet in all 88 judicial districts under the jurisdiction of the United States Trustee Program.

To remain an approved provider, a provider's application for re-approval shall affirmatively establish, to the satisfaction of the United States Trustee, that the provider has satisfied every requirement of 28 C.F.R. Part 58. 28 C.F.R. § 58.32(b). An approved provider shall comply with all applicable laws and regulations of the United States and each state in which the provider provides an instructional course, "including, without limitation, all laws governing licensing and registration." 28 C.F.R. § 58.33(a). The United States Trustee may remove a provider from the approved list (or deny its application for approval) when the United States Trustee determines that the provider has failed to comply with the standards or requirements set forth in 11 U.S.C. § 111, 28 C.F.R. Part 58, or the terms of its approval. 28 C.F.R. § 58.36(c).

A. Summary

Hummingbird should be removed from the list of approved debtor education providers because it has not affirmatively established that it has satisfied the requirements of 28 C.F.R. Part 58. As set forth below, Hummingbird, a nonprofit entity, provided misleading information to the Executive Office for United States Trustees (“EOUST”) with respect to its ownership and nonprofit operations in violation of North Carolina law, and accordingly is not in compliance with the debtor education rule.¹ Because of Hummingbird’s removal from the list of approved debtor education providers, its pending Application for re-approval also is denied.²

B. Applications and Quality of Service Reviews of Hummingbird

Hummingbird was formed on April 13, 2005 as a North Carolina nonprofit corporation, and first applied for approval as a credit counseling agency and debtor education provider on August 25, 2005.³ It has been approved subsequently every year in all 88 judicial districts within the United States Trustee Program. Hummingbird is located at 2724 Discovery Drive, Suite 110, Raleigh, North Carolina, but lists its principal place of business as 3737 Glenwood Avenue, Raleigh, North Carolina.

Hummingbird’s articles of incorporation state in part:

ARTICLE III – PURPOSES

A. General. The general purpose for which this corporation is formed is to operate exclusively for charitable and educational purposes under Section 501(c)(3) of the Internal Revenue Code of 1986.

....

ARTICLE IV – POWER, LIMITATIONS AND DISSOLUTION

This corporation shall have and exercise all rights and powers conferred on non-profit corporations under the laws of the State of North Carolina (specifically NCGS § 55A-2-02),

¹ References to 28 C.F.R. Part 58 are to *Application Procedures and Criteria for Approval of Nonprofit Budget and Credit Counseling Agencies by United States Trustees*, 78 Fed. Reg. 16139 (March 14, 2013)(to be codified at 28 C.F.R.§§ 58.12 -58.24)(the “credit counseling rule); and *Application Procedures and Criteria for Approval of Providers of a Personal Financial Management Instruction Course by United States Trustees*, 78 Fed. Reg. 16159 (March 14, 2013)(to be codified at 28 C.F.R.§§ 58.25 – 58.36)(the “debtor education rule”).

² Hummingbird has withdrawn its credit counseling application, 0513-CC-01458R (the “CC Application), on November 14, 2013 as set forth below. *See infra* at 6-7.

³ Copies of its articles of incorporation and bylaws are attached as *Exhibits A* and *B*, respectively.

provided, however, that this corporation is not empowered to engage in any activity which in itself is not in furtherance of its purpose as set forth in Article III above and its power and operations shall be subject to the following limitations:

- A. Private Benefit. No part of the net earnings, properties or assets of the organization shall inure to the benefit of, or be distributable to its members, trustees, officers, or other private persons, except that organization shall be authorized and empowered to pay reasonable compensation for services rendered and to make payments and distributions in furtherance of the purpose set forth in Article III above.

Ex. A at 1. A parallel prohibition against private benefit appears in Article 8, section 2 of Hummingbird's Bylaws. *Ex. B* at 11. Accordingly, although Hummingbird is not tax-exempt pursuant to IRC § 501(c)(3), it has adopted and incorporated by reference the IRC § 501(c)(3) prohibition against private benefit.

During and ever since its first application, Hummingbird has contracted with for-profit entities for nearly all aspects of its operation, including its real estate lease, customer service, technical support, web design and hosting, and other services. According to Hummingbird's financial statements, most of its annual revenues are paid to these for-profit entities. The entities, and the amounts paid, are as follows (rounded to the nearest dollar and based on information Hummingbird provided):⁴

Name	Principal(s)	Formation Date	Amount paid in 2009	Amount paid in 2010	Good standing?
Conclave Management Services ("Conclave"), 2724 Discovery Drive, Suite 110, Raleigh	Robert S. Brasco; Charles E. Hughes, Jr.	9/8/2005	1,720,194	1,517,112	No – administratively dissolved
Core Internet Services ("Core"), 2724 Discovery Drive, Suite 110, Raleigh	Charles E. Hughes, Jr.	9/8/2005	633,956	725,257	No – administratively dissolved

⁴ Hummingbird's total revenues in 2009 were \$6,404,337 and in 2010, \$7,232,493.

Network Invoicing, Billing, and Reporting Corporation (“NIBRC”), 2724 Discovery Drive, Suite 110, Raleigh	Charles E. Hughes, Jr.	9/8/2005	1,131,666	1,219,224	No – administratively dissolved
Star Coach, 2724 Discovery Drive, Suite 110, Raleigh	Robert S. Brasco	9/5/2006	3,344	5,000	No – administratively dissolved
Diamond Events, 2724 Discovery Drive, Suite 110, Raleigh	Robert S. Brasco	9/5/2006	47,577	101,417	No – administratively dissolved
Quality Assurance Software (“QAS”) 498-4 Neptune Bay Circle, Saint Cloud, Florida	Joseph Kathan	5/25/2006	129,500	61,000	No – administratively dissolved
Counselor-Soft 13037 Mulberry Park Drive, Orlando, Florida	Joseph Kathan	9/9/2005	653,336	933,441	No – administratively dissolved

According to Hummingbird’s most recent financial statement,⁵ Hummingbird incurred a net loss (before income taxes) of \$404,836 in 2010.⁶

EOUST commenced a Quality of Service Review (“QSR”) of Hummingbird by letter dated December 21, 2011.⁷ During the QSR, EOUST inquired about the relationship between

⁵ A copy of the financial statement setting forth these amounts, and an explanatory document from Michael Paul, Hummingbird’s principal contact, to EOUST dated October 4, 2013, are attached as *Exhibits C* and *D*, respectively.

⁶ Hummingbird has not obtained an audited financial statement since 2010 so it is not possible to determine whether Hummingbird incurred subsequent losses or not.

⁷ The QSR was pursuant to an earlier, interim rule, *Application Procedures and Criteria for Approval of Nonprofit Budget and Credit Counseling Agencies and Approval of Providers of a Personal Financial Management Instruction Course by United States Trustees*, 71 Fed. Reg. 38076-85 (July 5, 2006)(formerly codified at 28 C.F.R. §§ 58.15-58.17,

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Hummingbird and these private entities or their shareholders and principals to assess its compliance with the nonprofit requirement in the statute and applicable rules, 111 U.S.C. § 111 and Former 28 C.F.R. § 58.15(d). In particular, the findings letter prepared after the QSR⁸ the undersigned questioned Hummingbird about the revenue stream to Conclave.⁹ In a response, dated May 7, 2012, Mr. Paul characterized the listed for-profit companies as “disinterested third part[ies].”¹⁰ The information that Hummingbird disclosed (including corporate formation and meeting documents, tax returns, and audited financial statements) did not establish a relationship between Hummingbird and the for-profit entities and EOUST took no further action at the time. Nonetheless, EOUST has remained concerned about the relationship between Hummingbird and these entities, as well as their principals, because virtually all of Hummingbird’s revenues, other than wages and salaries paid to employees (and payroll taxes) are paid to private entities controlled by Messrs Hughes, Brasco, and Kathan.

Other individuals have questioned the relationship between Hummingbird and these for-profit entities. Sandra Cardone, Associate Attorney General for the Commonwealth of Massachusetts, has corresponded with Hummingbird concerning its relationship with Conclave in particular.¹¹ In reply, Mr. Paul specifically disavowed any knowledge of the principals or corporate structure of those entities.¹² “I do not know the names of the principals of Conclave,” he states. *Ex. H* at 1. “While I do not know the principals of Conclave,” he continues, “I can assure you that none of the Hummingbird Board Members, Staff, or Employees is related to the principals of Conclave.” *Id.* Mr. Paul made the same representations regarding Counselor-Soft and Core. *Id.* at 2.

Concerns have also been raised about the role an individual named Robert Brasco played in Hummingbird’s operations. Mr. Brasco appears in public records as the owner and manager of Conclave. Brian Sunderland, the executive director of Cricket Debt Counseling, Inc., another approved credit counseling agency, informed the undersigned in February 2013 that Mr. Brasco appeared on multiple occasions as Hummingbird’s representative at meetings of the National

58.25-58.27)(the “interim rule”). These rules were superseded, for applications submitted after April 15, 2013, by the credit counseling and debtor education rules. The QSR pertained to an application period before April 15, 2013, and accordingly was subject to the interim rule. References to “Former” 28 C.F.R. Part 58 are to the interim rule.

⁸ A copy of the findings letter dated March 14, 2012 is attached as *Exhibit E*.

⁹ EOUST earlier undertook a QSR in May 2007. Both the 2007 and 2012 QSRs were pursuant to an earlier, interim rule, *Application Procedures and Criteria for Approval of Nonprofit Budget and Credit Counseling Agencies and Approval of Providers of a Personal Financial Management Instruction Course by United States Trustees*, 71 Fed. Reg. 38076-85 (July 5, 2006)(formerly codified at 28 C.F.R. §§ 58.15-58.17, 58.25-58.27)(the “interim rule”). These rules were superseded, for applications submitted after April 15, 2013, by the credit counseling and debtor education rules. The QSR pertained to an application period before April 15, 2013, and accordingly was subject to the interim rule. References to “Former” 28 C.F.R. Part 58 are to the interim rule.

¹⁰ A copy of Mr. Paul’s response letter is attached as *Exhibit F*.

¹¹ A copy of that letter, dated March 8, 2010, is attached as *Exhibit G*.

¹² A copy of his letter to Ms. Cardone, dated March 18, 2010, is attached as *Exhibit H*.

Association of Consumer Bankruptcy Attorneys, that it was apparent to him and other members of the credit counseling industry that Mr. Brasco controlled Hummingbird operations, and that Mr. Brasco presented himself publicly as the head of Hummingbird.¹³

Hummingbird submitted the Application for approval on May 13, 2013.¹⁴ The staff analyst assigned to review the applications inquired into the relationship between Hummingbird and Conclave, and any other for-profit entities to which it disbursed funds, as well as its relationship with Mr. Brasco, in an email to Mr. Paul dated September 17, 2013.¹⁵ The staff analyst specifically asked for information concerning “the relationship between Robert Brasco and Hummingbird Credit Counseling and Education, Inc. (and any of its directors, officers, and employees). *Ex. J.* at 2. In his response dated October 4, 2013, described earlier as *Exhibit D*, Mr. Paul set forth the identities of the for-profit entities to which Hummingbird disbursed funds, and the amount of the funds disbursed to each. He also conceded that Mr. Brasco did have a relationship with Hummingbird apart from the agency’s business relationship with Conclave. He described Mr. Brasco as “a business consultant [who] was very helpful to Hummingbird in the early days to help it get up and running. As part of that assistance, he was ‘administrator’ for Hummingbird, assisting with such items as getting Hummingbird’s website, domain name, and email service set up.” *Ex. D* at 2-3. On October 29, 2013, the undersigned sent Mr. Paul an email requesting additional information, including a request for current audited financial statements or tax returns.

On November 6, 2013, Mr. Paul sent the undersigned an unsolicited facsimile stating that Mr. Brasco had laid him off from Hummingbird.¹⁶ Subsequently Mr. Paul confirmed each of the items set forth in his November 6 facsimile during a telephone conversation with the undersigned on November 20, 2013. He averred that the details he set forth during that conversation are true and correct by email on November 22, 2013.¹⁷

In his email, Mr. Paul stated that Mr. Brasco repeatedly asked him to lie about the ownership of NIBRC, Core, and Counselor-Soft, contrary to his earlier representations to EOUST and the Massachusetts Attorney General’s office that he did not know the ownership of those entities,¹⁸ *Ex. L* paras. 9-10. Mr. Paul stated that Mr. Brasco actually held an 80 percent controlling interest in each of Conclave, Core, NIBRC, and Counselor-Soft. *Ex. L* para. 4. He stated that Mr. Brasco purchased Mr. Kathan’s interest in those entities in October 2013, effectively consolidating his ownership in nearly all entities receiving income from Hummingbird. *Id.* He stated that Mr. Brasco is close friends with Hummingbird’s three board members, who permit him to run the

¹³ A copy of the email from Mr. Sunderland to the undersigned, dated February 5, 2013, is attached as *Exhibit I*.

¹⁴ At that time, Hummingbird also submitted an application for approval as a nonprofit credit counseling agency. Thea CC Application has been withdrawn and is not under consideration.

¹⁵ A copy of that email is attached as *Exhibit J*.

¹⁶ A copy of the facsimile transmission from Mr. Paul is attached as *Exhibit K*.

¹⁷ A copy of that email from Mr. Paul to the undersigned is attached as *Exhibit L*.

¹⁸ *See supra* at 5.

agency, *Ex. L* para. 3, even though Mr. Brasco is not a member of the board or an officer.

On November 12, 2013, Victoria Wright informed EOUST by email that Michael Paul no longer was employed by Hummingbird and that she was to be designated its principal contact. She subsequently informed EOUST that, effective November 14, 2013, Hummingbird no longer would be providing credit counseling services and requested withdrawal from the list of approved credit counseling agencies as well as withdrawal of its pending CC Application. Hummingbird expressed its intention to continue providing debtor education services. Although the staff analyst earlier had asked for information about Hummingbird's relationship with Mr. Brasco, Ms. Wright did not provide complete information concerning that relationship. "I've been assured that Hummingbird's payments to the Brasco entities have been comparable to what it would have paid to any company for the same services in the same circumstances (no personal guarantees of debt, no collateral, etc.)."¹⁹

C. Failure to establish that the agency complies with applicable law, 28 C.F.R. §§ 58.32(b)

North Carolina General Statute § 55A-1-40(17) defines a nonprofit corporation as "a corporation intended to have no income or intended to have income none of which is distributable to its members, directors, or officers," except pursuant to N.C. Gen. Stat. § 55A-13-02 (authorizing reasonable compensation for services). N.C. Gen. Stat. § 55A-1-40(8) defines a distribution as "a direct or indirect transfer of money or other property or incurrance of indebtedness by a corporation to or for the benefit of its members, directors, or officers." N.C. Gen. Stat. § 55A-8-01(b) vests all corporate powers in the board of directors, unless the corporation has described in its articles of incorporation the individuals who will perform some or all the duties of the board. N.C. Gen. Stat. § 55A-8-01(c).²⁰

Based on Mr. Paul's statements, Hummingbird is effectively controlled by Mr. Brasco, who is neither a member of the board of directors nor an officer, and was not otherwise listed in the articles of incorporation. *Ex. K* and *Ex. L* para. 3. His statements have been corroborated by an officer of another approved agency. *Ex. I*. Mr. Brasco thus lacks valid corporate authority to act on behalf of Hummingbird, and accordingly has exercised such authority in violation of N. C. Gen. Stat. § 55A-8-01(b) & (c). In addition, by Mr. Paul's admission, Hummingbird, through its officers, actively concealed Mr. Brasco's insider status with Hummingbird, as well as his ownership of Conclave, Core, NIBRC, and Counselor-Soft. *Ex. K* and *Ex. L* paras. 9-10.

Mr. Brasco did not receive a salary from Hummingbird as reasonable compensation for services pursuant to N.C. Gen. Stat. § 55A-13-02; rather, entities owned or controlled by Mr.

¹⁹ A copy of the letter from Ms. Wright to Sam Wang, dated November 19, 2013, is attached as *Exhibit M*.

²⁰ N.C. Gen. Stat. § 55A-14-30 authorizes judicial dissolution pursuant to a proceeding by the North Carolina Attorney General if the corporation obtained its articles of incorporation through fraud, § 55A-14-30(a)(1)(a), or, after written notice by the Attorney General, continues to exceed or abuse its authority.

Brasco, a de facto insider, received a substantial portion of Hummingbird's revenues, in violation of N.C. Gen. Stat. § 55A-1-40(17). These transactions between Hummingbird and for-profit entities also run afoul of the IRC § 501(c)(3) prohibition against private benefit referenced in Hummingbird's articles of incorporation at articles III and IV.A, and its bylaws at article 8, section 2. A contract between a non-profit entity and an insider or a for-profit entity controlled by an insider constitutes the quintessential example of private benefit pursuant to IRC § 501(c)(3). *KJ's Fund Raisers v. Comm'r*, T.C. Memo 1997-424 at (T.C. 1997), *aff'd*, 166 F. 3d 1200 (2d Cir. 1998) (holding that a fundraising entity that planned to raise money by selling lottery tickets at a bar owned by its principals was not exclusively operated for public benefit); *P.L.L. Scholarship Fund v. Comm'r*, 82 T.C. 196 (1984) (reaching the same holding on similar facts); *cf.* 26 C.F.R. § 1.501(c)(3)-1(d)(ii) (defining an entity that serves public rather than private interests as one "not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests").²¹ The entities formed by Charles E. Hughes, Jr.²² are all owned in whole or part by Mr. Brasco. Based on observations during the March 2012 QSR, further research, and subsequent discussion with Mr. Paul, NIBRC and Counselor-Soft have no other clients besides Hummingbird. These entities appear to have been created, and exist, for the sole purpose of allowing Hummingbird to make distributions to Mr. Brasco, who exercised control over Hummingbird.

Moreover, the determination that an entity is operating consistently with IRC § 501(c)(3) requires an examination of the size and scope of benefits conferred on non-insider private parties as well as insiders. "Impermissible benefit to "private interests" thus encompasses not only benefit to insiders, but also substantial benefits that an organization may confer on unrelated or even disinterested persons, i.e., outsiders." *Capital Gymnastics Booster Club, Inc. v. Comm'r*, T.C. Memo 2013-193, 2013 WL 4516170 at *13-*15 (2013)(citing *Am. Campaign Acad. v. Commissioner*, 92 T.C. 1053, 1068-1069, 1989 WL 49678 (1989) and 26 C.F.R. § 1.501(c)(3)-1(d)(1)(ii)). This prohibition against substantial benefit to disinterested private persons ensures the organization serves a public and not a private interest. *Capital Gymnastics*, 2013 WL 4516170 at *15. The amount of private benefit in this case is substantial; in 2009 and 2010 alone, Hummingbird paid nearly \$5.2 million to entities controlled by Mr. Brasco. *See supra* table at 3-4. In fact, Hummingbird appears to have disbursed to related entities nearly all revenues except for counselor and officer salaries and taxes, and incurred net losses in 2010 of over \$400,000. *Ex. C* at 6. Even if Mr. Brasco is truly a disinterested person and not an insider, entities he controls received substantial financial benefits, to the financial detriment of Hummingbird.

²¹ Hummingbird is not a federally tax-exempt entity pursuant to IRC § 501(c)(3), but its articles of incorporation and bylaws incorporate section 501(c)(3) by reference and specifically incorporate that section's prohibition against private benefit. Accordingly, it is appropriate to apply standards relevant to tax-exempt entities when determining whether Hummingbird has run afoul of that provision in its articles and bylaws.

²² According to Mr Paul, Charles E. Hughes, Jr. is an employee of Star Coach who drives cars for Mr. Brasco. *Ex. L* para. 6. He has no day to day role in the operation of those entities. *Id.*

Although nonprofit status is not required for debtor education providers, and although the debtor education rule, unlike the credit counseling rule, does not prohibit transactions that result in a private benefit, Hummingbird is a nonprofit corporation and must abide by North Carolina law. 28 C.F.R. § 58.33(a). Hummingbird entered into private benefit transactions in violation of the terms of articles III and IV.A of its articles of incorporation, and article 8.2 of its bylaws, as well as North Carolina law regarding distributions to insiders by nonprofit corporations. N.C. Gen. Stat. § 55A-1-40(17). In addition, Hummingbird concealed information about ownership and control over Hummingbird and the for-profit entities with which it does business, disguising the extent to which Hummingbird engaged in substantial transactions with for-profit entities owned by undisclosed insiders, in violation of its articles of incorporation and bylaws, N. C. Gen. Stat. § 55A-8-01(b) & (c). Hummingbird also permitted an individual who is neither an officer nor director to exercise corporate authority in violation of N. C. Gen. Stat. § 55A-8-01(b) & (c). Accordingly, Hummingbird has not established, to the satisfaction of EOUST, that it has satisfied every requirement of 28 C.F.R. Part 58. 28 C.F.R. § 58.32(b). Failure to demonstrate compliance is grounds for removal and for denial of the current application for approval. 28 C.F.R. § 58.36(c).

C. Conclusion

For the foregoing reasons, Hummingbird shall be removed from the list of approved debtor education providers. Because of Hummingbird's removal from the list of approved debtor education providers, its pending Application for re-approval also is denied. 28 C.F.R. § 58.36(c) & (d). Pursuant to 28 C.F.R. § 58.36(g), this decision to remove Hummingbird from the approved list, and to deny its pending Application, shall take effect upon the expiration of Hummingbird's time to seek review from the Director of the EOUST,²³ or, if Hummingbird timely seeks such review, upon the issuance of a final written decision by the Director.

This decision is final unless Hummingbird requests, in writing, a review by the Director of the Executive Office for United States Trustees, 441 G Street, N.W., Suite 6150, Washington, D.C. 20548. ***To be timely, the Director must receive such a request not later than 21 calendar days from the date of this letter.*** 28 C.F.R. § 58.36(g) & (i).

Any request for review shall be in writing and shall fully describe why the agency disagrees with the denial or removal decision, and shall be accompanied by all documents and materials the agency wants the Director to consider in reviewing the denial or removal decision. The agency shall send the original and one copy of the request for review, including all accompanying documents and materials, to the Office of the Director by overnight courier, for delivery the next business day. 28 C.F.R. § 58.36(i).

²³ In the event Hummingbird fails to timely seek review, its access to the Certificate Generation System will cease automatically five days from the expiration date set forth in 28 C.F.R. § 58.36(g).

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As of the date of this letter and for the duration of any subsequent review, Hummingbird shall not destroy, amend, alter, tamper with, change, revise, mutilate, move, relocate, or take any other action affecting Hummingbird's records described in this letter (whether tangible, electronic, or otherwise) pertaining to counseling client files, Hummingbird's business practices, financial matters, or any other matter relating to its approval as a debtor education provider, as set forth in 11 U.S.C. § 111 and the debtor education rule.

Yours very truly,

Wendy

Tien

Wendy S. Tien

Deputy Assistant Director, Office of Oversight

Digitally signed by Wendy Tien

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