

CURRENT LEGISLATION

COMMERCIAL DEBT ADJUSTMENT: AN ALTERNATIVE TO CONSUMER BANKRUPTCIES?

I. INTRODUCTION

An ever increasing number of consumer bankruptcies necessitates a solution to the problem of the wage-earner who has overextended himself on credit and become unable to pay his debts as they become due.¹ Many such cases involve persons who simply do not want to pay their debts, but in most cases the debtor would prefer to solve his problems in a way that avoided the social stigma of bankruptcy, and left his credit rating at least partially intact.² What is necessary is a method of concentrating and extending the debts without cancelling them.

Private enterprise has attempted an answer in the form of commercial debt adjustment, a business that grew rapidly during the 1950's. Debt adjusters, also known as budget planners, credit counselors, debt poolers or consolidators, financial managers or proraters, attempt to gain time for the debtor by formulating a plan whereby whatever weekly or monthly sum the debtor can afford is distributed among the creditors by the debt adjuster. Ideally, the adjuster should conclude contracts with at least some of the creditors to assure their acceptance and continuation with the plan. He is rarely successful in this regard, however, since creditors generally mistrust commercial debt adjusters and are reluctant to deal with them at all.³

In its bare essentials, the process of debt adjustment, as it is now carried on, entails: first, the formulation of a plan of payment by the adjuster, based on information supplied by the debtor as to how much he can afford and how much pressure is being exerted by each creditor; second, the attempt to persuade the creditors to accept the plan; and third, the disbursement of the funds to the creditors according to the plan.⁴ In addition to these essentials, an experienced debt adjuster may be able to give the debtor guidance on the future prudent use of credit. If he is not a lawyer, however, he is probably unable to advise on certain matters of more immediate concern, such as the validity of the claims against the debtor. In the actual process of debt adjustment, therefore, the adjuster performs no function that could not be handled by any layman with some business experience, including the debtor himself.

In many respects, commercial debt adjustment parallels a wage-earner

¹ Countryman, *The Bankruptcy Boom*, 77 Harv. L. Rev. 1452 (1964).

² Dolphin, *Thesis Reports on Causes of Consumer Bankruptcies*, 18 Pers. Fin. L.Q. Rep. 130, 132 (1964).

³ Surveys taken in St. Louis and Kansas City show that this antipathy is due to a remarkably bad record on the part of debt adjusters in completing prorating plans. Backman, *Debt Adjustment Abuses*, 9 Pers. Fin. L.Q. Rep. 44 (1955); Birkhead, *Debtors Misled and Deceived by Pro-Raters*, 16 Pers. Fin. L.Q. Rep. 116 (1962).

⁴ See *Home Budget Serv., Inc. v. Boston Bar Ass'n*, 335 Mass. 228, 229-31, 139 N.E.2d 387 (1957); *Developments in the Debt Adjustment Field*, 13 Pers. Fin. L.Q. Rep. 59 (1959).

plan under Chapter XIII of the Bankruptcy Act.⁵ This plan also affords the debtor a time extension, and sometimes a composition (reduction) of his indebtedness.⁶ The debtor's funds are deposited with a trustee, who prorates the money among the creditors according to the plan.⁷ Unlike the normal debt adjustment plan, however, creditors are bound to a Chapter XIII plan once they agree to it. In fact, a majority of the unsecured creditors may bind the remainder of the unsecured creditors to the plan.⁸ In addition, the validity of creditors' claims are determined before they are allowed.⁹

Certain practices, widespread in the debt adjustment field, led to numerous complaints from dissatisfied clients. False and misleading advertising lured debtors with the prospect of what seemed to be an easy-term loan.¹⁰ The adjusters often charged exorbitant fees, as much as thirty percent of the total indebtedness listed by the debtor.¹¹ Many times the adjuster made no attempt to secure the acceptance of the creditors before the debtor began paying in his money.¹²

Often the debtor, and many creditors who had assented to the plan, were led to believe that the deduction of the adjusters fee would be amortized over the life of the contract. Instead, it was common practice for the debt adjuster to withhold the initial payments until he had collected his entire fee.¹³ As a result, creditors were likely to become impatient and begin exerting pressure directly on the debtor for payment.

If the debtor became disillusioned and cancelled the plan, he found he still owed the adjuster the total percentage of listed indebtedness, even though little or no money may have actually reached the creditors.¹⁴ As a result, the debtor had merely added another creditor, and was more likely than ever to consider bankruptcy. Some debt adjusters purposely induced the debtor to cancel in this manner, so that they could collect their fee without the necessity of performing the contracted-for service.¹⁵

The growing volume of complaints about these practices led many states to act on the matter. Legislation attempting to curb these abuses took two courses: regulatory statutes designed to eliminate the abuses through state supervision, or the outright prohibition of commercial debt adjustment. Before considering legislative action, however, it is necessary to look at a possible method of controlling commercial debt adjustment without legislation, that is, an attack on debt adjusting as constituting the unauthorized practice of law.

⁵ 52 Stat. 930 (1938), as amended, 11 U.S.C. §§ 1001-86 (1964).

⁶ 11 U.S.C. § 1046 (1964).

⁷ 11 U.S.C. § 1033(4) (1964).

⁸ 11 U.S.C. §§ 1051-52 (1964).

⁹ 11 U.S.C. §§ 1044, 1056(b) (1964).

¹⁰ Backman, *supra* note 3, at 44-45; Gorman, *Debt Adjusters Continue False Advertising Despite Regulation*, 17 Pers. Fin. L.Q. Rep. 130 (1963).

¹¹ Geeding, *Debt Adjusting Prohibited in Kansas*, 15 Pers. Fin. L.Q. Rep. 87 (1961); 17 Vand. L. Rev. 1565 (1964).

¹² Birkhead, *supra* note 3, at 118.

¹³ Backman, *supra* note 3, at 45.

¹⁴ *Id.*

¹⁵ *Id.*

II. THE PRACTICE-OF-LAW QUESTION

The ultimate determination of whether any statute is needed in this field depends upon whether any layman may legally engage in the occupation of debt adjusting. The question of whether this business constitutes the practice of law has been debated for years.¹⁶ Three states, Massachusetts, South Carolina and Virginia, have enacted statutes deeming debt adjustment the practice of law.¹⁷ Historically, however, while the legislature has had some power to regulate the legal profession, the final determination as to what activities constitute the practice of law has been one for the courts.¹⁸

An exact and comprehensive definition of what constitutes the practice of law has not been formulated.¹⁹ The courts have preferred to decide on a case-by-case basis whether the activity concerned requires a legal education and the ethical bounds to which attorneys are subject. The ultimate aim is to insure that the public is protected against incompetent or unscrupulous assistance in legal matters.²⁰ There are, however, certain activities that have generally been deemed to constitute the practice of law, including the representation of another in court, the drafting of contracts, conveyances and other legal documents for others, and the advising on a point of law as it applies to a particular situation.²¹ Several jurisdictions regard the rendering of legal services by laymen as unauthorized practice of law whether done for compensation or not.²² Others require that a fee be charged.²³ It would seem that there is less potential danger to the public where no money is concerned.

In only one case has the question of whether debt adjustment constitutes the practice of law been squarely decided. In *Home Budget Serv., Inc. v. Boston Bar Ass'n*,²⁴ the Massachusetts Supreme Judicial Court upheld the validity of the Massachusetts statute that declares debt adjustment to be the practice of law. Although the court held that the statute was valid only as a statement of legislative opinion, the court supported the statute by deciding that debt adjusting amounted to the practice of law.

In coming to its decision, the court considered only two of the basic elements of the debt adjustment process: the formulation of the payment

¹⁶ See Briggs, *Unauthorized Practice of the Law in Minnesota*, 20 Minn. L. Rev. 451 (1936).

¹⁷ Mass. Gen. Laws Ann. ch. 221, § 46C (1958); S.C. Code Ann. § 56-147 (Supp. 1965); Va. Code Ann. § 54-44.1 (1967).

¹⁸ Rhode Island Bar Ass'n v. Automobile Serv. Ass'n, 55 R.I. 122, 179 A. 139 (1935); *Howe v. State Bar*, 212 Cal. 222, 298 P. 25 (1931).

¹⁹ *State Bar v. Arizona Land Title & Trust Co.*, 90 Ariz. 76, 366 P.2d 1 (1961).

²⁰ *Id.* at 86-88, 366 P.2d at 8-9.

²¹ Rhode Island Bar Ass'n v. Automobile Serv. Ass'n, 55 R.I. at 134, 179 A. at 144.

²² *State Bar v. Arizona Land Title & Trust Co.*, 90 Ariz. at 87, 366 P.2d at 9; *State ex rel. Wright v. Barlow*, 131 Neb. 294, 296-97, 268 N.W. 95, 96 (1936).

²³ Opinion of the Justices, 289 Mass. 607, 615, 194 N.E. 313, 317-18 (1935); *Fitchette v. Taylor*, 191 Minn. 582, 584, 254 N.W. 910, 911 (1934). For a compilation of cases on the issue of whether a fee must be charged, see S. Bass, *Unauthorized Practice Source Book* 77-78 (rev. ed. 1965).

²⁴ 335 Mass. 228, 139 N.E.2d 387 (1957).

schedule by the adjuster based on the pressure being exerted by each creditor, and the relationship of trust and confidence which is established between the adjuster and the debtor when the debtor discloses his debts. The first of these elements, the formulation of a schedule, appears to have little to do with the practice of law. A layman can assess the pressure from each creditor and decide the proper rate of payment to insure continued acceptance of the plan without overextending the debtor, as well as an attorney can. Nor is the second element considered by the court, the relationship of trust and confidence, any more determinative. Such a relationship is not restricted to attorneys and their clients, but extends to other persons, a loan company and a borrower, for instance, or a creditor and his bill collector, where it is clear that there is no practice of law question.²⁵ There is no distinction suggested by the court between the debtor-adjuster relationship and these other relationships.

Even if the court in *Home Budget* had performed a more thorough analysis of the elements of debt adjusting, it is difficult to see how it could have supported its conclusion. Debt adjusting is analogous to the function of a collection agency which transmits money received from the debtor to the creditor. The bill collector must work closely with the creditor in a position of trust; he must weigh the ability of the debtors to pay, and inform the creditor of the chances of collection; and often he must form a schedule of payment that will result in full liquidation of the debt. The bill collector, however, has not been found to be engaged in the practice of law when he engages in these activities.²⁶ There does not seem to be any distinction between the debt adjuster and the bill collector that suggests that the adjuster is practicing law while the bill collector is not.

The court in *Home Budget* did emphasize other facts in coming to its decision. The adjuster in question frequently attempted to negotiate compromises with the creditors in a situation of insolvency, and often dealt with creditors' attorneys in attempting to forestall pending legal action.²⁷ It is clear that these activities do require a legal education and thus alone may constitute the practice of law. They are not, however, essential to debt adjustment, and the extent of the antipathy of creditors toward debt adjusters indicates that such practices are the exception rather than the rule.²⁸ Therefore, the *Home Budget* decision should have been confined to a holding that the particular debt adjuster involved was engaged in the unauthorized practice of law, and not extended to all debt adjusting. For this reason, it is doubtful whether it will be followed in other jurisdictions. Thus, reliance on a possible court decision or on statutes declaring debt adjusting to be the practice of law is not a sure way of controlling the debt adjustment business.

²⁵ While these activities in themselves do not constitute the unauthorized practice of law, the bounds at times may be overstepped. See, e.g., A.B.A. Standing Committee on Unauthorized Practice of Law, Informative Opinion A of 1962, 28 Unauth. Pract. News 36 (1962); Note, Unauthorized Practice of Law by Collection Agencies, 8 W. Res. L. Rev. 492 (1957).

²⁶ See Annot., 84 A.L.R. 749 (1933); Annot., 157 A.L.R. 522 (1945).

²⁷ 335 Mass. at 232, 139 N.E.2d at 390.

²⁸ See note 3 *supra*.

III. REGULATORY STATUTES

Twelve states have attempted to curb the recurrent abuses of commercial debt adjustment by enacting statutes requiring adjusters to be licensed and bonded by a state authority.²⁹ All of the states, either specifically or by implication, exempt lawyers and banks from the requirement of a license. Other exemptions vary, but include title insurance and abstract companies, nonprofit organizations, persons acting under court order, credit unions and accountants.³⁰ The amount of the required bond varies among

²⁹ Cal. Fin. Code §§ 12002.1-12402 (West Supp. 1966); Colo. Rev. Stat. Ann. §§ 11-3-1 to -16 (Supp. 1965); P.A. 882, 1967 Conn. Laws (Conn. Leg. Serv. 1267 (1967)); Idaho Code Ann. §§ 26-2201 to -2213 (Supp. 1965); Ill. Ann. Stat. ch. 16½, §§ 251-72 (Smith-Hurd 1963), as amended, (Supp. 1966); H. File 284, 1967 Iowa Acts (Iowa Leg. Serv. 352 (1967)); Mich. Stat. Ann. §§ 23.630(1)-(18) (Supp. 1965); Minn. Stat. Ann. §§ 332.04-.11 (1966); Ore. Rev. Stat. §§ 697.610-992 (Supp. 1965); Utah Code Ann. §§ 58-30-1 to -15 (1963); Ch. 201, 1967 Wash. Laws (Wash. Leg. Serv. 467 (1967)); Wis. Stat. Ann. §§ 218.02(1)-(10) (1957), as amended, (Supp. 1967).

³⁰ California exempts attorneys, banks, merchant-owned credit associations, "joint control agents" who disperse funds for expenses incurred in construction or improvement of real property, employment agencies, real estate brokers, assignments for the benefit of creditors, and licensed certified public accountants. Cal. Fin. Code § 12100 (West Supp. 1966).

Colorado exempts attorneys, banks, title insurers and abstract companies, judicial officers or others acting under court order, and nonprofit organizations. Colo. Rev. Stat. Ann. §§ 11-3-3(1)(a)-(g) (Supp. 1965).

Connecticut exempts attorneys, banks, title insurers and abstract companies, any person acting pursuant to a law or court order, nonprofit organizations offering services for members, and employees of a licensee. P.A. 882, § 15, 1967 Conn. Laws (Conn. Leg. Serv. 1267, 1270 (1967)).

Idaho exempts attorneys, banks, real estate brokers, and title insurers and abstract companies. Idaho Code Ann. § 26-2208 (Supp. 1965).

Illinois exempts attorneys, banks, title insurers and abstract companies, employees of licensees, judicial officers and others acting under court order, nonprofit organizations, employers for their employees, and associations for their members. Ill. Ann. Stat. ch. 16½, § 252 (Smith-Hurd 1963).

Iowa exempts attorneys, banks, insurance companies, abstract companies, employees of licensees, judicial officers or others acting under court order, nonprofit organizations including credit unions, and persons whose business is the origination of first mortgage loans on real estate for their own portfolios or for sale to institutional investors. H. File 284, § 2(1), 1967 Iowa Acts (Iowa Leg. Serv. 352, 353 (1967)).

Michigan exempts attorneys, banks, title insurers and abstract companies, employees of licensees, and judicial officers or others acting under court order. Mich. Stat. Ann. § 23.630(2) (Supp. 1965).

Minnesota exempts attorneys, banks, charitable corporations and credit unions. Minn. Stat. Ann. § 332.10 (1966).

Oregon exempts attorneys, banks, real estate brokers, title insurers and abstract companies, organizations dealing with debts owing from commercial enterprises, credit men who are employees of one person or company which is not in the business of debt consolidation, express companies and telegraph companies, and a public officer or other person acting under a court order. Ore. Rev. Stat. § 697.615(2) (Supp. 1965).

Utah exempts attorneys, banks, title insurers and abstract companies, employees of licensees, judicial officers or other persons acting under court order, and nonprofit organizations. Utah Code Ann. § 58-30-2 (1963).

Washington exempts attorneys, banks, escrow agents, accountants, broker-dealers or investment advisors in securities, insurance companies including title insurers, employees for their employer, public officers and persons acting under court order, persons performing services incidental to the dissolution of a business enterprise, and nonprofit

the states, from \$5,000 to \$10,000, except Colorado and Utah, which require a \$25,000 bond.³¹

Most of the licensing statutes are aimed at eliminating the particular practices which caused so many complaints about debt adjusters. Ten of the laws set maximum fees that may be charged by a licensee, varying from 10% to 15% of the funds actually distributed to the creditors.³² Seven of the laws require that a certain percent of the creditors agree to the plan before the adjuster may collect any fee.³³ Most include requirements that the deduction of the adjuster's fee be amortized over the life of the plan.³⁴ Most also provide for a maximum charge to be made if the debtor cancels.³⁵ Ten of the

organizations dealing exclusively with debts owed from commercial enterprises to business creditors. Ch. 201, § 1(2), 1967 Wash. Laws (Wash. Leg. Serv. 467 (1967)).

Wisconsin has no exemptions as such. The definition of "adjustment service company," however, is limited to those who prorate as principals and do so for a service charge or other consideration. Wis. Stat. Ann. § 218.02(1)(a) (1957).

³¹ Cal. Fin. Code § 12206 (West Supp. 1966) (\$10,000); Colo. Rev. Stat. Ann. § 11-3-3(3) (Supp. 1965) (\$25,000); P.A. 882, § 3(a), 1967 Conn. Laws (Conn. Leg. Serv. 1267 (1967)) (\$10,000); Idaho Code Ann. § 26-2205 (Supp. 1965) (\$5,000); Ill. Ann. Stat. ch. 16½, § 254 (Smith-Hurd 1963) (\$7,500); H. File 284, § 2(3), 1967 Iowa Acts (Iowa Leg. Serv. 352, 353 (1967)) (\$10,000); Mich. Stat. Ann. § 23.630 (4) (Supp. 1965) (\$5,000); Minn. Stat. Ann. § 332.06 (1966) (\$5,000); Ore. Rev. Stat. § 697.650 (Supp. 1965) (\$10,000); Utah Code Ann. § 58-30-4 (1963) (\$25,000); Ch. 201, § 4, 1967 Wash. Laws (Wash. Leg. Serv. 467, 468 (1967)) (\$10,000); Wis. Stat. Ann. § 218.02(2)(c) (1957) (no bond required, but commissioner of banks may ask for a bond up to \$5,000).

³² California, 12% for first \$3,000 distributed, 11% for the next \$2,000, 10% for the remainder, Cal. Fin. Code § 12314 (West Supp. 1966); Colorado is unclear—although an adjuster may charge up to 12½%, Colo. Rev. Stat. Ann. § 11-3-10 (Supp. 1965), he must submit his proposed contract with the debtor to the commissioner of banks as a prerequisite to a license, and this contract cannot include a fee over 10%, Colo. Rev. Stat. Ann. § 11-3-3(4) (Supp. 1965); Connecticut, 10% if the plan is 10 months or less, 12½% if the plan is between 10 and 18 months, 15% if the plan is over 18 months, P.A. 882, § 11(c), 1967 Conn. Laws (Conn. Leg. Serv. 1267, 1269 (1967)); Idaho, 15%, Idaho Code Ann. § 26-2204 (Supp. 1965); Illinois, 10% if the plan is 10 months or less, 12½% if the plan is between 10 and 20 months, 15% if the plan is over 20 months, Ill. Ann. Stat. ch. 16½, § 262 (Smith-Hurd 1963); Iowa, 12½%, H. File 284, § 9, 1967 Iowa Acts (Iowa Leg. Serv. 352, 355 (1967)); Oregon, 15%, Ore. Rev. Stat. § 697.740(3) (Supp. 1965); Utah, 10%, Utah Code Ann. § 58-30-11(a) (1963); Washington, 15%, Ch. 201, § 8, 1967 Wash. Laws (Wash. Leg. Serv. 467, 470 (1967)); Wisconsin, maximum fees may be set by the commissioner of banks, Wis. Stat. Ann. § 218.02(7)(d) (1957).

³³ Colorado requires that 80% of the creditors agree before a fee may be charged. Colo. Rev. Stat. Ann. § 11-3-10 (Supp. 1965); five other states require that 51% of the total indebtedness and number of creditors agree to the plan. Cal. Fin. Code § 12315 (West Supp. 1966); P.A. 882, § 11(b), 1967 Conn. Laws (Conn. Leg. Serv. 1267, 1269 (1967)); Ill. Ann. Stat. ch. 16½, § 262 (Smith-Hurd 1963); Mich. Stat. Ann. § 23.630(13)(b) (Supp. 1965); Utah Code Ann. § 58-30-11(b) (1963); Iowa requires 50% of the total number of creditors, H. File 284, § 8(b), 1967 Iowa Act (Iowa Leg. Serv. 352, 355 (1967)).

³⁴ Cal. Fin. Code § 12314 (West Supp. 1966); Colo. Rev. Stat. Ann. § 11-3-10 (Supp. 1965); P.A. 882, § 11(a), 1967 Conn. Laws (Conn. Leg. Serv. 1267, 1269 (1967)); Idaho Code Ann. § 26-2204 (Supp. 1965); Ill. Ann. Stat. ch. 16½, § 262 (Smith-Hurd 1963); H. File 284, § 9, 1967 Iowa Acts (Iowa Leg. Serv. 352, 355 (1967)); Mich. Stat. Ann. § 23.630(13)(a) (Supp. 1965); Ore. Rev. Stat. § 697.740(3) (Supp. 1965); Utah Code Ann. § 58-30-11(a) (1963); Ch. 201, § 8, 1967 Wash. Laws (Wash. Leg. Serv. 467, 470 (1967)).

³⁵ California allows a charge of 7% of the remaining indebtedness, Cal. Fin. Code

statutes require that certain terms be included in the contract with the debtor, such as the adjuster's fee, a list of each debt, and the amount of each payment by the debtor.³⁶ False or misleading advertising is prohibited in most states.³⁷ Most also prohibit the licensee from commingling his own funds

§ 12314 (West Supp. 1966); Colorado, \$25, Colo. Rev. Stat. Ann. § 11-3-10 (Supp. 1965); Connecticut, 5% of the unpaid fee, not to exceed \$50, P.A. 882, § 11(d), 1967 Conn. Laws (Conn. Leg. Serv. 1267, 1270 (1967)); Idaho prohibits the taking of more than 15% of any one payment, so the maximum cancellation charge would be the difference, if any, between the adjuster's fee and 15% of any funds he has on hand, Idaho Code Ann. § 26-2204 (Supp. 1965); Illinois, 30% of the unpaid fee, not to exceed \$50, Ill. Ann. Stat. ch. 16½, § 262 (Smith-Hurd 1963); Michigan, 25% of the unpaid fee, Mich. Stat. Ann. § 23.630(13)(a) (Supp. 1965); Oregon, \$20, Ore. Rev. Stat. § 697.740(3) (Supp. 1965); Washington, 6% of the remaining indebtedness, not to exceed \$75, plus \$25, Ch. 201, § 8, 1967 Wash. Laws (Wash. Leg. Serv. 467, 470 (1967)).

³⁶ California requires inclusion of every debt prorated with the creditor's name, total of all debts, precise amount of payments, precise rate and amount of adjuster's charge, number and amount of installments, name and address of debtor and adjuster, Cal. Fin. Code § 12319 (West Supp. 1966); Colorado, complete list of creditors, total fees, beginning and expiration date of contract, Colo. Rev. Stat. Ann. § 11-3-9(1) (Supp. 1965); Connecticut, complete list of debts to be adjusted, complete list of creditors, total adjuster's fee, beginning and expiration date of contract, P.A. 882, § 8, 1967 Conn. Laws (Conn. Leg. Serv. 1267, 1269 (1967)); Illinois, total adjuster's fee, Ill. Ann. Stat. ch. 16½, § 261 (Smith-Hurd 1963); Iowa, list of creditors to obtain payments, total adjuster's fee, statement of how fee is to be paid, settlement charge in case of cancellation, beginning and expiration date of contract, H. File 284, §§ 8(1), 9, 1967 Iowa Acts (Iowa Leg. Serv. 352, 355 (1967)); Michigan, complete list of debts to be adjusted and the creditors holding such debts, total adjuster's fee, beginning and expiration date of the contract, Mich. Stat. Ann. § 23.630(10) (Supp. 1965); Minnesota, amount of indebtedness owed by debtor to his creditor, date of contract and its maturity, nature of the security, if any, for the contract, names and addresses of the debtor and adjuster, total adjuster's fees, Minn. Stat. Ann. § 332.09(1) (1966); Oregon, names and addresses of debtor and adjuster, each debt to be adjusted and creditor's name and address, total debt to be adjusted, payments to be made by debtor, rate charged by adjuster, payment and proration schedule, provision permitting examination of accounts by debtor, provision that contract cannot be cancelled by adjuster without debtor's authorization while debtor is employed and his salary is subject to any wage assignment made to the adjuster, Ore. Rev. Stat. § 697.743(1) (Supp. 1965); Utah, complete list of debts to be adjusted, list of creditors holding these debts, total adjuster's fee, beginning and expiration date of contract, a provision that the debtor can terminate at his pleasure without penalty, Utah Code Ann. § 58-30-8 (1963); Washington, each debt to be adjusted and the creditor's name, total of all debts, payments to be made by the debtor, total adjuster's fee, payment and proration schedule, name and address of debtor and adjuster, Ch. 201, § 10, 1967 Wash. Laws (Wash. Leg. Serv. 467, 471 (1967)).

³⁷ California empowers the commissioner of corporations to promulgate rules in regard to advertising that may be used, Cal. Fin. Code § 12330 (West Supp. 1966); Colo. Rev. Stat. Ann. § 11-3-12(1)(g) (Supp. 1965); P.A. 882, § 13(6), 1967 Conn. Laws (Conn. Leg. Serv. 1267, 1270 (1967)); Idaho requires that the adjuster submit all advertisements and literature to be circulated to the commissioner of finance along with the license application; the commissioner must determine that there is no concealment or misrepresentation of any fact before issuing a license; the adjuster is not allowed to circulate any literature that is not filed with the commissioner, Idaho Code Ann. §§ 26-2203(1), (6), -2204 (Supp. 1965); Ill. Ann. Stat. ch. 16½, § 263 (Smith-Hurd 1963); H. File 284, § 11(6), 1967 Iowa Acts (Iowa Leg. Serv. 352, 356 (1967)); Mich. Stat. Ann. § 23.630(15)(f) (Supp. 1965); Ore. Rev. Stat. § 697.740(4) (Supp. 1965); Utah Code Ann. § 58-30-15(f) (1963); Ch. 201, § 12(6), 1967 Wash. Laws (Wash. Leg. Serv.

with those of the debtor,³⁸ and require him to account periodically to the debtor on the disposition of funds.³⁹ All of the states require the adjuster to keep adequate records, which are to be open to inspection by the licensing authority.⁴⁰ The licensing authority is required in all twelve states to determine the fitness of an applicant as a financial counselor, and bar any person not of good moral character from obtaining a license.⁴¹

Even the most complete of the statutes suffer from defects. At least one incident in Oregon indicates that even the bonding requirements of Colorado and Utah are not sufficient to insure the debtor protection should the debt adjuster go bankrupt, or leave the state without having paid the creditors.⁴² Since the statutes necessarily depend on complaints from debtors to inform authorities of infractions, it is often too late for effective action.⁴³

Even if the statutes could be adequately enforced, and amended to afford the maximum protection against the abuses common to commercial debt adjustment, they would still be defective in allowing the practice at all, because of the great potential harm to the debtor. The most stringent examination given the prospective debt adjuster by the licensing authority cannot assure that he will be able to afford the debtor the type of financial counseling needed. The debt adjuster may be able to advise the debtor in the proper use of credit, but this advice is applicable only to the future. What

467, 471 (1967)); Wisconsin allows the commissioner of banks to regulate advertising, Wis. Stat. Ann. § 218.02(7)(b) (1957).

³⁸ Cal. Fin. Code § 12300.3 (West Supp. 1966); Colo. Rev. Stat. Ann. § 11-3-9(2) (Supp. 1965); P.A. 882, § 9, 1967 Conn. Laws (Conn. Leg. Serv. 1267, 1269 (1967)); Idaho Code Ann. § 26-2205a (Supp. 1965); H. File 284, § 8(2), 1967 Iowa Acts (Iowa Leg. Serv. 352, 355 (1967)); Mich. Stat. Ann. § 23.630(11) (Supp. 1965); Ore. Rev. Stat. § 697.740(2) (Supp. 1965); Utah Code Ann. § 58-30-9 (1963); Ch. 201, § 15, 1967 Wash. Laws (Wash. Leg. Serv. 467, 472 (1967)).

³⁹ Cal. Fin. Code § 12322 (West Supp. 1966) (an accounting every six months); Colo. Rev. Stat. Ann. § 11-3-9(5) (Supp. 1965) (upon request of debtor each 90 days); P.A. 882, § 12(a)(3), 1967 Conn. Laws (Conn. Leg. Serv. 1267, 1270 (1967)) (each 90 days); H. File 284, § 8(5), 1967 Iowa Acts (Iowa Leg. Serv. 352, 355 (1967)) (monthly); Mich. Stat. Ann. § 23.630(14)(c) (Supp. 1965) (upon request of debtor each 90 days); Ore. Rev. Stat. § 697.745 (Supp. 1965) (monthly); Utah Code Ann. § 58-30-12(c) (1963) (upon request of debtor each 90 days); Ch. 201, § 11(5), 1967 Wash. Laws (Wash. Leg. Serv. 467, 471 (1967)) (every six months).

⁴⁰ Cal. Fin. Code §§ 12303, 12305 (West, Supp. 1966); Colo. Rev. Stat. Ann. § 11-3-9(3) (Supp. 1965); P.A. 882, § 12(a)(1), 1967 Conn. Laws (Conn. Leg. Serv. 1267, 1270 (1967)); Idaho Code Ann. § 26-2205a (Supp. 1965); Ill. Ann. Stat. ch. 16½, §§ 261, 270 (Smith-Hurd 1963); H. File 284, §§ 8(2), (3), 1967 Iowa Acts (Iowa Leg. Serv. 352, 355 (1967)); Mich. Stat. Ann. § 23.630(14)(a) (Supp. 1965); Minn. Stat. Ann. §§ 332.07, .08 (1966); Ore. Rev. Stat. § 697.740(1) (Supp. 1965); Utah Code Ann. §§ 58-30-9, -10 (1963); Ch. 201, § 11(1), 1967 Wash. Laws (Wash. Leg. Serv. 467, 471 (1967)); Wis. Stat. Ann. § 218.02(7)(c) (1957).

⁴¹ Cal. Fin. Code § 12216 (West Supp. 1966); Colo. Rev. Stat. Ann. § 11-3-4(2) (Supp. 1965); P.A. 882, § 4, 1967 Conn. Laws (Conn. Leg. Serv. 1267, 1268 (1967)); Idaho Code Ann. § 26-2205b (Supp. 1965); Ill. Ann. Stat. ch. 16½, § 255 (Smith-Hurd 1963); Mich. Stat. Ann. § 23.630(5) (Supp. 1965); Minn. Stat. Ann. § 332.05 (1966); Ore. Rev. Stat. §§ 697.625, .630, .660 (Supp. 1965); Utah Code Ann. § 58-30-5 (1963); Ch. 201, § 6(2), 1967 Wash. Laws (Wash. Leg. Serv. 467, 470 (1967)); Wis. Stat. Ann. § 218.02(3)(b) (1957).

⁴² Regulation of Debt Adjusters Fails to Protect Debtors in Illinois and Oregon, 16 Pers. Fin. L.Q. Rep. 119 (1962).

⁴³ See *id.* at 120; Gorman, *supra* note 10.

the debtor needs in his present situation is advice as to the validity of the claims against him, and as to what alternative courses of action are afforded by law. As was pointed out by the court in *Home Budget*, and also by the United States Supreme Court,⁴⁴ only a lawyer can advise on such matters as usury laws and conditional sales statutes, which may have a bearing on the legality of the claim of a creditor. This information is crucial to the debtor, since without it he may end up paying invalid claims with money he can ill afford to waste.

In effect, the licensing statutes, in addition to encountering many problems of enforcement, merely give state approval to an activity that, even when carried on by the most experienced and honest of laymen, cannot be performed with any real efficacy, and is likely to do the debtor more harm than good.

IV. PROHIBITORY STATUTES

Thus far, in addition to the three states which deem debt adjustment to be the practice of law, nineteen states have prohibited commercial debt adjustment by statute,⁴⁵ with various categories of exemptions, including attorneys, retail merchants' trade associations, employers of the debtor, creditors acting without compensation, and nonprofit organizations.⁴⁶ These

⁴⁴ *Ferguson v. Skrupa*, 372 U.S. 726, 732 (1963).

⁴⁵ H. Bill 35, 1967 Arkansas Laws (Arkansas Becomes 21st State to Prohibit Commercial Debt Adjusting, 21 Pers. Fin. L.Q. Rep. 54 (1967)); Del. Code Ann. tit. 11, § 469 (Supp. 1966); Fla. Stat. Ann. §§ 559.10-13 (1962); Ga. Code Ann. §§ 84-3601 to -3603 (Supp. 1966); H. Bill 33, 1967 Hawaii Laws (Loo, Hawaii Becomes 22nd State to Prohibit Commercial Debt Adjusting, 21 Pers. Fin. L.Q. Rep. 108 (1967)); Kan. Gen. Stat. Ann. § 21-2464 (Supp. 1961); Me. Rev. Stat. Ann. tit. 17, §§ 701-03 (1964); Mo. Ann. Stat. §§ 425.010-040 (Supp. 1966); N.J. Stat. Ann. §§ 2A:99A-1 to -4 (Supp. 1966); N.M. Stat. Ann. §§ 50-17-1 to -4 (Supp. 1967); N.Y. Pen. Law §§ 410-12 (McKinney Supp. 1966); N.C. Gen. Stat. §§ 14-423 to -426 (Supp. 1965); Ohio Rev. Code Ann. §§ 4710.01, .02, .99 (Baldwin 1964); Okla. Stat. Ann. tit. 24, §§ 15-18 (Supp. 1966); Pa. Stat. Ann. tit. 18, § 4897 (1963); R.I. Gen. Laws Ann. §§ 5-42-1 to -2 (Supp. 1966); Ch. 274, art. 9.02-.04, 1967 Tex. Laws (Vernon's Tex. Sess. Law Serv. 657 (1967)); Wyo. Stat. Ann. §§ 33-190 to -192 (1957); West Virginia virtually prohibits debt adjusting by prohibiting solicitation of any kind, and setting a maximum fee of 2% of the debts to be adjusted, W. Va. Code Ann. § 61-10-23 (1966).

⁴⁶ Florida, Georgia, Kansas, Maine, New York, Pennsylvania, Rhode Island, West Virginia and Wyoming exempt only attorneys. Fla. Stat. Ann. § 559.12 (1962); Ga. Code Ann. § 84-3603 (Supp. 1966); Kan. Gen. Stat. Ann. § 21-2464 (Supp. 1961); Me. Rev. Stat. Ann. tit. 17, § 701 (1964); N.Y. Pen. Law §§ 410(2), (3) (McKinney Supp. 1966); Pa. Stat. Ann. tit. 18, § 4897(b) (1963); R.I. Gen. Laws Ann. § 5-42-1 (Supp. 1966); W. Va. Code Ann. § 61-10-23 (1966); Wyo. Stat. Ann. § 33-190(a) (1957).

Missouri and New Jersey exempt attorneys, full-time employees of the debtor, judicial officers or persons acting pursuant to court order, creditors who act without compensation, and persons who arrange loans for the debtor and disburse the funds without charge. Mo. Ann. Stat. § 425.040 (Supp. 1966); N.J. Stat. Ann. § 2A:99A-4 (Supp. 1966).

New Mexico has the same exemptions as Missouri and New Jersey, but adds nonprofit corporations organized as a community effort to assist debtors. N.M. Stat. Ann. § 50-17-4 (Supp. 1967).

Delaware exempts attorneys and nonprofit corporations or associations. Del. Code Ann. tit. 11, § 469(c) (Supp. 1966).

Hawaii exempts attorneys, including Legal Aid Societies, and nonprofit or charitable corporations and associations. H. Bill 33, § 4, 1967 Hawaii Laws (Loo, Hawaii Becomes

statutes eliminate the abuses often associated with debt adjustment by restricting its practice to classes which are unlikely to be guilty of such abuses, and are therefore more effective than the regulatory statutes.

The only positive effect of these laws in helping the overextended wage-earner to keep out of bankruptcy, however, is that they prevent the possible further harm to the debtor's financial situation resulting from the services of a debt adjuster. In most states that have prohibitory statutes, the only persons to whom the average wage-earner can turn are nonprofit organizations and attorneys. As yet, there are not enough nonprofit credit counseling agencies to serve all consumer debtors.⁴⁷ The services of an attorney should be an adequate solution to the debtor's problems, but this has not proved to be the case.

The lawyer can advise the debtor on conditional sales statutes and usury laws, which may affect the validity of creditors' claims. He can lawfully advise on the effect of assignments for the benefit of creditors, and negotiate with creditors or their attorneys to compromise claims or forestall legal action.

The lay debt adjuster can do none of the above, since he probably lacks knowledge of the legal matters involved, and even if he has it he cannot impart it to the debtor without engaging in the unauthorized practice of law. Unfortunately, it appears that attorneys, who can perform these services, are often reluctant to supervise an indebtedness extension plan, whether they act as debt adjusters themselves in prorating the funds, or act through a Chapter XIII proceeding. This is a result of the fact that, for the effort entailed, the reward must be relatively low in order not to endanger the plan by overburdening the debtor. In fact, the maximum fee an attorney can charge is not much greater than that for the far simpler straight bankruptcy proceeding.⁴⁸ As a result, the lawyer has an inclination to advise

22nd State to Prohibit Commercial Debt Adjusting, 21 Pers. Fin. L.Q. Rep. 108 (1967)).

Arkansas exempts attorneys, banks, title insurance and abstract companies, employers acting for their employees, judicial officers or others acting pursuant to court order, nonprofit organizations acting without fee or charge, and associations for their members. H. Bill 35, § 5, 1967 Arkansas Laws (Arkansas Becomes 21st State to Prohibit Commercial Debt Adjusting, 21 Pers. Fin. L.Q. Rep. 54 (1967)).

North Carolina exempts full-time employees of the debtor, persons acting pursuant to court order, creditors acting without compensation, persons who arrange a loan for the debtor and disburse the funds without charge, and persons who intermittently adjust debts for compensation but are not regularly engaged in debt adjusting. N.C. Gen. Stat. § 14-426 (Supp. 1965).

Ohio exempts those licensed by proper legislative authority before Jan. 1, 1958. Ohio Rev. Code Ann. § 4710.02 (Baldwin 1964).

Oklahoma exempts retail merchants trade associations or nonprofit associations formed to collect accounts and exchange credit information. Okla. Stat. Ann. tit. 24, § 18 (Supp. 1966).

Texas exempts attorneys, banks, judicial officers or others acting under court order, agency of the state or United States, retail merchants or nonprofit trade association formed to collect accounts and exchange credit information, and nonprofit organizations. Ch. 274, art. 9.03, 1967 Texas Laws (Vernon's Tex. Sess. Law Serv. 657 (1967)).

⁴⁷ See p. 119 *infra*.

⁴⁸ Note, Relief for the Wage-Earning Debtor: Chapter XIII or, Private Debt Adjustment? 55 Nw. U.L. Rev. 372, 380 (1960).

straight bankruptcy, even though eventual⁴⁹ social and financial effect on the debtor might be avoided.

The prohibitory and "practice of law" statutes protect the debtor from the unethical practices and incompetent advice of the commercial debt adjusters, but may also have the effect of depriving him of any assistance at all.

V. ALTERNATIVE SOLUTIONS

In addition to the services of an attorney, the debtor who wants to pay as many of his debts as possible still has several alternatives to the commercial debt adjuster. One method of extending the time available to the debtor is the wage-earner plan under Chapter XIII of the Bankruptcy Act, mentioned above. This plan protects the debtor against having to pay usurious or otherwise invalid claims, something the debt adjuster cannot do and, also, assures the debtor that confidential information on his financial affairs will remain privileged. The power of the court to bind creditors to continue with the plan once it is confirmed is also an advantage over the services of a debt adjuster, although this power does not seem to be absolutely necessary.

Unfortunately, Chapter XIII has received little use outside of a few states.⁴⁹ One reason for this appears to be unfamiliarity and mistrust of the plan on the part of creditors.⁵⁰ Another is the fact that attorneys prefer advising a straight bankruptcy discharge, which entails much less effort for them.⁵¹ At any rate, when attorney's fees and additional charges allowed under the plan are taken into account, the cost to the debtor may amount to 15% of the total indebtedness,⁵² which equals the highest allowable fee for a debt adjuster in a licensing state. This can be a great added burden on an already insolvent wage-earner. Borderline cases, those debtors who would like to pay their bills but are unwilling to add to them, may well decide that a straight bankruptcy discharge is the answer.

Another possible method of diminishing the increase in consumer bankruptcies is suggested by a North Dakota statute,⁵³ which provides for the court appointment of county boards to act like debt adjusters in prorating the debtor's funds among his creditors. The only charge is a five dollar application fee. Unfortunately, the plan has not received enough use to assess its effectiveness. This is due to a feeling that, since the boards lack the enforcement powers available under a Chapter XIII proceeding, their services are of little use.⁵⁴ This is not necessarily the case, however. A court-appointed board would certainly have more influence with a creditor than a commercial debt adjuster would have. Also, experience elsewhere has shown that enforcement powers, desirable as they may be, are not essential to a workable indebtedness extension plan. It is unfortunate that this plan has not received more use.

⁴⁹ Countryman, *supra* note 1, at 1461.

⁵⁰ *Id.*

⁵¹ Note, *supra* note 48, at 380.

⁵² Kennedy, *Debt Pooling Arrangements vs. Chapter XIII Proceedings*, 32 *Ref. J.* 109, 110 (1958).

⁵³ N.D. Cent. Code §§ 11-26-01 to -08 (1960).

⁵⁴ Letter from Elmer J. Dewald, Secretary, Judicial Council of North Dakota, Aug. 22, 1967.

There are now several nonprofit credit counseling agencies in cities throughout the country, especially in the Midwest. Many are affiliated with the National Foundation for Consumer Credit.⁵⁵ California, too, is witnessing the birth of what is hoped will become a statewide, free credit service, established on a city-by-city basis by banks, loan companies, credit unions and Legal Aid Societies.⁵⁶ The aim of these organizations is to provide the public with free or inexpensive aid in establishing and maintaining good credit relations, through educational programs, advice and debt adjustment services. Apparently the credit industry is coming to realize their duty to the public to insure that the system controlled by the industry does not victimize consumers by taking advantage of their lack of financial education.⁵⁷

While the spread of these private organizations is fairly rapid, considering their nonprofit character, it is not rapid enough. By the fall of 1966 there were only forty-nine agencies operating in twenty-seven states.⁵⁸ Some catalyst is needed to speed the process, and that will have to be supplied by governmental action, if the growth of these services is to keep pace with the rise in consumer bankruptcy.

The proposed Uniform Consumer Credit Code contains a provision for the licensing and regulation of nonprofit credit counseling agencies.⁵⁹ The measure provides for examinations of applicants to determine their fitness as credit counselors,⁶⁰ requires that an agency keep records of all transactions,⁶¹ and requires that all agencies submit any charges that they propose to make to the licensing authority, which will determine whether the fees are in keeping with the agency's nonprofit character.⁶² These provisions appear to be reasonable and helpful as far as they go, but there is no positive measure designed to assist in the establishment of such agencies. Also, the proposed law is designed as a supplement to existing state laws on debt adjusting, whether prohibitory or regulatory.⁶³ As it is an attempt at a comprehensive code, it would be desirable to include a prohibition of commercial debt adjustment.

The most promising development in this area so far is contained in the recent Texas consumer credit code,⁶⁴ which sets up a comprehensive regulatory scheme for all phases of the consumer credit industry. This act retains Texas' prohibition against commercial debt adjusting,⁶⁵ but in addition includes a positive measure, designed to aid the consumer in credit transactions, and to assist the overextended debtor. An office of the consumer

⁵⁵ Henderson, *Consumer Credit Counseling*, an Interview with Al Hackbarth, Part I, 20 Pers. Fin. L.Q. Rep. 139 (1966).

⁵⁶ Larkin, *Statewide Consumer Credit Counseling Service Being Set-Up in California*, 19 Pers. Fin. L.Q. Rep. 53 (1965).

⁵⁷ *Id.*

⁵⁸ Henderson, *supra* note 55.

⁵⁹ Uniform Consumer Credit Code §§ 7.101-.114 (Tent. Draft No. 2, 1967).

⁶⁰ *Id.* § 7.107(1)(b).

⁶¹ *Id.* § 7.108.

⁶² *Id.* § 7.111.

⁶³ *Id.* § 7.103(5).

⁶⁴ Ch. 274, 1967 Tex. Laws (Vernon's Tex. Sess. Law Serv. 608 (1967)).

⁶⁵ *Id.* ch. 274, Art. 9.02.

credit commissioner is set up, and, among other duties, it is charged with providing "advice, assistance and counsel to encourage the establishment and operation of voluntary non-profit debt counseling services," and with aiding public and private organizations in the "development of voluntary educational programs to promote the prudent and beneficial use of consumer credit. . . ."⁶⁶ It is hoped that this provision will speed the establishment of agencies of the type found in the Midwest and California. An active role, taken by a state official as important as the consumer credit commissioner will undoubtedly prove to be, will swing great weight in influencing banks, loan companies and other credit institutions to assist in providing this service to the public.

The Texas measure is not a complete answer, however. More direct state aid in starting these programs, such as grants of funds, may prove to be necessary. In addition, there is no provision to insure that the financial counseling afforded by these agencies will be really competent. It is true that most of the dangers inherent in commercial debt adjusting, where the adviser has a vested interest in the course of action chosen by the debtor, are not present where a nonprofit agency is concerned. It might be advisable, however, to include regulations similar to those in the proposed Uniform Consumer Credit Code, to insure that the agency actually makes no profit, and that the advisers are experienced in the credit field and able to educate the public properly.

In this last regard, even a credit counseling agency operated by bankers and other experts in finance would offer only incomplete service to the insolvent debtor, since they cannot furnish him with necessary legal advice. If they attempt to provide this advice, there will arise problems in those states where the rendering of legal services, even if done without compensation, is considered as the practice of law.⁶⁷ A requirement that such agencies afford the services of an attorney through a Legal Aid Society would avoid those problems, and at the same time assure more complete financial counseling.

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⁶⁶ Id. ch. 274, Art. 9.01.

⁶⁷ See cases cited note 22 *supra*.