

AMERICAN BANKRUPTCY INSTITUTE JOURNAL

Issues and Information for the Insolvency Professional

Credit Counseling: BAPCPA's Grendel

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With the enactment date of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) quickly approaching, many consumer bankruptcy attorneys feel as though they are entering the dark, scary forest of fairytales. In particular, the new credit counseling provisions may be BAPCPA's Grendel, with the bar waiting anxiously for the arrival of the hero Beowulf to save the day.

Effective Oct. 17, 2005, in order for consumer debtors to gain access to the bankruptcy courts, they must first meet the requirements outlined in §109(h), which include:

[A]n individual may not be a debtor under this title unless such individual has, during the 180-day period preceding the date of filing of the petition by such individual, received from an approved non-profit budget and credit counseling agency described in §111(a) an individual or group briefing (including a briefing conducted by telephone or on the Internet) that outlined the opportunities for available credit counseling and assisted such individual in performing a related budget analysis.

This requirement seems to be causing outright anxiety among the consumer bankruptcy bar, possibly with just cause. Attorneys will be referring clients to mandatory counseling, and many of the providers have earned less-than-stellar reputations.

The Dark, Scary Forest

In late June, the U.S. Trustee Program (USTP) announced that it would begin

accepting applications from organizations seeking to become approved providers of this new mandatory credit counseling.¹ The USTP also posted an application on its Web site.² The application and instructions provided some surprises for industry watchers, since a clear line was drawn between those organizations that offer debt-management plans (DMPs) and those that don't. Perhaps the most surprised was the debt-management industry itself, which for almost a decade had assumed it would be the sole provider of this mandatory credit counseling.

Another unexpected rule required DMP-providing agencies to post "a surety bond payable to the United States in an amount that is the lesser of (1) two percent of the agency's prior year disbursements made from trust accounts...or (2) equal to the average daily balance maintained in all trust accounts for the six months prior to submission of the application."³ Robert J. Barrett, president and CEO of InCharge Institute of America Inc., explained that the bonding requirement for his organization will be somewhere between \$4-8 million. There is a minimum bond requirement of \$5,000 for smaller agencies.⁴



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Though not required by BAPCPA, it would appear that the USTP thought it would be prudent to place a bonding requirement on what some have termed a problematic industry. There is some precedent for this bonding, as §322(a) requires that in order for a panel trustee "to serve as a trustee in a case...such person has filed with the court a bond in favor of the United States conditioned on the faithful

performance of such official duties." These bonding requirements, which appear in §6 of the credit counseling provider application, are only required of organizations seeking approval that offer DMPs. The apparent rationale behind this requirement is that organizations that receive and hold client funds should bond against failure in their fiduciary responsibility.

The surety bond requirement has thrown the DMP industry into disarray, as most organizations claim they are unable to afford them. This, coupled with the clear expectation from the USTP that non-DMP providers would seek approval, has set the stage for what many bankruptcy reform observers feared: the birth of a new cottage industry.

Grendel's Cousin?

During the recent National Association for Consumer Bankruptcy Attorneys (NACBA) bankruptcy workshop held in Chicago, one could not help but notice the disproportionate number of exhibitors offering credit counseling. Of interesting note, only one organization was a DMP provider.⁵ The other organizations were not DMP providers, many of which had just recently formed.

One such new organization is Cricket Debt Counseling, located in Portland, Ore. Cricket was founded this past June by Brian Sunderland, a general practice attorney. "I saw the need that other attorneys would face and the concern about having to refer out to other organizations who would have another agenda." Sunderland wasn't too concerned by the USTP requirement that an organization exist for at least two years⁶ because he feels that the need for alternatives is just too important. "Debt-management providers have great confusion over who their client is—the consumer or the creditor. They get paid by creditors."

Most of the credit counseling organizations at the NACBA workshop appear to be attorney-formed and run. This may provide a different conflict for many debtors'

¹ See www.usdoj.gov/ust/bapcpa/cdde.htm.

² See www.usdoj.gov/ust/bapcpa/credit_counseling.htm. Bankruptcy Administrators (BA), which serve the six districts located in Alabama and North Carolina, have also put an approval process into place that is not dissimilar to the USTP application.

³ Instructions for Application for Approval as a Nonprofit Budget and Credit Counseling Agency, OBM No. 1105-0084 (June 2005) (Adjustment to Bonding Requirement). The original instructions required DMP providers to post "a surety bond payable to the United States in an amount which is the greater of five percent of the agency's prior year disbursement made from trust accounts..."

⁴ *Id.* at 4.

⁵ It should be noted that the author is also the executive director of the Institute for Financial Literacy (IFL), an applicant with the USTP and BA for approval as a provider of the credit counseling. IFL also exhibited at NACBA.

⁶ See *supra* note 4 at 3.

attorneys, who may agree with Sunderland's opinions but may not be so quick to refer to their brethren of the bar.

Rick Gustafson is a partner at Macey & Aleman, the largest consumer bankruptcy practice in the country with offices in 19 states. Gustafson has some reservations about who will provide the mandatory credit counseling. "Consumer bankruptcy is becoming very competitive, and debtor attorneys are operating on a low profit margin. Now attorneys are going to have to be concerned with providers who might refer to a less-expensive attorney. I don't know what their formalized relationships are, and this can be a concern."

But Sunderland said, "attorneys want to just show their client what their options are. I won't benefit from one option over the other." Sunderland formerly practiced in the area of bankruptcy, but stopped seeing clients this past June. "My experience is [that] attorneys are more ethical than credit counselors. My clients have come to me after having been on a debt-management plan for one to two years and they are in no less debt."

Gustafson has found similar experiences: "I'm a bit cynical; the credit counseling industry was just set up as an alternative to collect money from debtors. A lot of my clients have already been to those programs and have fallen out of those DMPs. They put people into programs who should have been sent into bankruptcy. They pay for a year, year and a half and haven't paid down anything."

While most of the exhibitors readily admitted that they had not yet submitted their applications to the USTP, at the workshop this didn't prevent them from marketing their services and in some cases presenting themselves as already having been "approved."⁷

Another trend developing is the packaging of multiple services, including credit counseling, means testing and others. This bundling concept is not yet proven and may even be considered an unacceptable practice by the USTP and BA. One such company, Start Fresh Today, is the invention of **Kevin Chern**, a former bankruptcy attorney from Chicago who now manages an attorney marketing co-op. Chern is offering a combined means-test calculator, credit counseling certifications, debtor education and due-diligence package. Chern's company does not qualify under §111 because it is a for-profit business.

Chern explained that he worked in cooperation with several nonprofit DMP

providers to develop the credit counseling program that will be offered. The marketing materials state: "Start Fresh Today offers a state-of-the-art application to facilitate the credit counseling certification process. We have coordinated a group of reputable, nonprofit credit counseling agencies, and they all meet AICCCA, ISO and UST[P] standards." His firm plans to collect the counseling fee of \$39 and keep 10 percent as an administration fee. There are additional costs for the other services being offered in the package.

Chern is not alone. Another firm, BK Navigators LLC, recently formed in Delaware with offices in Salem, Mass. BK Navigators' spokesperson, Denise Dice, explained that theirs is a computer platform that will put attorneys and credit counseling agencies in touch with one another to offer the mandatory credit counseling. Dice explained that there are 12 DMP providers that have signed up to provide the mandatory credit counseling. When an attorney refers a client, the system will randomly select one of the 12 agencies to perform the mandatory credit counseling. BK Navigators will collect the \$99 counseling fee and then remit \$79 of that to the participating credit counseling agency.

These models pose an interesting question, as all agencies who seek approval from the USTP and BA must agree that they "will not pay or receive referral fees or other consideration for the referral of clients to or by the agency."⁸ Will the funds being kept by the third-party referral source be considered a prohibited referral fee? There is also the question of how the debtor will know or be able to select the counseling provider when the choice is being made by a third-party referral service, and in some cases randomly selected by a computer.

Yet another issue is whether the USTP and BA will be able to determine if an eligible nonprofit credit counseling agency is partnering with a third-party referral service such as Start Fresh Today or BK Navigators. All applicants must "identify each agent or independent contractor who performs credit counseling services on behalf of the agency or that regularly refers clients to the agency."⁹ When asked, Chern did not know if the agencies he is working with disclosed their affiliation with his firm on their applications.

This industry boom has also been reflected within the ABI membership itself. A review of the membership category "Credit Counseling Professional" shows that

since March there has been a 78 percent increase in membership in this category, with seven new organizations joining.

Prof. **Karen Gross**, a professor of law at New York Law School, isn't surprised to see this new cottage industry: "While many people are shocked by the growth of new providers, those familiar with mandatory counseling in Canada were aware that this was an issue and risk. You cannot mandate counseling for two million people virtually overnight and ignore the fact [that] you're creating a multi-million dollar industry."

Grendel and the Cave

Ultimately, the question becomes: What impact will these new organizations have on the traditional DMP industry? That depends. When recently surveyed, it was discovered that many of the organizations who belong to the National Foundation for Credit Counseling (NFCC) had yet to even submit their applications to the USTP.

Winchell Dillenbeck, the executive director of CCCS of the North Coast (Calif.), doesn't expect the new law to have much impact right away: "We don't really expect a lot of activity in the fall; we're gearing up for January."

When told of the new organizations and the Internet-based counseling models, Dillenbeck wasn't too concerned. "Attorneys don't want clients to go on DMPs, but Internet counseling is a conflict of interest," he said. "Clients need to go to a neutral party, and DMP providers would [not] be neutral."

Dillenbeck may not be the only one with concern regarding Internet delivery. Steve Bartlett, president and CEO of the Financial Services Roundtable, expressed similar concerns in a letter to the USTP:

For credit counseling to be successful as envisioned by Congress, face-to-face counseling should be given preference over other credit counseling techniques. Thus, CCF believes that where an agency seeking certification proposes to provide Internet counseling, the Executive Office should take steps to ensure that such agencies provide the type of quality counseling agencies Congress intended.¹⁰

It is also worth noting that both credit counseling trade associations, the Association of Independent Consumer Credit Counseling Agencies (AICCCA) and NFCC, have requested sizable grants from the Financial Services Roundtable on behalf of their members.

⁷ According to USTP spokesperson **Jane Limprecht**, as of Aug. 17, 2005 (well after the NACBA workshop), "the [USTP] has received dozens of applications so far, and continues to receive them on a steady basis. All applications are still under review."

⁸ Acknowledgments, Agreements and Declarations in Support of Application for Approval as a Nonprofit Budget and Credit Counseling Agency, Appendix A, #13 (June 2005).

⁹ Application for Approval as a Nonprofit Budget and Credit Counseling Agency, #2.4 OBM No. 1105-0084 (June 2005).

¹⁰ Letter from Steve Bartlett, president and CEO of the Financial Services Roundtable, to **Steve Dillingham**, Acting Deputy Executive Office for U.S. Trustees (Aug. 26, 2005).

The Arrival of Beowulf

No doubt when the original credit counseling provisions were placed in the early versions of the bankruptcy reform bill, Congress and creditors alike envisioned a system that would educate potential bankrupt debtors about their alternatives. Some of the early language of the bill even considered mandatory DMPs back when the credit counseling industry was viewed in a much different light, prior to the scandals, IRS audits and ever-growing Federal Trade Commission scrutiny.

The intent of Congress was to reduce the number of bankruptcy filings by having consumers first seek out credit counseling and learn about DMPs as an alternative to bankruptcy. Eight years have passed since this language was first introduced, and during this time a once-respected industry finds itself under constant investigation and scrutiny.

In June 2004, the U.S. Senate Committee on Finance held a hearing on charitable giving at which Mark Everson, Commissioner of Internal Revenue, explained the agency's concerns: "We are focusing our audit resources on those organizations with the highest risk of noncompliance with tax law. We have selected 50 tax-exempt credit counseling organizations for examination; the majority of these examinations are currently underway."¹¹

Commissioner Everson was back before the Senate just this past April to update the Committee on the progress of the investigation:

We are taking strong actions to eliminate the abuses... We have revoked or proposed revocation of tax-exempt status for credit counseling organizations representing more than 20 percent of the industry's gross receipts. We are using the knowledge we have gained from examining industry abuse to screen new applications more effectively.¹²

This past July, the National Conference of Commissioners on Uniform State Laws (NCCUSL) successfully passed the Uniform Debt-management Services Act,¹³ concluding their multiple-year effort to craft a uniform law to regulate the credit counseling and debt-management industry. Several states have reworked existing laws dealing with credit counseling or have decided to enact new legislation. Clearly, the enactment

of BAPCPA with the credit counseling requirements has put many legislators and regulators on notice.

Debtor Attorneys and Regulators All Have a Role

As the consumer bankruptcy bar moves closer toward enactment, many are struggling to deal with the issues raised by the new mandatory credit counseling requirements. Attorneys will need to understand what the new law requires as well as what providers of the mandatory counseling plan to offer.

Though the USTP, IRS and even NCCUSL all have a hand in regulating the credit counseling industry, it may very well be that attorneys themselves are ultimately the best defense in protecting their clients from questionable providers. Governmental regulators will be only able to regulate so far. They will need to rely on those working with debtors daily for feedback, information and advice on the effectiveness, delivery and implementation of the credit counseling provisions. ■

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¹¹ Hearing on Charitable Giving Problems and Best Practices Before the Committee on Finance U.S. Senate, 108th Cong., 2nd Sess. (2004) (statement of Mark W. Everson, Commissioner Internal Revenue).

¹² Hearing on Exempt Organizations: Enforcement Problems, Accomplishments and Future Direction Before the Committee on Finance U.S. Senate, 109th Cong., 1st Sess.(2005) (statement of Mark W. Everson, Commissioner Internal Revenue).

¹³ Formerly referenced as the Uniform Consumer Debt Counseling Act.