NO. 84858-1

SUPREME COURT OF THE STATE OF WASHINGTON

CHAD M. CARLSEN and SHASTA CARLSEN, husband and wife; and BARBARA HULSE; each individually and on behalf of a Class of similarly situated Washington residents,

Plaintiffs,

v.

FREEDOM DEBT RELIEF, LLC, a Delaware limited liability company; FREEDOM FINANCIAL NETWORK, LLC, a Delaware limited liability company; ANDREW HOUSSER, a resident of California; and BRADFORD STROH, a resident of California; JOHN DOES 1-5; and JANE DOES 1-5,

Defendants.

BRIEF OF AMICUS CURIAE ATTORNEY GENERAL OF WASHINGTON

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I. INTEREST OF AMICUS

Amicus Curiae is the Attorney General of Washington. This case, which is here on certified questions from the United States District Court for the Eastern District of Washington in a private class action, asks this court to interpret provisions of the Washington Debt Adjusting Act ("DAA"), RCW 18.28, which to date has no reported case law. Interpretation of the DAA affects the public interest because a violation of the DAA is also a per se violation of the Consumer Protection Act, RCW 19.86 ("CPA"), and because the Attorney General enforces the CPA, it has an interest in the development of DAA case law. The Attorney General also has enforcement authority pursuant to the DAA, and so is interested for that reason, too.

II. ISSUES ADDRESSED BY AMICUS

The Attorney General files this brief with respect to Certified Questions 1 and 2.

Question 1 asks if Freedom Debt Relief ("Freedom") is a debt adjuster under the DAA, in light of the fact that Freedom's consumers must approve each settlement before the settlement becomes final and in light of the fact that Freedom does not transfer funds to the creditors but instead relies on third parties to do that. The answer is "yes"; Freedom is a debt adjuster under the DAA and the statute applies to it.

Question 2 asks what the term "payment" means in RCW 18.28.080(1) for purposes of determining when and what fees may be taken by Freedom. The answer is that a "payment" occurs when a creditor is paid, and not until then.

III. STATEMENT OF THE CASE

Debt settlement companies, such as Freedom, sell their programs to debt-ridden consumers who can't pay their unsecured debts. Typically, that debt is credit card debt. Freedom's program, like other debt settlement companies' programs, involves consumers stopping monthly payments to their unsecured creditors and instead setting money aside monthly in a custodial "savings" or "settlement" account at a bank pursuant to a plan and instructions from Freedom. Both the bank and the third party that manages the transfer of the consumer's money into and out of that account, as well as the bookkeeping relating to that account, are entities that are recommended by and regularly work with Freedom. Freedom deducts its fees from the money placed in the "savings" or "settlement" account once the consumer has transferred money there. After Freedom's fees are paid and the consumer's funds begin to accumulate in the "savings" or "settlement" account, the money that remains is eventually used by Freedom to try to negotiate a settlement of the consumer's debts at a discount after the debts have gone into default and aged.

Freedom's, and other debt settlement companies', fees are for the most part paid by the consumer in advance of any settlements occurring. In other words, Freedom's fees are heavily front-loaded and withdrawn from the "savings" or "settlement" account as soon as money is transferred there. Freedom has two different kinds of fees that all consumers pay. One of the fees is a "retainer fee" equal to 5% of the amount of the debt, which Freedom's contract stipulates is due upon enrollment in the program. Brief of Plaintiffs at 7. That fee is deducted from the consumer's "savings" or "settlement" account over the first three months as the first three transfers into the account are made. After the 5% retainer fee has been paid, another fee, called a "service fee" that is equal to 10% of the amount of the debt, is then withdrawn over approximately the next fifteen months of the program as the consumer makes additional transfers into the account. *Id.* In plaintiffs' situation, which was typical not only with Freedom but with other debt settlement companies, that meant that approximately 70%-80% of the consumer's first three transfers into their "savings" or "settlement" account went to Freedom for its retainer fee and that approximately 33%-40% of the next fifteen transfers went to Freedom for its service fee. *Id.* at 8-9. Only after many months and all of Freedom's fees were paid would any appreciable amount of money begin to accumulate in the consumer's account so that it could be used to try to settle their debts. From the consumer's standpoint and significantly because of the way Freedom's fees are excessively front-loaded, debt settlement programs are risky, often unsuccessful, and regularly leave the consumer worse off financially.

In two separate class actions, the District Court certified seven questions involving the DAA. One case is against Freedom. The other lawsuit is against Global Client Solutions ("Global") and Rocky Mountain

Bank & Trust Company ("Rocky")[1]. Global performed the bookkeeping and accounting functions for consumer's accounts and processed the consumer's money into and out of those accounts as part of Freedom's program. Rocky is the bank where plaintiffs' and thousands of other consumers' kept their "savings" or "settlement" accounts. Plaintiffs contend that Freedom is a debt adjuster under the DAA, and that it violated the DAA by taking too much in fees and taking them too early, and that all fees should be returned to them as provided for in the DAA. Freedom denies these contentions. Plaintiffs moved for summary judgment, resulting in the certified questions from the federal court.

IV. ARGUMENT

A. Introduction

The for-profit debt settlement industry has become a consumer problem of national significance. In concluding a rulemaking last fall, the Federal Trade Commission (FTC) noted:

> In sum, debt settlement is a high-risk financial product that requires consumers simultaneously to pay significant fees, save hundreds or thousands of dollars for potential settlement, and meet other obligations . . . . Failure leads to grave consequences – increased debt, impaired credit ratings, and lawsuits that result in judgments and wage garnishments. . . . The injury . . . is substantial.

Telemarketing Sales Rule, 75 Fed. Reg. 48,458, 48,484-85 (August 10, 2010) (to be codified at 16 C.F.R. § 310.4) ("FTC Rulemaking").

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[1] The Attorney General has also filed a separate amicus brief in that case. That brief focuses primarily on the question of an implied cause of action against aiders and abettors under the DAA and on issues relating to helper, assistor, or facilitator liability under the Consumer Protection Act.

The scope of the problem is enormous because the consumer credit problem is enormous. Credit card debt in America exceeds $830 billion. Christine Hauser, *Bank Losses Lead to Drop in Credit Card Debt*, N.Y. Times, Sept. 24, 2010, at B1. Approximately 6.58 % of all recent credit card debt was delinquent. *See* FTC Rulemaking, 75 Fed. Reg. at 48,505. Since 78% of households have credit cards, this means over 8.3 million consumers have delinquent credit card debt. *Id.* at 48,504.

Most consumers who enter debt settlement programs drop out after paying all or part of the debt settlement company's fees. According to the debt settlement industry's own statistics, the drop out rate is almost 66%. *Id.* at 48,472. Of that 66%, 65% leave the programs with no settlements. *Id.* at 48,473.

These statistics and the FTC's conclusion that it needed to address the "deceptive and abusive practices of debt relief service providers" are the reasons why the FTC enacted a new rule banning advance fees for debt settlement companies. *Id.* at 48,465. However, the FTC rule is prospective and applies only to contracts signed after October 27, 2010. Consequently, the DAA with regard to matters that predate the new federal rule is especially important. Also, the DAA will continue to be important because it sets limits not only on when fees can be taken but limits excessive fees, and the new FTC rule does not address the latter.

Freedom is one of the largest debt settlement companies in the United States. In Washington, it has contracted with over 1,000 consumers. Brief of Plaintiffs at 5. Holding Freedom accountable to our law and the purpose for which it was designed is important.

B. Basic Rules of Statutory Interpretation Apply.

Several of the basic rules of statutory interpretation that apply in this case were summarized in *Schweikert v. Venwest Yachts, Inc.,* 142 Wn. App. 886, 176 P. 3d 577 (2008):

> This court's primary goal in interpreting statutes is "to ascertain and give effect to legislative intent." We look to the legislative enactment as a whole to determine the meaning. If the statute's meaning is plain on its face, we will give effect to that plain meaning. A statute is ambiguous if it has two or more reasonable interpretations, but not "merely because different interpretations are conceivable." If a statute is ambiguous, we may resort to legislative history. We avoid "readings of statute that result in unlikely, absurd, or strained consequences."

Id. at 893-94 (citations omitted). Additionally, in the absence of a statutory definition, a term should be given its usual and ordinary meaning, *Christensen v. Ellsworth*, 162 Wn.2d 365, 373, 173 P.3d 228 (2007), and use of a dictionary is appropriate in determining that meaning, *Lindeman v. Kelso School Dist. No. 458*, 162 Wn.2d 196, 201-02, 172 P.3d 329 (2007). Furthermore, "when the same word or words are used in different parts of the same statute, it is presumed that the words of the enactment are intended to have the same meaning." *Medcalf v. Department of Licensing*, 133 Wn.2d 290, 300-01, 944 P.2d 1014 (1997). Finally, a remedial statute designed to protect consumers, such as the DAA, should be liberally construed. *See Naches Valley Sch. Dist. No. JT3* *v. Cruzen*, 54 Wn. App. 388, 399, 775 P. 2d 960 (1989) ("remedial statute should be liberally construed to effect its purpose.")

C. Freedom is a Debt Adjuster under the DAA.

Question 1 asks if Freedom is a debt adjuster even though the consumer must approve the settlement before it can become final and even though Freedom does not physically hold or transfer the funds in the consumer's custodial "savings" or "settlement" account but instead uses third party business associates, such as Global and Rocky, to do that. The answer is yes; Freedom is still a debt adjuster.

The DAA defines "debt adjusting." RCW 18.28.010(1) states:

> "Debt adjusting" means the managing, counseling, settling, adjusting, prorating, or liquidating of the indebtedness of a debtor, or receiving funds for the purpose of distributing said funds among creditors in payment or partial payment of obligations of a debtor.

If Freedom did any of the activities set forth in RCW 18.28.010(1), then it is a debt adjuster. RCW 18.28.010(2) defines a "debt adjuster" as anyone engaged in "debt adjusting for compensation."

Because there is no statutory definition for "managing", "counseling", "settling", "adjusting", "prorating", or "liquidating", these terms all carry their common, ordinary meaning and a dictionary can be used to help determine that meaning. *Christensen, supra* at 373; *Lindeman, supra* at 201-02. The dictionary definition of "manage" includes handling, administrating, arranging, directing, or having persuasive influence over. *The American Heritage Dictionary, New College Edition* 792 (1980). "Counseling" includes providing advice or guidance or a plan. *Id.* at 303. To "settle" means "to put into order, arrange or fix definitely as desired." *Id.* at 1186. If Freedom did, or held itself out as doing, any of these activities, which ultimately is a fact question for the trial court, then Freedom is a debt adjuster under RCW 18.28.010(1) because it conducted its activities for compensation. Such is the plain meaning of the statute.

The remainder of Question 1 focuses on whether it matters for purposes of the definition that the consumer must approve a settlement before it becomes final or that Freedom does not hold the consumer's funds. For three reasons, neither matter.

First, the DAA does not say that either event matters. Nothing in the statute makes either event an exception that would exempt Freedom from being a debt adjuster. Second, whether a consumer must approve a settlement before it becomes final or who holds the consumer's money is immaterial to whether Freedom was "managing" the debt settlement process on behalf of the consumer or whether it was "counseling" consumers about how to eliminate their credit card debt. If Freedom was either managing or counseling, then requiring the consumer's approval or focusing on who holds the money is beside the point. What the DAA does consider material and what it does contemplate is that if one manages, counsels, settles, adjusts, prorates, or liquidates the debt of another, or receives funds to send to a creditor, then that person is a debt adjuster. Doing any of the seven identified activities for compensation makes one a debt adjuster, regardless of who has to approve the settlement or who holds the funds.[2] Third, even if a consumer has to approve a settlement that Freedom has negotiated on behalf of the consumer before the settlement becomes final, Freedom is still actively "settling" the debt in terms of common everyday English. In everyday parlance, Freedom settled consumer debts. The settlements were just subject to final approval by the consumers. Indeed, the fact that Freedom was settling debts, using an everyday understanding of the term, is why Freedom is called and has called itself a debt *settlement* company. To argue that Freedom did not "settle" debts would be an attempt to hold hyper-technical forms over common, everyday language and substance[3].

For purposes of deciding whether Freedom was a debt adjuster, it does not matter if the consumer had to approve the settlements or whether Freedom, a third party business associate, or the consumer held the funds used to fund the settlements. Freedom still managed and counseled and settled consumer debt and it did so for compensation. That makes Freedom a debt adjuster under the DAA.

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[2] Who holds the money might matter for purposes of interpreting whether Freedom was "receiving funds for the purpose of distributing said funds among creditors," but since receiving and distributing funds is only one of the seven ways one can become a debt adjuster, holding the funds is not a requirement. Custody of the consumer's money is a sufficient, but not a necessary, attribute of being a debt adjuster.

[3] Indeed, should Freedom argue that it was not engaged in settling consumer's debt, it would appear to be an admission that its advertising program is a misrepresentation and an unfair and deceptive practice under the Consumer Protection Act.

D. A Payment Occurs when the Creditor is Paid and Not Until Then.

Question 2 asks what "payment" means for purposes of determining the amount and timing of the fees that can be charged under RCW 18.28.080(1). In addition to capping the total fees that a debt adjuster can take over the entire life of the contract to no more than 15% of the total debt listed on the contract, the statute also limits when parts of the fee can be taken and how much each part can be. RCW 18.28.080(1) states in relevant part:

> The total fee for debt adjusting services may not exceed fifteen percent of the total debt listed by the debtor on the contract. The fee retained by the debt adjuster from any one payment made by or on behalf of the debtor may not exceed fifteen percent of the payment.

The DAA does not define "payment." Therefore, this Court should look to the ordinary meaning of the word, to the meaning that best advances the purpose of the entire statute, and how the term has been used elsewhere in the same statute. *See Christensen*, *supra* at 373; *Schweickert*, *supra* at 893-94; and *Medcalf*, *supra* at 300-01. "Payment" according to ordinary usage and the dictionary means the act of paying or the state of being paid. *The American Heritage Dictionary*, *New College Edition* 963 (1980). The definition of "pay" is to give money in exchange for something or to discharge a debt or other obligation. *Id.* at 963. Likewise, "payment is defined as the discharge of a pecuniary obligation by money or what is accepted as the equivalent of a specific sum of money." 60 Am. Jur. 2d *Payment* § 1 at 713 (2003).

A "payment" does not occur when money is transferred between two accounts owned by the same consumer. Specifically, a "payment" as contemplated by the statute does not occur when the consumer transfers money from his or her checking account at her home bank to the "saving" or "settlement" account at Rocky or another bank. The activity is simply a transfer of money. The money is still hers. No debt has been discharged. It is not a payment. Shuffling money between accounts owned by the same person is not a payment by any definition.

Freedom's withdrawal of its fees from the consumer's "savings" or "settlement" account as soon as money has been transferred there is also not a "payment" as that term is used in RCW 18.28.080(1). If it were the sentence would then mean: "The fee retained by the debt adjuster from any one payment of its fee...may not exceed fifteen percent of the payment of its fee." That is nonsensical, strained, and absurd. The meaning of "payment" that the statute contemplates is a payment to a creditor whose debt is being resolved. Furthermore, that is the way the term is used earlier in the statute at RCW 18.28.010(1) -- "distributing said funds among creditors in payment or partial payment of obligations of a debtor" -- and that is what it means in RCW 18.28.080(1).

Because no "payment" occurs when the consumer transfers her money from her home bank account to her "savings" or "settlement" account, that transfer activity does not earn Freedom the right to take any part of its fee. The right to take compensation under the statute is expressly contingent upon a "payment" being made, and a "payment" does not occur until the creditor whose debt is being settled or resolved is paid.

Even if, for the sake of discussion, "payment" meant anytime the consumer transfers money between accounts that she owns, the fees taken by Freedom would still be illegal. This is because the amounts taken by Freedom from all of the initial transfers is greater than 15% of each transfer, and reach as high as 82% of the amount of each transfer. *See* Brief of Plaintiffs at 8. Consequently, the timing and amount of these fees on its face exceeds the "fifteen percent of the payment" rule in the DAA.

The Attorney General's understanding of the statute makes linguistic sense. It is also the reading that comports with the statute's intent to protect consumers, and it honors the principle that remedial statutes should be liberally construed to effectuate their beneficial purpose.

V. CONCLUSION

Freedom is a debt adjuster. What it does fits the statutory definition like a snug shoe. Neither requiring the consumer's approval of the settlements nor having the consumer's funds held by a third party creates an exception. The shoe fits and Freedom must wear it. The DAA applies to it.

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Since the DAA applies to Freedom, its fees are limited to no more than 15% of what is paid to a creditor when the creditor is paid.

RESPECTFULLY SUBMITTED this 9th day of February, 2011.

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