COMMENTS BY MORGAN DREXEN, INC.
CONCERNING PROPOSED DEBT RELIEF AMENDMENTS
TO THE TELEMARKETING SALES RULE [R411001]

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DISCLAIMER

This submission is tendered by Morgan Drexen, Inc. ("**MD,**" "**Submitter**," or "**the Company**"). The opinions expressed in this submission and accompanying materials submitted confidentially to the Federal Trade Commission ("**FTC**" or "**Commission**") solely are those of the Company[1]; do not necessarily reflect the views of any law firm that contracts for outsourced services by the Company; do not necessarily reflect the views of any near-bankrupt law firm's client who receives outsourced services by the company's paraprofessional staff; and, if confluent with views expressed by other submitters, were developed and are presented independently and not in conjunction with or based on discussions with any other submitter.

I. SUMMARY:

A. THE NOTICE OF PUBLIC RULEMAKING TO AMEND THE TELEMARKETING SALES RULE.

Pursuant to Federal Register Notice on August 19, 2009 ("NPRM"), the FTC proposes to conduct a Rulemaking proceeding [Number R411001] intended to further modify the Telemarketing Sales Rule, 16 CFR Part 310, by: (1) defining "debt relief service" and applying it to services rendered by attorneys and others under their supervision [NPRM at 94]; (2) prohibiting any advance payment for "debt relief services" until fully performed and documented to the debtor; (3) applying the so modified rule to every form of advertising that involves inbound or outbound telemarketing for "debt relief services," thereby modifying "the general media exemption and the direct mail exemption (Sections 310.6(b)(5) and 310.6(b)(6)) to make them unavailable to telemarketers of debt relief services" [NPRM at 87]; (4) requiring certain mandatory disclosures, and (5) prohibiting misrepresentations concerning "debt relief services" (which predominantly concern generally abusive conduct (e.g., threats, intimidation, use of profane or obscene language, etc.)[16 CFR 310.4(a)].

The Commission has invited "comments on all issues raised by the proposed amendments" [NPRM at 1] and specifically seeks "answers" to numerous questions [NPRM, Part VIII, at 109-118]. MD provides these comments to the NPRM, answering many questions posed by the Commission, commencing at page 14 of this submission.

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1 MD's comments and data that provide non-public, proprietary information (*e.g.* financial information maintained confidentially, or information deemed a trade secret by Submitter) are filed separately in paper form, marked "Confidential" in compliance with 16 CFR Section 4.9(c). Such confidential information is referred-to by numbered reference in this public submission as "**MD #**__" to facilitate the Commission's review and analysis, without revealing the underlying non-public information.

B. MD'S OVERALL POSITION IN THE PROPOSED PROCEEDING TO FURTHER AMEND THE TELEMARKETING SALES RULE.

In this submission MD reaffirms its publicly stated position that it supports *partial* federal regulation of debt relief services.[2]

Financial modernization efforts undertaken by the Obama Administration and by Congress present a unique and important opportunity to create and implement appropriate federal regulation of the debt relief services industry. Such regulation is needed to improve the outdated and inefficient patchwork of state laws that regulate credit from its establishment to its extinguishment.

The lack of appropriate federal standards: (1) significantly increases compliance costs (which necessitates higher consumer fees); (2) limits a consumer's choice of options to select a credit relief-related service best suited to his or her needs; (3) retards market-driven, alternative solutions to Chapter 13 bankruptcy, for clearing unsecured debt that overhangs and impairs the nation's economy[3]; (4) unfairly preserves outmoded, asymmetrical laws originally enacted to accommodate consumer credit counseling services preferred by credit issuers. These laws arose in a different legal era long before creation of debt settlement services as one of the now important, market-driven options to better achieve objectives that consumers need when they encounter true circumstances of hardship (such as in instances of personal of family medical emergencies, loss of the ability to repay because of sustained recession in the economy, or materially adverse, durable personal misfortunes that preclude fully meeting contractual unsecured credit obligations [*e.g.*, death in a family, divorce, employment termination, loss of a small business coupled with inability to obtain employment at or near comparable salary, etc.]; and (5) has contributed to the Commission's now misguided attempt to rein-in allegedly "deceptive and abusive practices"[4] "unscrupulous practices,"[5] "false representations,"[6] "abusive

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2 *See*, MD's "Comments Submitted in Connection with the FTC Debt Settlement Workshop," December 1, 2008, http://www.ftc.gov/os/comments/debtsettlementworkshop/ 536796-00042.pdf.

3 "… [T]he unstated goal of the 2005 bankruptcy law was to raise the cost of filing and lower the benefit of doing so that consumers would wait longer to file bankruptcy while paying huge default interest rates and penalty fees." *Credit Slips* blog posting by Bob Lawless on August 25, 2009. Please see: http://www.creditslips.org/creditslips/2009/08/another-sign-of-the-futility-of-the-2005-bankruptcy-law.html; *see also* "Did Bankruptcy Reform Fail? An Empirical Study of Consumer Debtors," Lawless, Littwin, Porter, Pottow, Thorne, and Warren, *American Bankruptcy Law Journal*, Vol. 82, pp. 349-406, 2008.

4 NPRM at 40.

5 NPRM at 64.

conduct generally,"[7] and *presumed* "unfairness"[8] by some unknown number of unscrupulous debt settlement service providers.

The development of debt settlement services is a national phenomenon never envisioned by state legislatures at the time many laws were enacted that address other "debt relief" types of entities or methods of protecting creditor rights, debtor obligations, and most importantly "consumer sovereignty."[9]

Entities that provide debt settlement services typically service clients across the nation. The costs of complying with the divergent state laws can be prohibitive. Nevertheless, by its very nature debt negotiation and settlement tactics tend not to vary from state-to-state. This augurs for sound national regulations, not the outmoded, fragmented, state-by-state hostile regulatory approaches often written in ways that summarily preclude debt settlement services.[10]

In the Comments, below, MD explains: why it does not support the Commission's premise that, "advance fees for debt relief services" *necessarily* is "an abusive practice" [NPRM at 70]; and why MD does not support the Commission's skepticism about the "ability [of legitimate, well structured debt relief services] to deliver represented results" [NPRM at 80].

Based on MD's own proven experience, represented in competent, reliable, quantifiable data submitted by: (a) MD in confidential responses to the Commission's request for such data

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6 NPRM at 66.

7 NPRM at 68.

8 NPRM at 82.

9 *See* "The FTC's Use of Unfairness Authority: Its Rise, Fall, and Resurrection," J. Howard Beales, [NPRM, fn. 227]; http://www.ftc.gov/speeches/beales/unfair0603.shtm.

10 State legislation that only provides for, or confers, preferential treatment to consumer credit counseling services ("CCCS"), historically was supported by deceptively described "fair share" financial payments made by the credit issuers to "not-for-profit" credit "counselors." This cozy arrangement cloaked credit counselor's patent conflicts of interest detrimental to consumer welfare and euphemistically sometimes has been referred-to as a "soft collections practice." It really appears to have been contrived to connive consumers into believing the CCCS would independently assist the consumer with a budget and help stop interest and penalties from continuing, when in reality it essentially supported creditors interests in receiving all principal, interest, and penalties – even if that meant the consumer would end up paying the total debt over an extended period of time, not a discounted debt.

(and referenced elsewhere in this submission), as well as by (b) the wealth of data already in the Commission's possession from several actions brought by the Commission, the premise for the NPRM is flawed (as discussed in detail and in accompanying statistical analysis, elsewhere in this submission).

MD is [and presumably many other providers are] performing admirably within the expansive consumer lending marketplace.[11] The proposed Telemarketing Sales Rule amendments would subject many small companies – including law firms throughout the country – to intrusive, time consuming federal reporting requirements:

- It would force on them contingent-fee arrangements (because no "up-front or progress billing could be charged);
- It would add great restrictions to advertising [including advertising in local telephone books, road billboards on Interstate highways, law firm newsletters, as well as TV and radio advertising], all because these may provide a toll-free number for inbound callers;
- It would deny the opportunity for distressed debt holders to discuss their legal problem with a lawyer;
- It would add a layer of unwarranted complexity to, and attempt to expand existing state Bars' advertising restrictions (which would need to be amended throughout the country to address the FTC's intrusion into and interference with the practice of law), to apply to any law firm that provides debt settlement services and offers a toll-free telephone number in mass advertising (including telephone books), as a convenience to prospective clients;
- It would impose high compliance costs with potential fines or subject lawyers to having to defend their practice of law in Commission proceedings;
- It would undermine the attorney-client privilege (which predates the U.S. Constitution), the Attorney Work-Product Doctrine (created in 1947 by the Supreme Court in *Hickman v. Taylor*, 329 U.S. 49), and portions of long-standing, comprehensive, state-based police powers enforced by state judiciary systems, set forth in the "Code of Professional Responsibility," which regulates lawyers;
- It would abrogate multi-year legally binding contracts with debt settlement clients *ex post facto*, because properly disclosed services and limitations have been offered, accepted, and are being performed by debt settlement companies for

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[11] "[D]ebt settlement can provide some real benefits for consumers. For example, a debt settlement firm can advocate on the consumer's behalf, especially in cases where consumers are reluctant, embarrassed, or even afraid, to contact their creditors directly. A debt settlement firm also may be able to provide individualized attention to consumers, taking a holistic approach to all of the consumer's unsecured debt owed to several creditors, rather than just the amount owed to a particular creditor." Remarks by Commissioner J. Thomas Rosch before the Annual Credit and Collection News Conference, Carlsbad, California (April 2009). *See*, http://www.ftc.gov/speeches/rosch/090402debtsettlement.pdf.

clients partially through a multi-year process to enable them to become debt-free; and

- It would undermine MD's legitimate and well functioning outsourced paraprofessional services business model, even though MD has not contributed to the asserted "unfairness" or "deceptiveness" that the Commission asserts as a basis to twist the federal Telemarketing Sales Rule like a pretzel, into federal government powers well beyond what Congress ever intended for that legislation.

II. INFORMATION ABOUT MORGAN DREXEN, INC:

A. MD'S HISTORY:

Morgan Drexen, Inc. was founded in March 2007 with a half-dozen employees. It is headquartered in modern offices in Anaheim, California and currently has 300 employees at that location. MD provides administrative, marketing, paraprofessional and paralegal support services to law firms that represent near-bankrupt debtor-consumers throughout the United States.

MD's highly trained support staff and automated client services IT platform enable law firms to service a greater number of near-bankrupt clients, more efficiently, with unbundled legal services, with a greater level of attention and at far lower cost than would be possible in the absence of MD's proprietary approach.

Morgan Drexen, Inc. defines the overall outsourced services it provides to law firms, or on their behalf to near-bankrupt clients of those law firms, as constituting "**debt settlement**." The company's nomenclature appears to be more comprehensive than portrayed in the Commission's discussion concerning "for-profit debt settlement services," [NPRM at 21 to 28].

B. MD'S SERVICES FOR LAW FIRMS:

While not all law firms contract for every service MD can provide, MD offers the following unbundled services:

1. Accounting and Financial Reporting: Internet-based processing and reporting of accounts receivable, accounts payable, automatic payroll deposits or preparation of checks; trust account maintenance [daily attorney-approved disbursements and reports, monthly reconciliation, yearly audits];

2. Front and Back Office Paraprofessional Assistance [please *see* Confidential Business Process Flowcharts **MD #B-1 through MD #B-14** that depict the following services]**:**

[**a**] client screening and intake assistance (*inter alia*, verifying hardship at intake [see Confidential Chart **MD # B-6]** (to assure the existence of a

hardship that qualifies for debt reduction and to determine what amount of money can be set aside regularly to build a fund to pay-off debt); ascertaining *with prior client approval* a FICO score (to help verify a hardship), income and expenses; determining that the client appears to be a suitable candidate for debt settlement; creating a budget that includes routine electronic transfers to an attorney's trust account; administering extensive, recorded disclaimers and responses, assuring client understanding about the obligations he or she will be undertaking – all with consistent Quality Control procedures and exception reports to assure the attorney and the attorney's client are informed or made aware of all events and developments;

[**b**] routine data collection and processing to assure all relevant information is obtained concerning a law firm client's unsecured debts, by building a fully relational database that enables processing the daily high volume throughput necessary to service operations at an efficient scale and scope for the law firms and their clients;

[**c**] consistent, long-term, personalized communications and interaction with each law firm's client (that involves assisting development of willpower to become debt-free, counseling clients on difficult financial choices that arise in dealing with unsecured debtors over the span of their endeavor [which may be for 3 to 5 years], maintaining written and verbal communications that encourage clients to learn to live without instant gratification expenditures paid for by credit, to adjust to live within their means, and to continuously build their fund in the attorney's trust account to pay-off creditors either with lump-sum settlements or structured payouts over varying durations and with discounts negotiated by Morgan Drexen, Inc. and supervised by the client's counsel; avoiding succumbing to creditor entreaties to discontinue; and avoiding the stigma and long-term detrimental effects of bankruptcy;

[**d**] negotiating with creditors;

[**e**] assisting attorneys by obtaining legal documents and providing Internet-based docketing, by arranging *appointment calendaring for lawyers*, by notifying attorneys when lawsuits are filed by third parties or documents require responses, by arranging telephonic appointments for attorneys, by making daily paralegal updates to databases, *preparing settlement documents for lawyers' review and approval*;

[**f**] preparing and accurately processing settlement offers for attorney's approval then paying-off credit holders at negotiated discounts; and

3. **Marketing Services:**

[**a**] creating, producing, and placing television and radio commercials in suitable media and tracking performance by various measures);

[**b**] creating an Internet presence for law firms through Web site creation and maintenance;

[**c**] designing logos and ligatures (for Web sites, stationary, business cards, etc.);

[**d**] handling reporting of advertisements to state Bar officials, where required;

4. **Database Design, Maintenance and Access:** collecting data and maintaining a fully relational, proprietary database that provides Internet-based, encrypted/password protected, secure, and real-time access to all client matters, on a "24/7" basis from remote computers and portable devices such as iPhone™, Blackberry™, Trio™, etc.);

5. **Capability to Provide Custom "Dashboards" and "Benchmarking"**; *and*

6. **Capability to Provide Complete Web-based Human Relations Services.**

C. MD'S EXECUTIVE TEAM:

MD's has an Executive Team that has been building for future development of the Company's business model. It is a team with the level of experience more typically seen at corporations with long-established market presence.

MD's **Chairman** of the Board was one of the founding executives of Ditech Mortgage Corporation (the nation's first Internet-based mortgage provider), subsequently pioneered automation of debt settlement services as an executive with a former debt relief services company, and is a trained concert orchestra violinist. [He is a signatory to a FTC consent order, which was entered into "without adjudication of any issue of fact or law" (Settlement Agreement, at 3); in which he categorically did not admit, and specifically denied "liability as to the charges in the Complaint… [which] shall not be interpreted to constitute an admission that he has engaged in any violations of any law or regulations" (Stipulated Findings of Fact, at 4, ¶7); the Final Order "is remedial in nature and shall not be construed as the payment of a fine, penalty, punitive assessment, or forfeiture" (Stipulated Findings of Fact, at 4, ¶13); and he neither has violated nor facilitated anyone else to violate the Final Order. He is observant of all FTC regulatory requirements and initiatives.]

MD's **President** is a former Assistant Florida Attorney General; FTC Bureau of Competition Attorney Advisor and FTC "Complaint Counsel" (in a fully and successfully adjudicated Part III matter); a Special Assistant United States Attorney (Fraud Section); is included in *"The Best Lawyers in America"* (2009), Chambers USA *"America's Leading Lawyers for Business"* (2009), International Bar Association *"Who's Who Legal"* (Competition Law) (2009), *"Top Lawyers," South Florida Legal Guide* (2009), *Florida Trend Magazine's "Legal Elite"* (2008), *Florida "Super Lawyers"* (2008), is "AV" rated by *Martindale-Hubbell Law List* (for over 25 years); a recent member of the Florida Supreme Court Task Force on Complex Litigation (2006-2008) [which proposed and wrote Florida's new Rule of Civil Procedure for Complex Litigation, Rule 1.201, *see* http://www.floridasupremecourt.org/decisions/2009/sc08-1141.pdf; made extensive technology recommendations to accommodate proposed statewide electronic filings; and crafted new filing forms for use in civil cases, including a more comprehensive Civil Cover Sheet *see http://www.floridasupremecourt.org/decisions/2009/sc08-1141a.pdf* (October 15, 2009)]; former Chair of the Editorial Board of *The Florida Bar Journal*, Editor of *The Florida Bar Business Law Journal* (2009), Adjunct Professor of Law, St. Thomas University School of Law (1984-94), and is Board Certified by The Florida Bar in Antitrust and Trade Regulation Law as well as in Intellectual Property Law.

MD's **Chief Financial Officer** has a B.A. in Economics and a MACC degree (Masters in Accounting) from Brigham Young University. He is a Certified Public Accountant who worked for 4 years with Deloitte & Touche, LLP, then was Divisional President of RSM EquiCo. [part of RSM McGladrey] (for 4 years), then Interim VP of Finance and Controller of a sports manufacturer, CFO/COO of a property maintenance company, and Vice President of a financial due diligence firm that provided advisory services to strategic and financial buyers in private equity groups before he joined MD. He possesses 13 years financial and operational experience with numerous "Fortune 500" companies, small publicly held middle market companies, and private equity groups; has strong command of financial theory; and is skilled at managing cross-functional teams and implementing financial metrics and processes to improve productivity.

MD's **Vice President of Human Resources** received her B.A. in Applied Psychology and her M.S. in Industrial/Organizational Psychology from California State University; Senior Professional Human Resources Certification; DiSC Assessment Certification; over 20 years of experience in several public companies, including work for McDonnell Douglass Corp. (currently Boeing Corp.), National Education Centers, Inc., Volt Information Sciences, Inc., Trojan Battery Corp. (for 7 years) as Director of Human Resources, then The Merit Companies (for 3 years) as Vice President of Human Resources with 500 employees, 8 regional offices and 50 on-site locations, before joining MD.

MD's **General Counsel** received his J.D. from the Hastings College of Law at the University of California (where he was a member of the National Moot Court Team), and has 17 years of experience in the law, first as an attorney (for 6 years) with a large Los Angeles-based law firm, then as General Counsel (for 5 years) with a large dental HMO with over 150 mall locations in the West and 3,000 employees, then as Director of Regulatory Affairs (for 2 years) with a very large

HMO that created consumer-oriented health benefit plans and services in 20 states, then as General Counsel (for five years) at another large dental HMO with over 70 mall locations in California and Nevada and 1,200 employees, after which he joined MD as its General Counsel.

MD's **Chief Operations Officer** attended Northeastern University, has worked for the Company since its inception, recently attended courses at the Kellogg School of Management, and has direct responsibility for all day-to-day operations. She monitors internal workflows and processes to assure sustained levels of efficiencies and effectiveness, assures that employees maintain a strong client-service orientation, considers departmental workloads and makes recommendations concerning reporting relationships throughout the organization, continually analyzes all internal operational systems across the company to assure standards are met and that the company is doing its best to meet the current needs of the law firms MD supports, and takes immediate actions to address challenges, re-deploy personnel, bring cross-departments anomalies to the attention of supervisors for corrective measures, and advises the President, CEO, CFO, HR Vice President, or IT Director about urgent matters that may require their input or direction.

MD's **Chief Software Architect** has worked for the Company since its inception. He received his B.E. from Pune University (India), and has over 15 years experience in project management, business analysis, application life cycle, developing and deploying Web-based and Client-Server applications, with in-depth knowledge of Microsoft® .NET Framework, COM architecture, Oracle® 7.3, SQL Server 6.0, C++, Microsoft® Access, etc. He previously worked for Visibility, Inc. (an ERP solution provider), Goldman Sachs & Co. (as a Senior Developer [a financial services company]), WiseUp.com (as a Senior Programmer Analyst [an E-Commerce Website]), London Financial Group (as Lead Programmer and Analyst), United Consumer Law Group (as Lead Programmer and Analyst [a firm specializing in bankruptcy law]), SoLidium.com (as Senior Programmer/Analyst [an E-commerce Website]), Financial Rescue Services (as a Systems Analyst [a debt settlement company]), and was a System Analyst at NCC [a debt settlement company]), prior to joining MD.

MD's **IT Director** has an AA degree in Business Administration (and is working on obtaining a Bachelor's degree), a strong technical and managerial background with 23 years experience as Director of Information Technology and as a Management Systems Director for several mid-size companies in California, is Microsoft Exchange Certified, and is acquiring Cisco Certified Network Certification. The IT staff under his direction supervises VoIP technology, optical character recognition scanners, as well as all computer upgrades, maintenance, and testing. The Company utilizes a robust IP network with a 1GB fiber/copper backbone; redundant Juniper firewalls; high availability Cisco switching, and Microsoft Clustered Servers to provide fault tolerance in all key aspects of server infrastructure. MD uses the latest in technologies from Cisco, Microsoft, ESet, IBM, Juniper, and VeriSign encrypted software to assure security and stability of its IT infrastructure providing on-the-fly redundancy and back-up recovery systems that insure the integrity of all law firm client documents and data.

MD's **Administrator of Legal Liaison Services** has a B.A. in Psychology from California State University, is Board Certified as a paralegal assistant by the University of California, and currently is attending the M.B.A. program at the University of California (Irvine campus). She previously served as Manager of Risk Management at Argent Mortgage Company for 4 years, and then was Manager of Risk Management in the Litigation Department of Citibank, N.A. for a year and a half before joining MD. Her assistant also attends a M.B.A. program.

MD also is proud to employ numerous colleagues at various levels in the Company who have received or are pursuing advanced degrees. Well trained, experienced middle management run each of MD's constituent Departments, providing "bench strength" within the Company, Department by Department.

D. MD'S FUNCTIONAL DEPARTMENTS THAT ASSIST LAW FIRMS WITH DEBT SETTLEMENTS:

The twelve flowcharts in composite Confidential Exhibit MD #B-1 to MD # B-14 accurately depict the Company's functional Departments devoted to providing outsourced services to law firms that represent near-bankrupt debtor-clients. MD developed the departmental structure reflected in these charts to accommodate a growing scale of operations as the number of law firm clients (discussed in Confidential Exhibit **MD #A-1**) expands, and the velocity of settlements significantly increases as clients steadily build a fund of money to pay-off credit holders (depicted in Confidential Exhibit **MD #A-1**). Because MD's business model is properly constructed to work with attorneys – for the reasons explained in Comments to Commission Question RFA(2) at page 58 of this submission – there are numerous decision trees and input points for attorney supervision, as needed.

The flowcharts describe the reliance on the Company's comprehensive computer database but do not discuss the various constituent proprietary programs on which MD relies, or the hardware it uses. MD is heavily dependent on a totally computer-based, "paperless" work environment.

MD has invested heavily in developing software. It employs numerous programmers and a UI designer, all of whom work in the Microsoft .NET Framework™ environment, with rack-mounted, latest generation, dual Zeon servers. The Company recently invested in a MAS500 accounting system to accommodate more law firms that may contract for outsourced paralegal and paraprofessional services in debt settlement matters for their clients.

E. THE IMPORTANCE OF REASONING BY ANALYSIS, NOT ANALOGY:

It would be ludicrous to suggest that MD would have assembled such a qualified group of upper management, with a complement of experienced middle management; have developed such a comprehensive business model for providing paraprofessional services attorneys, or have

created such a highly functional corporate infrastructure simply to "take consumers' money for services that… [it] has no intention of providing and in fact does not provide." [NPRM at 70-71.]

Consequently, to lump MD in with 1000 [NPRM at 88] to 2000 debt relief companies [NPRM at 97], is to reason "by analogy rather than by reasoned analysis."[12] It would deleteriously impact many lawyers for whom MD works[13], raise Constitutional issues concerning whether the FTC can or should attempt to regulate the practice of law, create great financial harm to MD, and – if the NPRM proceeds as currently is proposed – would significantly harm consumer welfare.

Because the provision of legal services to near-bankrupt debtors cannot be performed on a skilled, consistent basis without sufficient funding to cover total costs, including a return on the practitioner's investment, the Company is able to provide suitable services to law firms by adopting an innovative approach to the unbundled provision and supervision of services for that segment of clients. To best understand MD's "just in time," unbundled services business model and the essential nature of outsourcing of paraprofessional support to MD, it is appropriate to understand the importance of choice and innovation in the context of consumer welfare.

F. CONSUMER WELFARE: CHOICE OF OPTIONS, FOSTERING INNOVATION

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[12] Nagin, "After GTE Sylvania; Vertical Restraints Limiting Intrabrand Competition," *The Florida Bar Journal*, Vol. 51, No. 7, at 439 (1977).

[13] Law firms are accustomed to outsourcing various services to third parties. Some law firms employ "runners" to file documents with a court; others outsource that function to a local courier service, or use an overnight delivery service (*e.g.*, Federal Express, United Parcel Service, etc). Most law firms outsource copying of significant quantities of documents to a copying service; others handle it in-house. Some small law firms outsource legal research to a remotely located company that employs researchers; others handle it in-house. Some law firms hire an investigator; others contract for such services from third parties. Some law firms outsource review of documents obtained in discovery to a forensic accountant; others employ the forensic accountant in-house. Some law firms outsource computer forensics (to restore deleted e-mails and computer files or to construct a minute-by-minute or keystroke-by-keystroke chronology of a person's computer activity at a crucial time), others possess that expertise in-house. Some lawyers prefer to check the background of an adversarial expert or fact witnesses for issues that might be used to impeach his or her credibility or to show bias; others outsource that work to a third party. Some law firms may be hired to assist a client in preserving or expanding market share, and choose to hire a consultant to obtain information about their competitors' strategic plans and product pipeline; others assign the task to an in-house paralegal. Outsourcing of functions that law firms could handle in-house is a time-honored practice. The lawyer who outsources ultimately retains responsibility for final product, may need to supervise third party resources at critical junctures to control costs, must sign or approve ultimate acts or practices that will change rights, duties, liabilities, powers, etc. (as is discussed in more detail in response to Commission Question RFA(2), below.

ACHIEVING ECONOMY OF SCALE; UNBUNDLING LEGAL SERVICES:

According to the June 15, 2009 issue of BusinessWeek magazine, "…the past decade has seen far too few commercial innovations that can transform lives and move the economy forward" which has "contributed to today's financial crisis." *Id.* at 34. Over the past dozen years, every television news program has from time-to-time covered technological breakthroughs in cancer treatments, cloning, fuel-cell-powered automobiles, gene therapy, smart phones, flat-screen televisions, improved drug development, miniaturized silicon-based machines, satellite-based Internet service, speech recognition technology, artificial tissue engineering, and – most lately, use of Facebook and Twitter to provide alternative news coverage of embargoed world events.

However, where are the reports of innovation in the practice of law? The fact is, the practice of law is resistant to change and does not embrace innovation. It should. It needs to. If there is one constant that clients abhor, it is high and unpredictable cost of legal services.

The same BusinessWeek issue portrayed the current severe financial recession through "a plausible narrative for the financial bust that gives a starring role to innovation – or rather, to the lack of it." According to the magazine, "Consumers borrowed against their home equity, assuming their future incomes would rise." Further, "[t]his underlying optimism about the economy's growth potential became an enabler for Wall Street's financial shenanigans and greed." Moreover, "the credit market collapse in September 2008 reflected a downgrading of expectations about future growth, which put trillions of dollars of debt underwater." *Id.* at 40.

The magazine suggests, "[w]hatever the ultimate cause of the downturn, a pickup in innovation would provide a welcome economic boost. In part that could come from information technology…." *Id.* It also should come from finding ways to serve near-bankrupt debtors whose under-performing or non-performing repayment of unsecured debt is a huge overhang on the nation's economy and an impediment to enabling banks that must turnover reserves committed to existing debt.

The June 2009 issue of the *Harvard Business Review* ("HBR") published an insightful article on "Innovation in Turbulent Times." The authors write that "creativity that leads to game-changing ideas is missing or stifled" in many organizations." That sentiment surely is equally applicable to law firms and to the way the decisional law progresses. According to the authors, "If you don't have highly creative people in positions of real authority, you won't get innovation" because "creative people typically imagine a whole picture and see every innovation as a part that has to fit that whole. They are less concerned with perfecting any one component than with creating a brand statement that enhances the entire customer experience." *Id.* at 80.

The HBR piece explains, "Conventional companies [law firms] look at innovation differently, and wrongly. Without creative people in top positions, they typically focus on innovations that can be divided and conquered rather than those that must be integrated and

harmonized. They break their innovations into smaller and smaller components and then pass them from function to function to be optimized in sequence. The logic is simple: improving the most important pieces of the most important processes will create the best results. But breakthrough doesn't work that way." *Id.* at 81.

By way of explanation, "…the iPod offers an overall experience – including shopping, training, downloading, listening, and servicing – that the others have not yet matched. Little wonder that many companies may increase their patent portfolios yet grow disillusioned with their innovation efforts." *Id.* This paradigm expressed as an "overall experience" for iPod and iPhone™ users, serves as a model for how MD's business model performs.

For sole practitioners and small law firms (with less than a dozen attorneys), the best opportunity to embrace innovation is to align with a strategically positioned company, such as MD, that provides an innovative approach to enable lawyers to focus on what they do best, namely: (a) provide advice to clients, not simply process paperwork; (b) use legal judgment to review settlements for sufficiency (to assure they extinguish a debt and achieve a meaningful reduction for the client); and (c) supervise paralegals and paraprofessionals at all critical junctures involving such settlements; and when necessary, (d) assist clients with limited advice and counseling on how to deal with collection suits. This is completely consistent with **MD Appendix I**, "Hohfeld Analysis of Legal Relationships Defines the Practice of Law."

When it comes to clearing the overhang of non- and under-performing unsecured debt, the more astute banks recognize that a well functioning debt settlement organizational model serves as a "hedge" to what was and is, essentially, an actuarial exercise with respect to repayment expectations. It enables the credit issuer to concentrate on other mission-critical issues.

Increasingly, large credit issuers may sell tranches of non- or under-performing credit obligations to investor attorneys who purchase those debt obligations at a significant discount and then work the files to attempt to achieve a higher return on their book of assets (i.e., the investment in packaged debt obligations). Some credit issuers continue to use collection law firms that consist of a few attorneys and a slew of paralegals who actually handle all the day-to-day functions (processing paperwork, negotiating, preparing legal documents for a lawyer's signature), and may be paid for their productivity with bonuses.

What MD has done is to create an extremely efficient mirror image of the long standing organization of the better collection law firm model – in a more innovative way, enabling counsel in the state where a near-bankrupt debtor lives to have access to a limited services model, with informed client approval. This model capitalizes on economies of scale by using considerable infrastructure concentrated in one state-of-the-art facility in one location [Anaheim, California] to

perform what otherwise would be a high volume of dreary back-office services that small law firms otherwise would need to perform less efficiently.[14]

The procedures and course of dealing in the credit and collection industry operates on a continuum with predominantly a national scope of practice with few aspects based on knowledge of law in a given state. Nonetheless, for those occasions when knowledge of local practice or procedure is needed, locally based counsel provides that knowledge to tailor pleadings or other filings for *pro se* litigants and to assure every settlement document meets local requirements.

Just as Delta Airlines or American Airlines might outsource a call center to a remote location, a small law firm may utilize Morgan Drexen, Inc.'s experienced staff of intake paralegals to qualify clients, procure paperwork and process files electronically, handle client support (except when the judgment of undersigned counsel is needed), handle preliminary negotiations with their counterparts in the creditor's collection law firms, and then electronically provide documents for counsel's review and approval to initiate settlements for clients.

MD's own creative studio prepares Web sites for law firms, as well as logos, and creates marketing campaigns for the lawyers who choose to utilize that service. MD has audio-video crews at its disposal in its own production studio where inexpensive, creative television and radio commercials are produced using actual clients and lawyers in interactive settings. The MD Web site is used for informational purposes; not to sell any service to retail consumers. In fact, there is nothing any consumer can buy or contract for from the Company's Web site.

The lawyer who engages MD for services has access to all assigned clients' files, 24/7. At any time he or she can go "on-line" to review paralegal notes and appointments, as well as to check the status of each and every client's situation and all changed circumstances. If a client's circumstances materially change and any client becomes a candidate for bankruptcy, undersigned counsel can pursue that option if warranted. The system far exceeds the level of efficiency any small law firm could afford. With it, a small law firm can go "toe-to-toe" with a large creditor law firm.

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[14] Analogy also can be made to the advent of "Medical Management" service providers to physicians. With increasing frequency, small private medical practices engage a "Medical Management" company to handle all non-physician-related services for patients, such as staffing, patient scheduling, billing, accounting, and the like. Some doctors choose to have a small laboratory within their office to provide immediate results for simple blood-work; others outsource that to a laboratory, which provides an analysis via e-mail. The doctor remains responsible for reading lab. results, diagnosing symptoms, devising a treatment plan, prescribing medicine, explaining possible side effects, providing follow-up care, counseling the patient on alternative regimens in the event a treatment plan is ineffective or has unacceptable side effects, and referring a patient to a "specialist" in the event needed.

III. MD's COMMENTS TO THE COMMISSION'S "GENERAL QUESTIONS FOR COMMENT" AND "QUESTIONS ON PROPOSED SPECIFIC PROVISIONS"

The Commission has posed "general" and "specific" questions for which it seeks comments. [NPRM at 109-118.] MD answers (to the extent it is knowledgeable about the issue or facts) as follows:

A. General Questions for Comment:

Question A-1 How would the proposed Rule impact different entities or the provision of different types of debt relief services? Please provide as much detail as possible. Useful information would include information about the services provided by particular entities or types of entities, and how different entities perform their services.

a. In particular, do entities differ in how they currently collect their fees, *e.g.*, what payments are required before the services are begun, what payments are required while services are being provided, and what payments are not collected until after the work is completed? Which providers of debt relief services currently require consumers to make some payment before services are completely provided? Which entities do and do not require such payments? How much of the total fee do the various providers charge prior to completion of the services being offered?

b. How do the various types of entities measure their success in providing the represented services and what level of success are they able to achieve? (Please provide data to support these representations.)

MD'S ANSWER TO QUESTION A-1[a]:

Morgan Drexen, Inc. is not a member of any trade organization. It does not specifically know – other than what the FTC has asserted in the NPRM, in its report on a workshop conducted in September 2008, in reported court decisions from actions it brought, or in scholarly articles – how other entities may be organized or the manner in which they may be assisting near-bankrupt consumers in dissolving, reversing, paying-off, or extinguishing non-secured debt obligations. Consequently, with regard to matters concerning competitors or about facets of the line of commerce to which the Commission refers in its proposed term "debt relief services" for which facts MD is uninformed by corporate knowledge, it limits its comments and answers at this time, reserving the right to supplement its comments or answers consistent with Part II Rules.

Although Submitter lacks particularized factual knowledge to comment with regard to current entities other than it, MD believes that "the proposed Rule impact" has the potential to produce a devastating effect on consumer welfare. Its assessment is based on legitimate concerns that a "lead generation" business model that extracts all or the predominant portion of revenue (and profits) in a manner inconsistent with the labor, capital infrastructure, human resources,

extended workflow, and concurrent cash-flow needs of the endeavor, would materially misalign servicing and fulfillment interests of near-bankrupt debtors with the fulfillment interests of originators and service providers. Moreover, the velocity of intake could imperil the success ratio of the endeavor in a total up-front business model.

MD believes that for proper service to a growing base of customers, a lead generator model must provide for increased back-end capability to service that growing base of customers over time. With just a front-end payment of 15% (which MD understands may be commonplace), there would appear to be little incentive for fulfillment entities to provide more than minimal services, or triage of services in a manner inimical to the near-bankrupt debtors' interests.

Such a lead generation model could produce a potential Ponzi-like outcome if the up-front intake is insufficient to sustain the enterprise over the extended duration of the fulfillment endeavor. In such a scenario, earlier customers might be paid from money obtained from later customers, whether caused by: (a) an *internal dysfunction* (e.g., poor management decisions or, perhaps, greed-induced squabbling between the equity participants that reduces available resources to fulfill obligations), or by (b) an *externality* such as a *force majeure* or a severe recession causing widespread unemployment and consequent inability to save, or increased regulatory efforts not unlike those in the proposed amendments to the NPRM. In either such circumstance lead generators would be driven out of business immediately upon implementation of the Rule amendments or ultimately by abandonment of a resultant endeavor that has become too costly to maintain.

MD'S ANSWER TO QUESTION A-1[b]:

MD is not in a position to know the methodology applied or the underlying data others might use internally to measure their "success," aside from what has been reported in published professional articles about the line of commerce (*e.g.*, "Economic Factors and the Debt Management Industry," Richard Briesch, Ph.D., *Americans for Consumer Credit Choice*, August 6, 2009; "Debt Settlement: Fulfilling The Need for An Economic Middle Ground," Bernard L. Weinstein, Ph.D. and Terry L. Clower, Ph.D., *United States Organizations for Bankruptcy Alternatives*, September 2009), and in public filings or underlying data used in two court actions it has examined, *FTC v. National Consumer Council*, No. SACV04-0474 CJC(JWJX) (C.D. Ca. 2004), and *FTC v. Connelly*, No. SA CV 06-701 DOC(RNBx) (C.D. Cal. 2006).

Levels of success achieved in the *National Consumer Council* case are set forth in MD Confidential Exhibits **MD #A-2 through MD #A-6** (the NCC "Reason Codes" for drop-outs). Comparable data submitted [under provisions of Section 6(f) of the Federal Trade Commission Act ("FTC Act"), 15 U.S.C. 46(f), and FTC Rule 4.10(a)(2), 16 CFR 4.10(a)(2)], responsive to Question A-1(b), provide the measurements MD uses to continuously monitor its singular success. Please *see* MD Confidential Exhibits **MD #A-7 through MD #A-9, MD #A-11, and MD #A-12**.

MD believes that, if the Bureau of Economics reviews the data provided by MD in this proceeding, it will confirm that MD has performed well for the many law firm clients it has serviced to date. Further, MD believes that such a sound empirical analysis will show that debt settlement services inherently benefit consumers throughout the duration of their participation in the engagement of legal counsel, with MD's support.

Composite Question A-2 [a]: What would be the effect of the proposed Rule changes (including any benefits and costs), if any, on consumers?

MD'S ANSWER TO QUESTION A-2[a]:

MD's Comments in response to Question A-1[a] that a "lead provider" business model relying predominantly on up-front fees paid to a "front-end originator" and "back-end processors" is unlikely to be viable under the proposed Rule changes.

Existing up-front payment plans that have not provided for increased fees to accommodate potential internal dysfunctions or externalities discussed in response to Question A-1[a] would be vulnerable and at risk. Consequently, from a macroeconomic perspective the Commission's "proposed Rule impact" has the potential to trigger mass abandonment of customers or significantly reduced (but needed) services, either of which could result in many customers simply choosing insolvency under state laws, bankruptcy under federal law.

MD believes that, if the Commission's presently proposed Rule amendments emerge from the Rulemaking proceeding, there is a likelihood that insufficiently funded or poorly managed debt relief entities would anticipate their demise (as a consequence of the proposed curtailment of any advance fees and the burdensome reporting requirements), simply ramp-up to engage more clients until the cut-off would be effective, then discontinue all services, which would cause nationwide bankruptcies for potentially hundreds of thousands of consumers. Consumer welfare would be *significantly* harmed by such a precipitous outcome. The FTC would achieve pariah status among federal agencies, which would damage its credibility indefinitely.

If prohibition of all advance payments for "debt relief services" were to be enacted as proposed by the Commission in the NPRM, it would be the precipitating cause of untold numbers of personal bankruptcies, would exacerbate foreseeable widespread financial distress during a time of prevalent unemployment, and cause great harm to the national economy. If the FTC miscalculates by implementing the currently proposed Rule amendments it would produce a calamity for many consumers. It also could stigmatize the entire debt settlement industry to the point that even MD, which works for attorneys by means of a competent business model, would have its reputation unnecessarily harmed by guilt of other service providers, if they fail to properly service their customers [setting aside the legitimacy of their services as a matter of state law]. The Commission must not cast so wide a net that it tarnishes MD good reputation. The FTC's approach needs to be nuanced to avoid harm to competition that does not engage in deception or unfair

acts or practices, including lawyers who outsource assistance with their clients' debt settlement services to MD.

With regard to MD, charges for outsourced debt settlement services to law firms have been calculated specifically to align fees with the law firms' clients' interests. For that reason, a portion of "up-front" fees are appropriate and necessary, provide benefit to the law firm clients, and realize financial consumer benefits that ultimately exceed costs by a wide margin. [*See e.g.,* confidential exhibits **MD #A-7**, **MD #A-9**, and exhibit **MD #C-1** (a chart depicting "New Savings by Duration of the Engagement") that is attached to this submission.]

MD's fees are paid over time in three portions: (1) MD charges law firms an intake fee; (2) MD charges a standard monthly service fee, and passes along third party costs (such as Federal Express deliveries); and (3) MD charges a success fee for each settlement. Law firm clients are charged volume-based, reduced fees for unbundled legal services, which are billed and paid as incurred. Clients have the option to obtain in-court advocacy at an additional fee (the amount of which is determined by each law firm based on duration of the hourly commitment, or flat fee charges). All such fees are set forth in detail in Confidential Exhibit **MD #A-10**.

These apportioned initial, progress, and success fees properly align the incentives for the Company, the law firms, and the law firms' clients. Unlike competitors that charge all fees in advance of settlements (which MD believes may constitute as much as 15% of enrolled debts), MD is fully integrated and performs a variety of services for extended periods of time to ultimately achieve desired results for the law firms and their clients. Confirmation of the alignment of the respective interests is partially portrayed in Confidential Exhibits **MD # A-10 and MD #A-9**, which charts indicate the respective law firm clients' expenses and the settlements of debt over time, and project averaged client savings through completed engagement to debt-free status.]

Because many credit collection suits predominantly involve disputed contractual claims, and the defenses tend to be categorized in non-novel ways, MD has been able to develop a volume-discounted payment schedule for unbundled services by law firms that contract for MD's outsourced services. This greatly benefits near-bankrupt debtor-clients who otherwise could not afford legal services. Moreover, utilizing a paperless, fully relational computer database for all files, communications, billing, and documentation drives down the price of services closer to marginal cost. MD believes that most small law offices do not have the resources or capability of duplicating the efficiencies inherent in the MD unbundled services business model, which – combined with Internet-based transmissions – facilitates "just in time" legal services at a fraction of the cost of traditional, all-inclusive legal services. This enables MD to pass along such savings to the law firms and to their clients.

Composite Question A-2[b]: Would the benefits to consumers differ depending on the service offered or the type of provider offering it, and if so, how?

MD'S ANSWER TO QUESTION A-2[b]:

MD explains in comments responsive to Question RFA(2), at page 58 below, that the services provided by or under the supervision of attorneys provide inherent safety for clients who are near-bankrupt debtors, due to a pervasive regulatory scheme enforced by state judiciary systems that provide "disciplinary" and "regulatory" control of sufficient power to assure safety for consumers.

For entities or persons practicing law without a license, the remedy should be to report such persons or entities to appropriate state enforcement agencies for prosecution. The Commission should not arrogate to itself such powers of enforcement under this particularized federal TSR, principally because there is no preemptive basis to do so.

If the Commission does not believe that states' police powers are adequate or are insufficiently funded to undertake appropriate action to curtail abusive practices by persons or entities practicing law without proper state license, than it can and should seek express preemptive authority from Congress to occupy the field by displacing state regulators. While MD believes such an approach to be proper, an alternative approach would be for the Commission to enact a Rule amendment that limits its enforcement prerogatives with respect to lawyers or paraprofessionals acting under lawyer supervision to proceed against any person(s) acting abusively and not licensed by a state's judiciary to practice law..

Further, MD expresses in detail elsewhere in these Comments [and previously expressed in Comments filed in connection with the Report concerning the September 2008 Workshop], the possibility of setting threshold Standards that debt settlement entities need to meet (if not supervised by lawyers over who existing state judiciary enforcement applies), in order to protect consumers from harm.

Question A-2[c]: What evidence is there that consumers are or are not misled in the promotion and sale of different types of goods or services or by different providers? Please provide as much detail as possible.

MD'S ANSWER TO QUESTION A-2[c]:

MD's response to this question has three parts:

1. QUALITY CONTROL DISCLAIMERS:

MD employs a staff of Quality Control personnel whose sole responsibility is to assure that all necessary procedures are undertaken, 100% of the time. *See* Confidential Exhibit

MD #B-7. For example, one key procedure entails utilizing a uniform list of mandatory disclosures that all intake paraprofessionals must explain to prospective law firm clients. The list further requires – before engagement of a lawyer – the prospective client's affirmative assent (which is recorded with the client's explicit consent) *before* a written contract with identical disclaimers is signed with any law firm serviced by MD.

A copy of MD's pre-disclosure qualifier question, **16 mandatory disclaimers, and 6 supplemental disclaimers** [used where warranted] are set forth at pages 35 to 37, below. All disclaimer recordings are preserved as a ".wav" file for *at least* the duration of all services to each client.

MD estimates that, to assure prospective law firm clients who may not be experienced in understanding contracts are properly informed about each disclaimer, review by an intake paralegal requires on average, **twelve to eighteen minutes**, after which the disclaimers are read by the paralegal [and each must be assented-to by the prospective law firm client and recorded with consent], which requires approximately **four and a half minutes** (for 1806.3 Kb of data), which then automatically is attached to the computer database and stored in the prospective client's file. The disclaimers are reviewed by specially trained personnel in the Quality Control Department (requiring **another four and a half minutes** for each file in addition to the time required to assure that all required procedures have been followed and that all necessary information and documents are on file. MD believes all its disclaimers may be needed, and that its estimate of a total of sixteen and a half minutes to twenty-two and a half minutes [*not even counting the subsequent QC audio review*] is more accurate than the Commission's wholly unrealistic estimate of "**12 seconds**" [NPRM at 105] or "**20 seconds**" [NPRM at 106].

MD has invested millions of dollars in proprietary software to enable it to have a fully relational database with accountability and audit trails for entry of data, tracking client contacts, etc. MD believes a sophisticated computer system with redundancy and routine back-ups is necessary to the success of its business. Hundreds of thousands of dollars have been invested in computers, and the annual cost of IT personnel also is several hundred thousand dollars. Consequently, MD believes the Commission's assumptions [NPRM at 106] of the annual cost to record, store, index, and retrieve disclosures and to maintain recordkeeping is underestimated by Commission staff. Moreover, the projected annual expenditure of "$50… on office supplies" [NPRM at 108] simply is ludicrous.

2. COMPARISONS OF BENEFITS AND COSTS BY INFORMED "CONSUMERS"

MD is aware that clients apparently contact 4 or 5 potential debt relief service providers before determining which one they wish to engage. Many are informed about the supposed benefits other service providers have explained and advise they are considering alternative proposals to assist them. While no records are maintained of such contacts, numerous paraprofessional assistants have reported that clients have informed them that they have

considered other debt relief services before making their decision to engage an attorney serviced by MD.

3. SOME "CONSUMERS" USE THEIR CREDIT CARD TO FUND A SMALL OR START-UP BUSINESS.

The Commission may not be aware that although all debt settlement services are performed for individual consumers, many individual credit card holders make purchases for a small business in which they have an equity interest. The small business may be, unable in its own right to obtain a business line of credit. Arguably, the individual who uses a personal credit card to purchase commercial office equipment, tools and supplies for a construction business, plants and fertilizer for a gardening supply company, or kitchen supplies for a restaurant, really is not really engaging in a consumer transaction (even though financing is supplied via a credit card purchase made by the proprietor of the business). Debt settlement service undertakings frequently are made to assist individuals who made purchases or invested in required inventories for a business but are unable to repay the unsecured "loan" on their credit card because of a severe financial hardship (which could be a bad business decision that resulted in a failed commercial endeavor), or more recently, a significant decline in their business due to worsened economic conditions.

In such circumstances disclosure rules predicated on assumptions about lack of sophistication of the purchaser may be misplaced. It may be, not the finance method, but the use to which some proportion of the credit is applied, that would be a better indicator about how the debtor could be characterized (regardless of whether the business entity that may have benefited from the purchases has a separate federal tax identification number). MD would not know about particular charges or the use of the credit that was extended to an individual when the prospective client engages a law firm. It only might be after documentation is provided concerning credit cards in arrearage that such information *might* come to light. MD simply utilizes standard disclaimers for all debt settlement matters. If a consumer line of credit was used (to some extent or for specific charges) for a business purpose, the debtor may be more knowledgeable about business-related documents, and the limitations of debt settlement services, than a consumer who exclusively charged items to his or her credit card for personal uses.

Question A-3: What would be the impact of the proposed Rule changes (including any benefits and costs), if any, on industry?

MD'S ANSWER TO QUESTION A-3:

Given the Company's belief that its business model would be imperiled if the proposed amendments to the TSR are enacted as set forth in the NPRM, it is uncertain whether it would be prudent to invest in further infrastructure. Further, because its "just in time,"

outsourced business model is heavily dependent on law firms' offering unbundled legal services to near-bankrupt debtors, cessation of revenue as proposed in the Commission's Rule amendments would deleteriously affect not just MD, but also the law firms on which it depends for business, as well as on potential clients of law firms. Those law firms would no longer be able to obtain value-priced services so inextricably intertwined with their interests and the objectives of their clients, were MD to discontinue servicing the future debt settlement clients of those law firms.

The Commission's intent to subject state-licensed and judicially regulated lawyers to new federal regulation of the portion of their practice that utilizes in-bound telephone calls through mass-media advertising (which would include telephone books, newsletters, and television and radio commercials) would impose significant additional reporting burdens and expense. Additionally – as currently proposed – the amended Rule would invade the attorney-client privilege and the work-product doctrine), which could simply drive some lawyers to discontinue serving near-bankrupt debtors. MD believes this assessment to be realistic, because most small law firms generally work in a paper-driven environment, and lack personnel or financial resources to efficiently undertake the reporting burden contemplated by the proposed Rule amendments.[15]

Question A-4: What changes, if any, should be made to the proposed Rule to increase benefits to consumers and competition?

MD'S ANSWER TO QUESTION A-4:

First, MD recommends establishment of threshold "**Standards**" that must be met to engage in debt settlement, subject to state police powers of enforcement. Such "Standards" might include the following types of considerations:

- Annually audited financial documents confirming a minimum capitalization of at least $250,000;
- Fidelity bonding that covers every employee who has access to trust accounts in which a debtor's funds may be held, to protect consumers in the event of a default by the debt settlement service provider;

[15] Setting aside MD's position that lawyer supervised services should not be covered by the proposed TSR amendments, for the sake of accuracy and without waiving objections on legal grounds, MD's software-driven business model could adapt through programming to produce reports [even though law firms may not permit the Company to reveal attorney-client confidences, including even the fact that a client of the firm sought legal services to stave-off bankruptcy, are impecunious, or have certain amounts or types of debt, etc.].

- An independent annual audit of trust accounts;
- An independent accreditation of minimum business practices including adequate infrastructure to service clients;
- A requirement for independent screening of all employees to assure no history of breaching fiduciary obligations;
- Independent legal counsel in the state where each debtor resides, who can review all settlements to assure the near-bankrupt debtor's rights are not improperly or insufficiently protected;
- An assurance that each prospective client will undergo a comprehensive, thorough analysis to ascertain whether a true hardship exists and to estimate what reasonably can be afforded to accumulate a fund of money to pay-off debts at a discount.
- An assurance that no client will be charged any inception, start-up, or initiation fee prior to settlement of a debt, more than to set-up files and incur the average variable cost of the client procurement, qualification, and intake functions[16]; a monthly service fee of nominal amount sufficient to process documents, maintain contact and communications with the clients, and to commence negotiations with credit holders once sufficient funds are in place to engage in serious negotiations to settle a debt at a discount; fees for legal services in the event of suit; and documented costs for third-party services (such as overnight courier delivery of documents, filing fees, and the like.;
- An assurance that the limitations of what the debt settlement provider can achieve will be disclosed to every client, and that such disclosures are recorded (with the consumer's approval), with a retention policy that assures adequate disclosures are provided before any client executes a contract for services;
- An assurance that every client will receive a contract written in plain language, which sets forth the scope of services, the potential limitations of what may be achieved, the true cost of the services on an on-going basis, and monthly statements that detail total payments made to the debt settlement service provider, total fees paid, total amount of funds available to settle debts, and the duration of the estimated engagement for debt settlement services;
- An assurance that after settlement of each debt, every client will receive a complete recap of all fees and costs paid to the debt settlement company or any related entity, directly or indirectly, and the amount of the debt extinguished;
- Maintenance for a period of years beyond the period of services, of a comprehensive database that records all transactions on behalf of each client and all correspondence to or from the client in any tangible means of expression, as well as all complaints or claims, if any, by each client so that a state's judiciary can effectively exercise enforcement prerogatives over compliance with applicable licensure requirements.

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[16] Such costs typically are in the range of 6%-8% for total debts less than $15,000 and constitute a sliding-scale lower percentage for total debts above that amount, depending on the total amount of unsecured debt that is covered under contract with the debt settlement service provider.

Second, MD believes that Debt Settlement service providers should be required to obtain: (a) a FICO score *at inception* of an engagement and *upon completion* of all services, to show clients' improvement as a consequence of Debt Settlement services, and (b) be prepared to demonstrate, at least on a monthly basis, the net client savings to the formerly near-bankrupt debtors upon completion of services.

Question A-5: What changes, if any, should be made to the proposed Rule to decrease any unnecessary cost to industry or consumers?

MD'S ANSWER TO QUESTION A-5:

Please see answer to Question A-4, above.

Question A-6: How would the proposed Rule affect small business entities with respect to costs, profitability, competitiveness, and employment?

MD'S ANSWER TO QUESTION A-6:

Even with a fully functioning business model that is achieving success for law firm clients, as is confirmed in Confidential Exhibits **MD #A-1, MD #A-7, MD #A-9, MD #A-13, MD #A-14, MD #A-15, MD #A-16, MD #A-17, and MD #A-18** [a sampling of pre-FICO and post-FICO scores for recent MD-serviced law firm clients], MD could not function and could not adapt its business model to accommodate the lack of its initial fee and progress payments, given the marketing expenditures and salaries necessary to sustain operations. Moreover, the *ex post facto* preclusion of any advance fees would abrogate existing contracts between law firms and their clients which would force clients to obtain higher cost services *ad hoc*, or to default if sued, and it likely would cause MD to wind down offering debt settlement services to law firms.

Because MD's ability to provide services is dependent on a business model that requires alignment of interests throughout the continuum between engagement and extinguishment of debt, without any payment for the settlement services until each settlement is performed, the proposed Rule would needlessly drive MD out of business, and would cause the law firms to have to handle their clients without the benefit of the efficiencies MD provides. This would unnecessarily impede fulfillment of existing contractual obligations because of the loss of efficiencies unattainable by most small law firms. In all likelihood, the financial impact on the law firms could cause many of them simply to cease operations because without MD's infrastructure their ability to properly service the near-bankrupt clients would be unprofitable. The lawyers would then restart their practice or seek employment elsewhere.

The disruption to the legal practices (and potential suits against the attorneys) would be very detrimental to the attorneys and would competitively disadvantage them in the

market for legal services. This factor, discussed elsewhere in the Comments submitted by MD, confirms the wisdom of the Remarks by Commissioner Pamela Jones Harbour, "…policymakers should tread carefully, to ensure they fully understand the likely competitive implications and long-term consequences of their decisions." Remarks "The Federal Trade Commission's Perspective On Biosimilars: Current Initiatives and Long-Term Goals," *Biosimilars 2008*, Washington, D.C. (September 23, 2008).

The personal financial impact on the law firms' clients would be even more horrific. For example, in *FTC v. Nat'l Consumer Council, Inc.*, No. SACV04-0474 CJC (JWJX) (C.D. Cal. 2004), the Commission sought and was granted an *ex parte* Temporary Restraining Order.[17] Consumer defaults commenced within a week after the TRO was served and accounts were frozen. While the Receiver (selected by the FTC) took *six months* to analyze the 44,000 consumer files the FTC had seized, neither the FTC nor its hand-picked Receiver made any efforts to protect innocent consumers' rights. They failed either to notify creditors or to seek a court order freezing claims, so that consumers would not be harmed by the TRO. Creditors or their agents simply swooped in. They foreseeably filed claims against NCC's customers all around the United States. All the while, the Commission was oblivious to the debacle it caused.

Regardless of the fact that the Receiver ultimately determined that there were no irregularities in accounting for the funds received from consumers to be used to pay off creditors, and that there were no missing funds, the ill-advised, *ex parte* Temporary Restraining Order obtained by the Commission directly caused great harm to consumer welfare because of the massive number of bankruptcies. A similar economic result could be predicted if an advance fee ban causes debt settlement companies to voluntarily cease operations because of the Commission's proposed amendments to the Trade Regulation Rule.

Moreover, the advance fee ban would not just interfere with contractual obligations. It also would invade the province of state lawyer regulatory systems enforced by state judiciary systems through the Code of Professional Responsibility that applies to lawyers, which *encourages* lawyers to provide services to the poor and near-poor (which certainly would include near-bankrupt debtors). Aside from Constitutional issues that would be triggered by the Commission's impact on lawyers who handle debt settlements and defend clients in suits, the regulatory collide between state judicial systems – which clearly have occupied the field for lawyer regulation since before the creation of the FTC – the FTC's attempt to impose a federal overlay on those state judiciary regulations is likely to become the subject of litigation to stop enforcement of the Rule against lawyers on more compelling Constitutional grounds than are at issue in the

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[17] The Temporary Restraining Order froze assets, appointed the FTC's request for appointment of its hand-picked Receiver, prohibited destruction or alteration of books and records, granted immediate access and inspection rights, permitted expedited discovery, and Ordered the defendants to show cause why a preliminary injunction should not issue. It shut down the business immediately. [Docket entry number 10.]

imposition of the "Red Flags Rule" that is the subject of the pending suit, *American Bar Association v. Federal Trade Commission*, Civil Action No. 09-1636 (RBW) (DC Dist. 2009).

B. Questions on Proposed Specific Provisions:

Section 310.2 – Definitions

Composite Question B.310-2 (1): Does the definition of "debt relief service" in proposed Section 310.2(m) adequately describe the scope of the proposed Rule's coverage? If not, how should it be modified? Is the proposed definition accurate? Are there alternative definitions that the Commission should consider? Should additional terms be defined, and, if so, how? What would be the costs and benefits of each suggested definition?

MD'S ANSWER TO COMPOSITE QUESTION B310-2 (1):

MD's position concerning the Commission's proposed definition is that, (a) whatever definition is adopted must not intrude on states' police powers over enforcement of compliance with the Rules of Professional Conduct or regulation of lawyers through licensure, certification, or otherwise; and (b) "debt settlement" is sufficiently distinct from credit counseling or bankruptcy that better protection for near-bankrupt consumer debtors would be to treat the "debt settlement" business model that provides services to and is supervised by lawyers separately, and not lump it in with the larger classification and includes CCCS and other non-lawyer regulated services.

Composite Question B.310-2 (2): Are there reasons to broaden the definition of "debt relief service" to include the word "product"? Would the addition of "products" allow the Rule to reach additional deceptive and abusive practices engaged in by sellers and telemarketers of debt relief products and services? Are there reasons to include "products" to ensure that the scope of the definition is appropriately broad to anticipate likely changes in the marketplace? Why or why not?

MD'S ANSWER TO COMPOSITE QUESTION B310-2 (2):

MD does not sell products to consumers. It does not understand the question because it is unfamiliar with any "debt settlement products."

Question B.310-2 (1): The definition of "debt relief service" in proposed Section 310.2(m) would apply to "any service represented, directly or by implication, to renegotiate, settle, or in any way alter the terms of payment or other terms of the debt between a consumer and one or more *unsecured* creditors or debt collectors." (emphasis added). The Commission has so limited the provision in anticipation of covering mortgage loan modification and foreclosure rescue services under its new rulemaking authority with respect to mortgage loans. As a result of this determination, with a few exceptions, only outbound telemarketing calls to sell mortgage loan modification or foreclosure rescue debt relief services would be covered by the TSR. Is this determination appropriate? Why or why not?

MD'S ANSWER TO QUESTION B.310-2 (3):

MD sees no distinction between a limitation to outbound calls for loan modifications (which services appear to be offered by lawyers in some states) and the proposed expansion for inbound calls by prospective clients who seek debt settlement services of law firms. Entities that offer "loan modification" services also may offer "debt settlement" services. Many debtors view their financial obligations, regardless of whether or not secured, as "debt," and do not necessarily understand that UCC-1 forms constitute a form of secured debt.

Question B-4: Should any entities encompassed by the definition in proposed Section 310.2(m) be excluded or exempted from this definition? If so, which entities? Why or why not?

MD'S ANSWER TO QUESTION B.310-2 (4):

As more fully discussed in Comments responsive to Question RFA(2), below, lawyers and service providers under their supervision should be excluded from the proposed Rule amendment in § 310.2(m). MD adopts by reference as though fully set forth in this Comment, its Comments responsive to Question RFA(2).

Section 310.3 – Deceptive telemarketing acts or practices

Question B.310.3(1): The proposed amended Rule contemplates extending coverage of the existing TSR disclosure and misrepresentation provisions contained in Section 310.3(a) to inbound debt relief sales calls (as defined in the proposal). Would this adequately address the harms to consumers that occur in the sale of debt relief services? Why or why not?

MD'S ANSWERs TO QUESTION B.310.3(1):

MD believes its disclosures are sufficient to inform prospective law firm clients about the limitations of the unbundled legal services and that to provide additional disclosures, such as those set forth as the proposed provisions of 310.3(1)((viii): the disclosures could not be succinctly or accurately conveyed as written, for the following reasons:

FTC's PROPOSED DISCLOSURE:	FLAWS IN THE PROPOSED DISCLOSURE:
(**A**) the amount of time necessary to achieve the represented results, and to the extent that the offered service may include the making of a settlement offer to one or more of the customer's creditors or debt collectors, the specific time by which the debt relief service provider will make such a bona fide settlement offer to each of the customer's creditors or debt collectors;	The amount of time to complete the debt settlement process is a function of the number of unsecured debts, the total amount of the unsecured debts, the total monthly payment the prospective client is able to make on a consistent basis, the absence of externalities such as an unforeseen more serious hardship, the date of first pay-off to a creditor, and whether a structured payout is acceptable to the credit holder and the debtor. These variables are inextricably intertwined; any can affect the outcome. Further, the specific time by which a bond fide settlement offer will be made to each credit holder may be dependent on the credit holder's proprietary algorithm applicable to writing down a nonperforming debt, market externalities or financial conditions that may encourage or discourage the credit holder from offering a reasonable (or exceptional) discount; and whether a credit holder may offer a one-time opportunity to settle at a substantial discount.
(**B**) to the extent that the offered service may include the making of a settlement offer to one or more of the customer's creditors or debt collectors, the amount of money or the percentage of each outstanding debt that the customer must accumulate before a debt	The historical average discounted percentage of settlements MD has experienced with a credit holder may not necessarily predict what that creditor holder may agree-to in the future; it only is a guide and cannot be assured because of managerial decisions by the

relief service provider will make a bona fide settlement offer to each of the customer's creditors or debt collectors;	creditor, external to the circumstances of the debtor. Further, if a "window of opportunity" were to arise, an offer might be made out of turn, or unexpectedly, which could not be predicted.
(**C**) that not all creditors or debt collectors will accept a reduction in the balance, interest rate, or fees a customer owes such creditor or debt collector; and	While it is true that not all creditors *claim* they will accept a discounted pay-off, in reality all of them do so, although the discounted pay-off may be offered by a third party, not the original creditor. Because there are only a small number of credit issuers that claim they will not accept a reduction in the balance, interest rate, or fees a customer owes such creditor, specific disclaimers can be administered just for those creditors, in the event the debtor has an account with such a creditor.
(**E**) to the extent that any aspect of the debt relief service relies upon or results in the customer failing to make timely payments to creditors or debt collectors, that use of the debt relief service will likely adversely affect the customer's creditworthiness, may result in the customer being sued by one or more creditors or debt collectors, and may increase the amount of money the customer owes to one or more creditors or debt collectors due to the accrual of fees and interest.	A pilot survey of FICO scores at inception and at completion of services reveals – without exception – that all debtors favorably improved their FICO score! An improved FICO score contradicts the Commission's assumption that there *will* be an "adverse affect" on "creditworthiness." If that appertains for all, or the vast majority of the law firm debtor-clients, the proposed disclosure would be untruthful and punitive to MD's debt settlement services for law firms, which would harm consumer choice and competition for debt settlement services.

Composite Question B.310.3(2)[a] – [f]: Proposed Section 310.3(a)(1)(viii) has six required disclosures. For each disclosure, please provide comment on the following questions:

a. Is this disclosure appropriate to address harms to consumers that occur in the sale of debt relief services? If not, why or why not? How could the proposed amended Rule be modified to better address such harms?

MD'S ANSWER TO QUESTION B.310.3(2)[a]:

Please see comments, above, in response to Questions B.310.3(1), above, Question B.310.3(3), below, and Question RFA(2) at the end of this submission. MD is willing to assist the Commission to the extent of its experience, but does not believe that debt settlement services offered through attorneys should be subject to the proposed Rule amendments. As more fully discussed in Comments responsive to Question RFA(2), below, lawyers and service providers under their supervision should be excluded from the proposed Rule amendment in §310.3(2)[a]. MD adopts by reference as though fully set forth in this Comment, its Comments responsive to Question RFA(2).

b. Should this provision be applicable to all providers of debt relief services, or should this provision be tailored to apply only to certain debt relief providers? Why or why not? If so, which entities should be covered?

MD'S ANSWER TO QUESTION B.310.3(2)[b]:

There is no reason to apply this provision to legitimately attorney-supervised debt relief services. Please see comments, above, in response to Questions B.310.3(1), above, Question B.310.3(3), below, and Question RFA(2) at the end of this submission. MD is willing to assist the Commission to the extent of its experience, but does not believe that debt settlement services offered through attorneys should be subject to the proposed Rule amendments. As more fully discussed in Comments responsive to Question RFA(2), below, lawyers and service providers under their supervision should be excluded from the proposed Rule amendment in §310.3(2)[a]. MD adopts by reference as though fully set forth in this Comment, its Comments responsive to Question RFA(2).

c. What would be the benefits to consumers of this proposed requirement?

MD'S ANSWER TO QUESTION B.310.3(2)[c]:

For the reasons discussed in response to § B.310.3(2)[a] there is no reason to apply this provision to legitimately attorney-supervised debt relief services, which use the disclaimers that are as extensive as the ones MD uses, set forth above in response to FTC Question B.310.3(3), below. As more fully discussed in Comments responsive to Question RFA(2), below, lawyers and service providers under their supervision should be excluded from the proposed Rule amendments in § B.310.3(2). MD adopts by reference as though fully set forth in this Comment, its Comments responsive to Question RFA(2).

d. What burdens would be imposed on providers of debt relief services if this requirement were adopted?

MD'S ANSWER TO QUESTION B.310.3(2)[d]:

As discussed in the Comments responsive to FTC Question A-2[c], above, the disclaimers MD delivers, as set forth in Question B.310.3(3), below, **already require 22 minutes to deliver and record**. To add the unnecessary additional disclaimers proposed in (viii) [A] to [F] would be superfluous and annoying. The proposed disclaimers appear more intended to frustrate a caller to the point that he or she simply will get frustrated, disgusted with the bureaucratese, hang-up, and swear at their telephone. The proposed disclaimers sound like something a government lawyer would write if he or she did not understand that *legitimate* debt settlement services offered to clients of law firms have the distinct advantage of **the lawyer's license being at risk if the promised services are not delivered, as promised.**

MD may be unique because it has a business model that complies with state laws, properly aligns incentives of the parties under contract, provides affordable services that achieve results for the law firm's clients, and is providing both a benefit to competition, and to consumer choice and options.. Consequently, proposing to engraft more mandatory disclaimers MD would have to deliver, and which are not necessary or already are covered in the disclaimers MD uses, is nonsense.

Further, the government written, proposed mandatory disclaimers are static. They do not and cannot adapt to dynamic developments in the marketplace or to retrenched service offerings. Consequently, the burden of adding additional disclaimers that either would replace better written, simpler disclaimers already working well, or would expand the total number of disclaimers by another estimated three to five minutes (which would include questions by the caller) is preposterous.

As more fully discussed in Comments responsive to Question RFA(2), below, lawyers and service providers under their supervision should be excluded from the proposed Rule amendments in § B.310.3(2). MD adopts by reference as though fully set forth in this Comment, its Comments responsive to Question RFA(2).

e. As a practical matter, how would providers comply with the requirement? Would it be necessary to provide disclosures that were specific to the situation of an individual consumer or could the requirement be satisfied with a generic disclosure that would be given to all of the provider's potential customers? What would such a disclosure look like?

MD'S ANSWER TO QUESTION B.310.3(2)[e]:

Please read MD's comprehensive response to Commission Question B.310.3(2)[d], above. As more fully discussed in Comments responsive to Question RFA(2), below, lawyers and service providers under their supervision should be excluded from the proposed Rule amendments in § B.310.3(2). MD adopts by reference as though fully set forth in this Comment, its Comments responsive to Question RFA(2).

f. Are there changes that could be made to lessen the burdens without reducing the benefits to consumers?

MD'S ANSWER TO QUESTION B.310.3(2)[f]:

Please read MD's comprehensive response to Commission Question B.310.3(2)[d], above. As more fully discussed in Comments responsive to Question RFA(2), below, lawyers and service providers under their supervision should be excluded from the proposed Rule amendments in § B.310.3(2). MD adopts by reference as though fully set forth in this Comment, its Comments responsive to Question RFA(2).

Question B.310.3(3): Are there other disclosures that should be included in the Rule to address harmful practices in the sale of debt relief services? If so, provide the suggested disclosure and discuss the relative costs and benefits to industry and consumers of such a requirement.

MD'S ANSWER TO QUESTION B.310.3):

Debt settlement service providers must provide for a structured approach for regular monthly payments to assist the near-bankrupt debtor to accumulate a fund to pay-off unsecured creditors [in a way that legally protects the near-bankrupt debtor, such as ACH payments to an attorney's trust account]. Even if the provider or a back-end fulfillment entity might be capable of settling *some* debts at a discount, its customers *must* be able to actually pay the discounted settlements in keeping within negotiated amount and terms. Otherwise, creditors or collection agents will be disinclined to negotiate favorably discounted settlements comparable to what is offered to debt settlement companies that assure cash is available to fulfill obligations *before* negotiating the settlement.

Accordingly, a disclosure should be required that funds must be available to pay a settlement on negotiated terms whenever a settlement [or structured payout] is approved, comparable to what is in MD's Disclosure Number 12, below.

Because MD believes its disclosures are appropriate, well understood by prospective law firm clients, are more specifically tailored to the realities of the relevant market than are the proposed disclaimers in the NPRM, and assure that "reasonable" consumers acting as such are fully informed about all matters discussed (as set forth in its current "**QC Recorded Questionnaire**"), MD hereby waives its proprietary rights to the disclosures it uses in the following questionnaire, and makes them available to any entity that chooses to use them:

MD's GENERAL DISCLOSURES

1. Do I have your permission to record this conversation?

2. Please state your name, address and telephone number.

3. Are you or your co-applicant an **active** member of the armed forces? [NOTE: This must be asked to every prospective client.]

If yes:

Were you made aware that according to DoD Directive #1344.9 " A Service member's failure to pay a just financial obligation may result in disciplinary action."

4. To make sure I have fully explained important parts of your representation by a law firm, I will ask you to answer the following questions. If there's anything that you are unsure of, I will be happy to answer any questions that you may have.

5. Were you made aware that the following payment arrangements have been made for you: (State the payment arrangements including payment amount and start month/date? [If $100program, state month/date of initial and second part of the payment).]

Example: "Your monthly payment is ($). On behalf of the law firm we will arrange to debit $100 on (month/date) and the balance of ($___) will be due on (month/date), making your official payment to your attorney's trust account on the (15th) of every month after that. Is this correct?

6. Were you made aware that your monthly payments will not be paid to your creditors and this may adversely affect your credit?

7. Were you made aware that your monthly payment includes the following three (four) different fees:

a) The Engagement fee of ____% which equals $_______and is non-refundable and will need to be paid before funds are able to accumulate in your client trust account.

b) The contingency fee which is equal to 25% of what the negotiators save you at the time settlements are made.

c) The monthly maintenance fee of $______

8. Were you made aware that your creditors may call you and attempt to collect on the debt that you owe them?

9. Were you made aware that you would be a client of a law office of ________________ and that your attorney will be responsible for helping negotiate and/or settling your unsecured debt on your behalf, which may help alleviate creditor phone calls?

10. Were you made aware that your creditors may bring legal action against you, and if this happens, you have the opportunity to enter into a separate agreement for additional legal services and that those additional legal services would be available to you at an additional cost?

11. Were you made aware that although we provide access to a legal service, Morgan Drexen provides services to your lawyer; we do not give legal advice?

12. Were you made aware that your creditors will be contacted once you complete and return your welcome kit, yet settlements cannot be reached until sufficient funds have accumulated in your client trust account?

13. Can you confirm that each debt listed for negotiation is an unsecured debt and that none of the debts listed are secured by property such as a home, car or appliances?

14. Were you made aware that your creditors might send you a form 1099 regarding your closed accounts settling for less than the original amount owed and that you may be liable for federal and state taxes on the amount your debt is reduced?

15. Do you acknowledge that you have disclosed a true and valid hardship that has rendered you insolvent and that you intend to supply this hardship along with any 1099s to your tax advisor In order to try to alleviate any tax burden?

16. Were you made aware that if any of your debts are held or serviced by the bank in which you have your checking or savings that the creditor may attempt to access them in their attempts to collect on that debt?

ADDITIONAL DISCLOSURES FOR SPECIFIC CIRCUMSTANCES

Disclosure If At Least 2 Accounts Are Involved:

EDAF: Were you made aware you may be eligible for a one-time monetary advance of up to $1,000.00 towards your qualified client trust accounts with the Law Office of __________________, with no fees or interest for the advance, providing you meet the EDAF Certificate requirements detailed in your contract with the law firm, which offers the advance?

a) Were you made aware that a settlement with **Discover** is more difficult and it is our experience that they typically demand between 50% and 85%, which at this time is usually above what generally can be negotiated with other creditors?

b) Knowing that this is our experience and given the fact that you have an account with **Discover** is it still your desire to attempt settlements with them for your lawyer to review?

Disclosure if an ASPIRE Account Is Involved:

a) Were you made aware that a settlement with **Aspire** is more difficult and it is our experience that they typically demand between 50% and 85%, which at this time is usually above what generally can be negotiated with other creditors?

b) Knowing that this is our experience and given the fact that you have an account with **Aspire**, is it still your desire to attempt settlements with them for your lawyer to review?

Disclosure if Debt Amount is Less Than $500.00:

"Were you made aware that some of your accounts in the settlement process have a balance that is less than $500 which may result in no monetary savings from settlement activity?"

[ASPIRE ASA **$200.00]**
[MCYDSNB 422124057 **$100.00]**
[Test. 234 **$23.00]**

Disclosure if Aggregate Debt of All Accounts being handled is Less Than $5,000.00:

Were you made aware that you probably will not experience a net monetary savings due to your low consumer debt of **$2,226.23,** [**FirstName LastName]?** By choosing to engage legal counsel to attempt debt settlements with Morgan Drexen's assistance, you agree that you are doing so with the express intent of achieving settlements of your debts in a systematic and orderly process?

Disclosure if Apparent Lack of Language Skill or Apparent Old Age:

We will attempt to speak clearly to avoid difficulties in communicating recommendations to you. However, neither we **nor the attorney we work for** knowingly can assist you if it becomes obvious we are unable to communicate with one another. Please acknowledge that you understand we may decline further assistance in the event it becomes apparent our communications are misunderstood due to lack of comprehension."

Question B.310.3(4): Proposed Section 310.3(a)(2)(x) prohibits misrepresentations of any material aspect of a debt relief services, and provides specific examples of such prohibited misrepresentations. Is each specified misrepresentation sufficiently widespread to justify inclusion in the Rule?

MD'S ANSWER TO QUESTION B.310.3(4):

The standard of proof that must be met to prohibit "misrepresentations of any material aspect of a debt relief services" is set forth in the Federal Trade Commission Act, 15 U.S.C. § 45(n): "The Commission shall have no authority under this section or section 57a of this title to declare unlawful an act or practice on the grounds that such act or practice is unfair unless the act or practice causes or is *likely to cause substantial injury* to consumers which is *not reasonably avoidable by consumers* themselves and *not outweighed by countervailing benefits* to consumers or to competition. In determining whether an act or practice is unfair, the Commission may consider established public policies as evidence to be considered with all other evidence. Such public policy considerations may not serve as a primary basis for such determination" [emphasis added].

This statutory definition of "unfairness" requires proof of three elements: (1) a likelihood of substantial injury **(2) that** consumers could not avoid**, (3) not outweighed by** countervailing benefits **to (a) consumers** *or* **(b) competition.** According to former Bureau of Consumer Protection ("BCP") Director, J. Howard Beales, **"Each step involves a detailed, fact-specific analysis that must be carefully considered by the Commission."** *See* "The FTC's Use of Unfairness Authority: Its Rise, Fall, and Resurrection," http://www.ftc.gov/speeches/beales/unfair0603.shtm [NPRM, fn. 227].

MD has submitted in the confidential portion of its submission or discussed in these public Comments, that quantitative data demonstrates – at least with respect to its business model – that there is no substantial injury to near-bankrupt consumers. MD also shows in the public portion of its submission that, because its extensive disclaimers are given to all consumers (confirmed orally and in the required written contract, before it is executed between a client and his or her lawyer), alleged injury can be [and is] avoided inasmuch as the prospective law firm client is fully informed about the nature and limitations of the unbundled legal services offered, before entering into a contract for such services, which thereafter actually *are* performed. Finally, the benefits to consumers are demonstrated in several of the confidential charts.

The existence of MD's legitimate outsourced service model for attorneys demonstrates that competition for debt negotiations and settlements exists, and that the allocative efficiency produced by affordable, unbundled, just-in-time, limited legal services *promotes consumer welfare*, including by increasing options and choices. "The primary purpose of the Commission's modern unfairness authority continues to be to protect consumer sovereignty by attacking practices that impede consumers' ability to make informed choices." *See* Section III of

the above-referenced paper by former BCP Director, Mr. Beales, "The FTC's Use of Unfairness Authority: Its Rise, Fall, and Resurrection"

The Commission's rebuttable presumption that consumers are *likely* to be injured by debt settlement practices **is rebutted by the exceptional performance lawyers provide with MD's paraprofessional assistance. It also is rebutted by the information provided by MD** in its confidential charts, which is supported by a proper analysis of the *NCC* data already in the Commission's possession, as well as by these public comments. If *some* providers of debt settlement services fail to perform – due to a flawed business model; avarice, greed, malfeasance, nonfeasance; "unfair" or "deceptive" sales practices; or by practicing law without a license in violation of state law – their conduct does not support the presumption that all debt settlement service providers engage in unfairness or deceptiveness. Perhaps, MD is in a sub-set of legitimate service providers to lawyers, which warrants exclusion.

However, for the Commission to subject MD and the attorneys it serves to additional regulations because the Commission has reservations about *other* service providers, unconstitutionally would interfere with legitimate practices by lawyers for clients, attempt to preempt state police powers historically enforced by state judiciary systems, and undermine long-standing evidentiary privileges or doctrines in both state and federal law.

Question B.310.3(5): Are there other prohibited misrepresentations that should be specified in the Rule to address harmful practices in the sale of debt relief services? If so, why?

MD'S ANSWER TO QUESTION B.310.3(5):

MD believes that the actual settlement of a debt by paying it off at a discount and extinguishing it with proper documentation, inevitably changes rights, duties, liabilities, etc., which individual consumers can handle for themselves without violating Professional Rules of Conduct applicable to lawyers, but that for a third party to engage in such conduct without a properly licensed attorney's ultimate review and approval would constitute the unlawful practice of law, which is enforced by states judiciary systems.

Any debt settlement company that assists attorneys should meet minimum standards, such as the ones proposed in response to Question number **A-4**, above. No debt settlement company should attempt to advise clients about the law. All should be supervised by lawyers at the state level *in the state where the consumer resides*.

If a debt settlement company is not working in a business model that provides the protection to consumers that should be rendered by a lawyer in the consumer's state of residence, *at the very least* they should be required to advise that:

> **"Settling a debt with finality constitutes the practice of law. You can handle settlements yourself, or you can engage a lawyer to assist you. We cannot provide any service that would be required by a lawyer. That means we cannot provide legal advice, or provide you any forms and tell you how to prepare the forms, and we cannot handle actual settlements on your behalf, although we can negotiate for you, and then you will be responsible for handling the actual settlement. We are required to make this disclosure to you by federal law."**

Question B.310.3(6): Does the proposed Rule need to be modified in any way to better address any misrepresentations or omissions, and if so, what should those modifications be?

MD'S ANSWER TO QUESTION B.310.3(6):

MD disputes the Commission's hypothesis theory that "the practice [of debt settlement] appears to meet the statutory test for unfairness because it *appears* to cause significant harm to consumers that is not outweighed by countervailing benefits to consumers or competition, and the harm is not reasonably avoidable." [NPRM at 82, emphasis added.] Consumers are not harmed if a service provider utilizes a business model that aligns consumer interests with the service provider's legitimate interests as is demonstrated in MD's submission, including the confidential exhibits. Significant countervailing benefits to consumers and to competition exist. Harm is reasonably avoidable through use of disclaimers and voluntary allowance of rescission before services commence.

Material circumstantial data on which the Commission relies does not support the Commission's hypothesis. Further, certain data utilized by the Commission to support its hypothesis was obtained through illegal means, and should be suppressed such that any reliance on or use of such data must be excluded to protect the integrity of the Rulemaking proceeding.

A. RELIANCE ON THE *NCC* ACTION IS BASED ON "MISREPRESENTATIONS OR OMISSIONS" BY THE RECEIVER, THAT DO NOT SUPPORT THE FEDERAL TRADE COMMISSION'S ASSUMPTION THAT THE PRACTICE OF DEBT SETTLEMENT MEETS THE STATUTORY TEST FOR UNFAIRNESS.

To support its unfairness hypothesis the Commission boldly cites a First Report prepared by the Receiver in *FTC v. Nat'l Consumer Council, Inc.*, No. SACV04-0474 CJC (JWJX) (C.D. Cal. 2004) ("NCC"), for the *unqualified* statement that "only 1.4% of the consumers that entered defendant's debt settlement program obtained the promised results" [NPRM at 30, fn. 102]. Submitter carefully determined how the FTC obtained the data it provided to the Receiver, how the Receiver analyzed the data seized by the FTC and was obtained by the Receiver, and whether the NCC data actually supports the Commission's position in the proposed Rulemaking proceeding.

From what Submitter has been able to ascertain, and to learn from interviews, it appears that: (a) the data was obtained improperly, (b) the Receiver's analysis was materially flawed, (c) the data does not support the Commission's hypothesis that debt settlement services inherently are unfair, and (d) that – because of misconduct by Commission staff – the data should be suppressed or excluded from the proposed Rulemaking proceeding.

The Commission appears to be unaware – despite citing the *NCC* action it a dozen times [NPRM fns. 53, 55, 86, 92, 95, 102, 110, 150, 189, 214, 217, 250] for the premise, *inter alia*, that there is a low likelihood of success by debt settlement services – that the Receiver's First Report contains material "misrepresentations and omissions" that do not support the Commission's premise for the proposed Rule changes.

The "First Report to the Court" ("Report") by the "temporary receiver," Rob Evans & Associates LLC [an entity repeatedly selected by the FTC for such services in a number of debt settlement actions], explained that the 44,844 consumers enrolled for debt relief services "had a total of 250,891 creditors (or 'cards') with indicated outstanding debt balances of $1,308,068.147." [Report at 5.]

The Commission's synopsis of the Report [NPRM fn.102] cites a "1.4%" completion rate. The 1.4% is derived from the following quote in the Report: "The debt reduction process was promoted to potential and existing consumers as the opportunity to reduce consumer debt by 25% to 50% and then become debt free. Statistics from the LEADS database … document that 638 consumers, or 1.4% of the 44,844 consumers that entered the program, have completed the debt reduction program. 19,235 consumers, or 43% of the 44,844 consumers, have cancelled the program after incurring fees that were 64% of the funds remitted to NCC for the debt reduction program." [Report at 7.] Setting aside how the Receiver obtained the data, the patent flaws in the Receiver's analysis are as follows:

1. NCC commenced operations on January 1, 2002. [Report at 4.] The Report acknowledges that the duration of services necessary to fully achieve settlement of all debts was 3 to 4 years. It mentions that "[t]he earliest entry on the database is three years and four months old…" [Report at 8; emphasis added.] It acknowledges having been informed that the process would take consumers "36 to 42 months to try to get a discounted resolution of their debts." [Report at 13.] Although the Receiver's comments constitute hearsay, and were not subject to cross-examination, there can be no reasonable dispute that the **Receiver had been fully informed about the anticipated 3 to 4 years' duration of services and ignored that knowledge in reaching its conclusion on the completion rate and neglected to conduct a thorough empirical analysis. The Receiver further ignored the fact that the actual number of customers during the first *four months* of the NCC program was very small, and failed to analyze the percentage of customers who completed the NCC debt settlement program out of the total number of customers who originally enrolled during the first *four months*, less drop-outs through no cause by NCC.**

2. The 1.4% completion rate cited in the Report was calculated on the materially flawed assumption that, because only 638 consumers had completed the program out of a total of 44,844 consumers who had enrolled in the program, the program did not achieve promised results. The Report fail to analyze the number of Engagements by month or year, which would have revealed that, at the time of the cessation of activities due to the FTC's *ex parte* filing for temporary injunction, the first of the enrollees were just completing the program and that **the bulk of the enrollees were nowhere near the full 36 to 42 months needed to complete the debt relief program.**[18]

[18] The Receiver appears to have made the identical mistake in mischaracterizing data in its possession in *FTC v, Connelly*, No. SACV06-701 DOC (RNBx) (C.D. Cal. 2006). According to the Receiver's September 14, 2006 Report it found, "From November 15, 2001 through September 30, 2005, 12,706 debts with original balances of $60.7 million were settled for $35.5 million. The settlements averaged 58.5% of the original balance indicating the entire consumer benefit was $25.2 million before taxes for discharge of indebtness (sic.), compared to the $41.4 million paid by all consumers for fees. The settled debt balance of $60.7 million was 12.3% of the $495 million total debts turned over for negotiation. During the same period, the database shows that consumers cancelled negotiation services for debts totaling $349.9 million, or 70.7% of the $495 million turned over debts." The Receiver did not analyze the data by month of enrollment (which would have identified whether early entrants were concluding within the estimated duration of their endeavor), did not analyze any reasons for cancellations (thereby treating them as irrelevant), ignored the multi-year duration of the program, did not analyze the performance by time to first settlement, total number of creditors per client, total amount of funds paid into the program by customer to be applied to debt settlements, etc. Its analysis was deficient in numerous ways, which the FTC apparently did not question.

3. The Receiver was provided a fully relational SQL database that included 19 "reason codes" for cancelled consumers, and it had access to the computer programmer who had full knowledge of the database. **The Receiver failed to analyze *any* of the reason codes.** Had it done so it would have recognized that it should have *excluded* from the total enrollment, for example, consumers who (1) never made a payments due to insufficient funds, (2) cancelled within the first 15 days, (3) died, or (4) cancelled after some settlements were achieved and their "hardship" [a threshold requirement for the debt relief services] had been resolved, which permitted them to resume payments to creditors in a normalized manner. **The Receiver's failure to analyze *any* reason codes erroneously exaggerated the misleading reference to "19,235 consumers" alleged to have cancelled prior to completion** of the program. [The NCC "reason codes" the receiver ignored are set forth in confidential exhibits **MD #A-5** and **MD #A-6**.]

4. Most tellingly, "…funds frozen by this Court's Order totaled $24,332,794, which exceeded total liabilities to consumers." [Report at 7.] This acknowledgement confirmed that **no jeopardy existed with regard to funds customers paid into an escrow account, to assure the ability to pay discounted settlements and to complete the *NCC* debt settlement services program**. Consequently, the presumed necessity for *ex parte* seizure was erroneous. On information and belief FTC staff received a declaration by Don Rasmussen, lead investigator with the California Department of Corporations, who testified that NCC's management was entirely cooperative with the investigation conducted by his Department, and that the consumers' funds were held in trust accounts. The FTC staff had reviewed the Rasmussen declaration prior to the TRO hearing. They buried that declaration amid well over 2,500 pages of information in submitted to the Court[19], and knew or should have known that the federal Judge would not have the time to read the entire file before having to rule.

5. The FTC moved the Court to appoint its preferred Receiver (selected in numerous other debt settlement cases brought by the Commission), ratified the Report by uncritically accepting it and relying on it in Court, ratified it to support the instant NPRM, and completely ignores the ***widespread*, avoidable consumer bankruptcies** directly caused by the improvident determination to proceed by requesting a TRO. Most tellingly, the Commission repeatedly relies on the erroneous "1.4%" conclusion in the Report despite the fact the Commission certainly would not blithely accept such sloppy, and materially

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[19] Because it was (or should have been) routine practice for all documents that supported Commission approval for the filing of an action and motion for TRO to have been reviewed by an Assistant Director at the Bureau of Consumer Protection, and by the Bureau Director (and the Director's staff), and would have been made available to the Commissioners and their staff, the Commission can substantiate the information about which Submitter is informed.

erroneous conclusions in a comparable submission by a respondent in any other FTC proceeding.[20]

From the record and facts currently available to Submitter, it appears that a more cautious approach by the Commission would have documented that: (a) the NCC and related enterprise entities constituted an enterprise that was pioneering a new approach to debt relief (which ultimately fostered the debt negotiations and settlement industry which is the subject of the NPRM) for which there was – at the time – no established path or approach; (b) NCC had developed processes and controls to accommodate exponential growth; (c) NCC had implemented recorded disclaimers as facts and circumstances came to the attention of management and appeared to warrant disclaimers; (d) NCC had trained and supervised 500 employees to service over 40,000 customers; and (e) NCC had deposited customers funds (less fees and costs) in escrow accounts, all funds were secure, and such funds only were used to was settle debts at significant discounts; and all of these facts demonstrated that no immediate threat existed, warranting extraordinary TRO proceedings to shut down the company.

At the time of the Commission's action against NCC new debt settlement emerging business models were being introduced in a field long occupied by non-profit credit counselors with vested interests to protect extensions of credit by financial institutions. The not-for-profit credit counselors received deceptively described "fair share" payments from the credit issuers, which enabled the financial institutions funding the credit counselors to achieve maximized returns on otherwise defaulted, unsecured [predominantly credit card] debts), rather than by discounting or compromising the financial obligations of the borrowers, regardless of hardships.

To have treated NCC, a relatively new market entrant then in a learning process to achieve best practices in an emerging industry, as though its business model and practices were tantamount to what would constitute a fraud in a more mature industry, and then not to have learned from that misplaced law enforcement experience (which had been based on faulty impressions), culminated in a lost opportunity for the Commission to better target its resources and to avoid causing harm to consumers.

From available evidence, NCC may have been imperfect in its execution. Its disclosures may have needed expansion to cover other areas and to better assure customers were fully informed. These flaws did not justify abruptly shutting down the company. In light of the bankruptcies caused, instead of shutting down the company prematurely, NCC should have been provided the opportunity to improve its processes to assure better consumer understanding of the debt settlement process.

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[20] Submitter encourages the Commission to assign review of the statistical analysis in the *NCC* Receiver's Report to the Bureau of Economics for an independent verification of these assertions concerning the flawed conclusions in the Report. Submitter offers to assist the Commission and its staff to understand – aside from illegality in seeking a TRO – why reliance on the materially flawed "First Report" by the Receiver harms Consumer Welfare.

The material evidence the District Court evidently did not see before entering the TRO – the Rasmussen declaration – confirms that the NCC management voluntarily had cooperated with the California authorities, without delay. There was nothing to indicate it was unlikely to cooperate further. Further, as the Report confirmed, funds were being kept in client trust accounts. Nothing in the declarations indicated any irregularities in accounting records.

The *NCC* action properly understood, really stands for the unremarkable proposition that a premature cessation of operations via a TRO can be a clumsy enforcement approach that clearly will cause more harm than good if it is not based on: (a) sound economic understanding of the relevant market, (b) a proper understanding of the target's business model, and (c) a very careful assessment of whether the conduct of the target presents immediate and unavoidable harm to consumers, *before* the FTC authorizes a Court action for a TRO. The *NCC* case evinces a failure of the regulator, not a success.

The Commission's staff possesses a fundamental misunderstanding of the benefits *NCC* had produced and was projected to produce had it not been improperly shut down. The faulty institutional knowledge built on the *NCC* case now appears to have uncritically permeated the mindset of staff in the Division of Financial Practices of the Bureau of Consumer Protection; led Commission staff to mischaracterize the very flimsy circumstantial evidence from *NCC* because it needs data to successfully frame the hypothesis that certain practices are inherently unfair. Consequently, the *NCC* Report now forms a weak (and improper) underpinning for the Commission's current hypothesis that the *entire* debt relief services industry is troubled and broken, and as a consequence, the Telemarketing Sales Rule needs to be further amended to avoid unfairness to consumers.

Because the Receiver's conclusion is materially flawed and misleading, recipients of the NPRM logically may assume that comparable computational flaws and omissions exist in other data on which the FTC relies, or that the other data was procured illegally, and then was incompetently analyzed by the same Receiver. Consequently, the Commission's reliance on the Receiver's "First Report" in the NCC case is seriously misplaced. Conclusions based on that document are unreliable [completely aside from Constitutional and legal issues discussed, below].

B. THE COMMISSION'S TEMPORARY RESTRAINING ORDER THAT RESULTED IN FORCED CLOSURE OF THE *NCC* WAS PROCURED BASED ON MATERIAL "MISREPRESENTATIONS OR OMISSIONS" BY COMMISSION LAWYERS WHO *KNEW* WERE THEY WERE MISLEADING THE COURT, AND THAT THEIR CONDUCT WOULD RESULT IN A "DEATH WARRANT" TO THE *NCC*, AND POTENTIAL HARM TO CONSUMERS.

On information and belief, Submitter is informed that FTC staff submitted to the Court as part of its voluminous submission to substantiate the need for a TRO, the declaration of

Don Rasmussen, lead investigator with the California Department of Corporations, who testified that the *NCC* management was voluntarily cooperative with the DOC's investigation, and noted that funds from customers were in trust accounts. He expressed no alarm.

As a consequence of proceeding *ex parte*, the Receiver "furloughed about 400 employees." [Receiver's Report at 1.] The seizure of funds and furloughing of staff was an entirely foreseeable "Death Warrant" for *NCC.* It caused cessation of debt settlement services for all customers. The seizure and forced cessation of services foreseeably caused many thousands of bankruptcies throughout the country, most of which would have been avoidable had Commission staff not prematurely sought to proceed via an *ex parte* TRO proceeding. Aside from the ultimate carnage of numerous avoidable consumer bankruptcies, the Commission's oral representations to the Court were well below the level of professional conduct required of government attorneys appearing in a federal court, and warrant suppression of the *NCC* data in this or any other FTC proceeding.[21]

In connection with the *NCC* proceeding, at an *ex party* hearing to obtain the TRO against the *NCC*, the FTC lawyers presented to the United States District Court for the Central District of California, evidence they decided would sustain their burden of proof. On information and belief, Submitter is informed that the District Judge specifically expressed concern that if the TRO issued it would be a veritable "Death Warrant" for the company. The FTC lawyer responded

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[21] The Fourth Amendment to the United States Constitution forbids "unreasonable searches and seizures." It ensures "[t]he right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures, shall not be violated, and no Warrants shall issue, but upon probable cause, supported by Oath or affirmation, and particularly describing the place to be searched, and the persons or things to be seized." *U.S. Const. Amend. IV*. While "[p]roperty used for commercial purposes is treated differently for *Fourth Amendment* purposes from residential property," *Minnesota v. Carter,* 525 U.S. 83, 90, 119 S. Ct. 469, (1998) (plurality opinion), if a defendant takes precautions to secure the place searched or things seized without his authorization, such exclusive use in a closely held enterprise can establish standing for Fourth Amendment purposes. *U.S. v. SDI Future Health Inc.*, *et al.*, 553 F.3d 1246, 1256-57 (9th Cir. 2009). This was the situation in *NCC.*

Federal law requires a government lawyer to have probable cause before seeking a Temporary Restraining Order, because [at the least] if the lawyer is wrong, evidence obtained in such a seizure must be excluded in a later prosecution. Suppression is not automatic. *Herring v. United* States, __ U.S. __, 129 S. Ct. 695 (2009). It is an appropriate sanction if the attorney's culpability is such that the exclusion of evidence is proper to deter wrongful prosecutorial conduct. This "exclusionary rule" applies to an improper seizure of property to deter government misconduct. *U.S. v. Ruehle*, __ F.3d __, 2009 U.S. App. LEXIS 2145, *4 (9th Cir, 2009).

to Judge Carney, that in the FTC's experience in *dealing with other companies like Jubilee*,[22] money was missing and she was "concerned" about that possibility. However, the FTC lawyer did not inform the Court about the Rasmussen declaration or other exculpatory evidence that was buried in over 2,500 pages of documents supporting the Motion for a TRO.

Local Civil Rule L.R.83-3.1.2 that sets forth the "Standards of Professional Conduct – Basis for Disciplinary Action" in the United States District Court, Central District of California, provides:

> In order to maintain the effective administration of justice and the integrity of the Court, each attorney shall be familiar with and comply with the standards of professional conduct required of members of the State Bar of California and contained in the State Bar Act, the Rules of Professional Conduct of the State Bar of California, and the decisions of any court applicable thereto. These statutes, rules and decisions are hereby adopted as the standards of professional conduct, and any breach or violation thereof may be the basis for the imposition of discipline. The Model Rules of Professional Conduct of the American Bar Association may be considered as guidance.

[Emphasis added by over-lining.] **Rule 5-200** of the State Bar of California, "California Rules of Professional Conduct" ("CRPC"), provides:

> In presenting a matter to a tribunal, a member:
>
> (A) Shall employ, for the purpose of maintaining the causes confided to the member such means only as are consistent with truth;
>
> (B) Shall not seek to mislead the judge, judicial officer, or jury by an artifice or false statement of fact or law;
>
> (C) Shall not intentionally misquote to a tribunal the language of a book, statute, or decision;

[22] *FTC v. Jubilee Fin. Servs., Inc.*, No. 02-6468 ABC (Ex) (C.D. Cal. 2002) cited in the NPRM at 24-25, fn 84, for the proposition that the defendants in that action "regularly withdrew money from consumers' trust accounts to pay their operating expenses."

(D) Shall not, knowing its invalidity, cite as authority a decision that has been overruled or a statute that has been repealed or declared unconstitutional; and

(E) Shall not assert personal knowledge of the facts at issue, except when testifying as a witness.

[Emphasis Added by over-lining.] CRPC, **Rule 5-220** "Suppression of Evidence" provides:

A member shall not suppress any evidence that the member or the member's client has a legal obligation to reveal or to produce.

[Emphasis added by over-liner.] Having buried the Rasmussen declaration in a mound of over 2,500 pages that the Court would not have been able to read and fully appreciate, the FTC lawyer was duty bound *at the least* to advise the Court – in response to a direct question on point – that exculpatory evidence existed, even if the lawyer then might have attempted to argue against its significance, or attempted to question its findings.

Instead of being forthright and acting in a manner required of government attorneys practicing in the federal District Court, pursuant to California Rules 5-200 and 5-220, in **an *ex parte* hearing** in which no opposition was present, and during which the Commission's evidence could not be tested by cross-examination or presentation of contrary evidence, the FTC lawyers chose not to reveal the existence of a declaration that undermined the necessity for the FTC's motion for an *ex parte* Temporary Restraining Order and Order granting the right to search and seize *NCC's* assets. This constituted a reckless regard for the truth.[23]

The FTC attorneys failed in their ethical obligation to the Court. Their misconduct misled the Court to sign the TRO, which then was used by the FTC to shut down the *NCC's* operations and by the Receiver to furlough 400 employees, which foreseeably caused no communications with the company's customers or the creditors of those customers, which inexorably led to numerous otherwise avoidable bankruptcies. If suppression or exclusion of the evidence offered by the Commission in connection with the NPRM was procured through attorney misconduct, omission is not warranted because of improper conduct by the FTC lawyers in the *NCC* TRO *ex parte* hearing, the Fourth Amendment is meaningless.[24]

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[23] The FTC has (or would have in storage) the transcript of the *NCC ex parte* TRO hearing in 2004. Submitter learned about the misconduct by the FTC attorneys based on information from counsel for the *NCC* who described the Rasmussen declaration and his recall of the hearing transcript, as well as by verifying the information through speaking with another person who was not a defendant, who also read the transcript.

C. IMPROPER RELIANCE IS PLACED ON THE FTC'S SECRET "SENTINEL DATABASE."

The Commission's unqualified assertion that "…data from law enforcement actions and consumer complaints indicate that, *commonly*, consumers either are not apprised that refunds are unavailable or are misled by material omissions regarding the full terms and conditions of these policies" [NPRM at 51, emphasis added] is misplaced. This proposition is supported by a reference in footnote 166 that cites five FTC court actions [one of which, the *Connelly* action (discussed elsewhere in this submission) clearly is based on materially flawed assessments]. That footnote then advises, with no particularity or any quantifiable data *whatsoever*, "Commission staff has *reviewed a sample* of debt relief complaints received between April 1, 2008 and March 31, 2009, included in the Commission's Sentinel database. These complaints *routinely allege* that debt relief providers fail to give dissatisfied consumers refunds." [Emphasis added.]

The Commission's Sentinel database is described on its Web site as "…available to any federal, state or local law enforcement agency" and that it "…provides law enforcement members with access to complaints provided directly to the Federal Trade Commission by consumers, as well as providing members with access to *complaints shared by data contributors*, who include: – Participating Better Business Bureaus…."

Perhaps, the Commission has not been informed by staff and is unaware that for many years the President of the Better Business Bureau of the Southland, Inc. ("BBB") [which covers portions of southern California] also was on the Board of Directors of Springboard, a non-profit credit counseling organization in the same service area. Springboard shared office space

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[24] Pursuant to Rule 65(b)(2) of the Federal Rules of Civil Procedure, a TRO expires in ten days time unless extended by the Court or the adverse parties consent to the entry of the TRO. The *NCC* defendants apparently consented to entry of the TRO without knowing that the FTC lawyers recklessly failed to advise the Court about evidence that likely would have caused the Court to deny the TRO. By the time a transcript was available for their review, it appears that the company already had been shut down, the employees had been furloughed, and consumers were filing for bankruptcy. Consequently, that the NCC defendants may have had no incentive to challenge the improperly procured TRO, or chose not to challenge it for other reasons, is not a bar to springing rights to a challenge at this time, in this proceeding. Once the Commission announced in the NPRM, its reliance on materially misleading facts adduced from the improperly procured TRO in *NCC*, its supervening announced reliance has revived standing of third parties to challenge the "fruit of the poisonous tree." Accordingly, Submitter respectfully (but reluctantly) states the grounds for a challenge in these Comments and seeks suppression or exclusion, or such grounds would be waived. If the Commission expunges all references to the *NCC* (and to *Connelly*, and to the Sentinel database), and concomitantly excludes reliance on facts supported by those references, the proposed Rulemaking proceeding would not be tainted *ab initio*, and Submitter will withdraw its Comments on such matters.

with the BBB, which automatically gave its highest "A" rating to the not-for-profit Springboard and uniformly gave its lowest "F" rating to for-profit debt settlement companies, many of which were located in Springboard's and the BBB's service area. The BBB routinely recommended Springboard to consumers who inquired about debt settlement service providers, including *NCC*. Further, the BBB had been sued by *NCC* for improperly diverting customers to Springboard. That suit was ongoing at the time of the FTC's TRO action.

It is likely that the Commission's blind spot for the commercial interests of the BBB may have caused it to overlook the potential for self-serving complaints about *NCC* and other for-profit debt settlement companies. Further, the BBB may have encouraged callers to complain to the FTC, or it could have uploaded contrived complaints to the Sentinel database.

Given the BBB's *patent* conflict of interest in supporting Springboard and lambasting all debt settlement companies in Southern California, the objectivity, veracity, and reliability of the FTC's Sentinel database is highly questionable – especially for the purpose of supporting an asserted need for a FTC Rulemaking proceeding in this instance.[25]

Most importantly – and regardless of the perfidy of a BBB local office – **reliance on the Sentinel database is improper for 5 reasons**:

1. Access to reading complaints in the Sentinel database is restricted to law enforcement agencies;

2. There is no way to independently determine the sample size on which Commission staff claimed to rely;

3. There is no indication of the methodology Commission staff used to estimate the existence or duration of such "routine" allegations,

4. There is no way to verify whether the complaints were valid, exaggerated, contrived, bogus, or malicious, and

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[25] If the BBB also was a source of information on which FTC staff relied to support proceeding via a TRO against the *NCC*, the competitive animus by the BBB. Such an animus was evident based on market-share loss for Springboard due to: an emerging entrant's meeting a market-driven need; revenue loss to Springboard on which the local BBB's CEO was a Board Member; lowered "fair share" payments by banks to Springboard (which then shared an office with the BBB); as well as the BBB's own actual or contrived misunderstanding of the benefits of "debt settlement" to consumers should have raised a red flag for FTC staff. The Commission should determine whether staff properly assessed the competitive implications of the BBB's information, or uncritically accepted it as support for a TRO against the *NCC*.

5. Most tellingly, the Commission would not, itself, rely on information that amounts to “trust me,” for which there is no independent verifiability.

Reliance on such data is tantamount to a regulatory “Star Chamber” where allegedly pejorative facts are held in secret from the accused and filings may be based on unrealistic or contrived expectations. Further, reliance on such intentionally non-public hearsay regardless of its catchy name or the value the FTC might place on its internal repository of assorted information to generate leads for law enforcement entities, or for other legitimate purposes, simply does not constitute a fair or appropriate basis on which to propose a rulemaking proceeding.

Setting aside the Constitutional and legal issues discussed above, the Commission staff’s reliance on: (1) what may have occurred in a few isolated actions; and/or (2) financial data obtained in the *NCC* or *Connelly* actions, which is unreliable (due to ignorance of or nonchalance by the same Receiver on which FTC staff placed uncritical, misguided reliance multiple times in numerous cases) and patently improper because of misconduct of Commission staff; and/or (3) the non-public Sentinel database (which contains hearsay and unrebutted assumptions), is unfortunate. However, it reveals more about the Commission staff’s inability to intelligently deploy enforcement resources in a manner attuned to preserving consumer choices and options *in a then emerging industry*; and about the paucity of competent and reliable data to support the Commission’s hypothesis about inherent “unfairness” of debt settlement services.

Section 310.4 – Abusive telemarketing acts or practices

Composite Question B.310.4(1): What has been the experience in states that have regulated the fees that debt relief providers can charge – for example, allowing a limited initial or set-up fee, and then limiting the fees that can be charged while the services are being provided? Have providers of debt relief services been able to comply with these restrictions and still operate successfully in those states? What kinds of providers have been able to do so? Would it be appropriate for the Commission to consider such an approach? Why or why not? If providers were permitted to collect such limited fees, what fees should be permitted and what limits should be established on them?

MD’S ANSWER TO QUESTION B.310.4(1):

Because MD only works for lawyers, and lawyers are regulated by the judiciary, a state Act that would attempt to limit the scope of practice of a lawyer would be unconstitutional. Consequently, either lawyers expressly or impliedly are exempted from operation of state laws that would attempt to intrude upon the practice of law. To MD’s knowledge, no state has limited the fees lawyers can charge for unbundled debt settlement services for near-bankrupt clients, although the financial circumstances of such clients serves to limit the lawyer’s willingness to undertake multi-year commitments for debt settlement without the assistance of a service provider, such as MD. The lawyer’s involvement is important, because if a tipping point occurs that

augurs for filing for protection under federal bankruptcy laws, the client can readily pursue that option.

However, if MD did not work for lawyers it could not pursue work that would alter the financial incentives and compensation essential to successfully representing the near-bankrupt debtor. The financial model set forth in confidential exhibit **MD #A-10**, provides sufficient incentives for the lawyer, MD and the client to proceed with debt settlement, and typically avoid the long-term stigma of bankruptcy.

Composite Question B.310.4(2): To what extent does proposed Section 310.4(a)(5) prevent harm to consumers that would not be eliminated by the disclosure Requirements in proposed Section 310.3(a)(1) and misrepresentation prohibitions in proposed Section 310.3(a)(2)? Alternatively, if you believe that proposed Section 310.4(a)(5) would not prevent any additional harms, please explain why.

MD'S ANSWER TO COMPOSITE QUESTION B.310.4(2):

Proposed Section 310.4(a)(5) states: "Requesting or receiving **payment of any fee or consideration** from a person for any debt relief service **until** the seller has provided the customer with documentation in the form of a settlement agreement, debt management plan, or other such valid contractual agreement, that **the particular debt has**, in fact, **been** renegotiated, **settled**, reduced, or otherwise altered." [Emphasis added.]

This draconian approach evinces an attempt to act without empirical analysis to remedy a problem of allegedly insufficient disclosure by debt relief firms, using a bludgeon to implement an unsubstantiated view of insufficiently justified performance by those firms. The Commission simply has not met its burden under the modern view of the unfairness doctrine as articulated in the referenced article [at fn. 9] by former Bureau Director, J. Howard Beales.

Consequently, MD reaffirms its support for *partial* federal regulation of debt relief services. The present lack of federal standards underscores the need to modernize the outdated and inefficient patchwork of state laws that now regulate the provision of debt relief services and the practice of law in doing so. Under the current enforcement regime, increased compliance costs for providers raises consumer costs, restricts the ability of hardship consumers to choose among debt relief options, and retards the development of market-driven, innovative alternatives to Chapter 13, all of which would be avoidable with Congressional enactment of a coherent set of federal standards.

MD further believes that the lack of appropriate federal standards governing debt relief service providers [other than lawyers] has substantially contributed to the Commission's presently misguided attempt to reign-in allegedly "deceptive and abusive practices,"

“unscrupulous practices,” “false representations,” and “abusive conduct generally” under the penumbra its Unfairness Policy Doctrine.

MD believes that the Commission's skepticism about the ability and actuality of legitimate debt relief providers to deliver represented results fairly is misplaced. Commission staff appears not to have thoroughly reviewed the multiple datasets available to them to determine the falsity of this premise.

MD also is concerned with the alleged ubiquitousness of "deception" in the debt relief services industry, and concurs that misrepresentations have no countervailing consumer benefits, unlike MD's legitimate and well functioning outsourced paraprofessional services model that helps lawyers operate more efficiently.

MD believes that a full-blown Unfairness analysis that appropriately considers the costs and benefits of its service format, especially a study based on sound empirical analysis using the databases available to Commission staff, would demonstrate that "unfairness" is not endemic in the marketplace; certainly not in MD’s business model, which has been shown to provide hardship consumers with net savings from participation in the program.

In summary, the proposed Section 310.4(a)(5) is not ripe for Commission consideration. Further empirical analysis of net consumer benefits from and a more thorough understanding of different models of debt relief that provide widely divergent net consumer benefits is needed, and realization that consumer harm is easily avoidable with a proper business model, alignment of interests and incentives, simple disclaimers, and the ultimate protection by lawyers, supervised by state judiciary systems.

Composite Question B.310.4(3): Proposed Section 310.4(a)(5) provides that payment may not be requested or received until a seller provides a customer with “documentation in the form of a settlement agreement, debt management plan, or other such valid contractual agreement, that the particular debt has, in fact, been renegotiated, settled, reduced, or otherwise altered.” Is it appropriate to require provision of these documents before a covered entity can request or receive payment of any fee or consideration? In addition to those listed in the proposed amended Rule or described this Notice, are there other documents that typically evidence the completion of a debt relief service? Do such documents adequately demonstrate that a consumer’s debt has been successfully renegotiated, settled, reduced, or otherwise altered? Is one type of document preferable to another?

MD’S ANSWER TO COMPOSITE QUESTION B.310.4(3):

The practice of law at the state level, under a federalist model, has adapted to different court procedures and different forms of documents. When a client is sued, advice from a

lawyer in the client's state is necessary to assure that filings (which the lawyer can prepare) are adequate and that there is no default against the client.

If a client is not sued, the documents necessary for settling an unsecured debt – regardless of form, must actually provide finality by extinguishing the debt and, if a creditor has reported the debt and an arrearage status of any reporting agencies, provisions should be made to inform the recipient of any such report or notice, that the debt has been compromised and extinguished, and it is not left as an open item in any future credit reports.

Unfortunately, some credit collection agents refuse to cooperate in these matters, or only assent to their choice of wording that leaves ambiguity. Requiring creditors to affirmatively accept the debt as extinguished is a normative *quid pro quo*. It should not be a matter of contention. Accordingly, uniform settlement language should be acceptable in most circumstances and in most jurisdictions, if the debtor has performed pursuant to the payment terms of a settlement (or structured settlement).

Further, there should be a limited period of time for the creditor or its agent to execute documents and notify reporting agencies that the debt is not disputed, is extinguished, and that the debtor is relieved of any further obligation [regardless of the discount].

It is inappropriate to require provision of finally executed documents by the creditor before a covered entity can request or receive payment of *any* fee or consideration. That type of provision can be used by a creditor to penalize a debt settlement service provider by intentionally delaying execution needed to trigger payment for the lawyer and debt settlement service provider by the client who received the services. Because MD's payment model spreads out fees over the course of services, MD does not believe the approach the Commission proposes is superior to a payment approach that more carefully aligns incentives – a pay-as-you-go approach – within parameters such as those depicted in confidential exhibit **MD #A-10**.

Composite Question B.310.4(4):

(4) Should any type or portion of fees charged by entities offering debt relief services be exempted from Section 310.4(a)(5)? If so, which fees – either by type of entity providing the service or by type of fee – should be exempted, and why? Will entities that offer a measurably beneficial service to consumers be adversely affected by this proposed Section? Why or why not? Will covered providers find it is no longer possible to provide particular types of services if this requirement is imposed? Which services will it no longer be economic to provide and why will it no longer be economic to provide them?

MD'S ANSWER TO COMPOSITE QUESTION B.310.4(4):

Please see MD's responses to Questions B.310.4(1) through (3).

Question B.310.4(5):

(5) Would an alternative formulation of an advance fee ban, such as the one in Section 310.4(a)(4) of the existing Rule (prohibiting requesting or receiving a fee in advance only when the seller or telemarketer has guaranteed or represented a high likelihood of success in obtaining or arranging the promised services), be more appropriate than a ban conditioned on the provision of the promised goods or services? Why or why not?

MD'S ANSWER TO QUESTION B.310.4(5):

MD adopts by reference as though fully set forth in this response, its response to Commission Question B.310.4(2), in conjunction with its Comments responsive to Question RFA(2), below, that lawyers and service providers under their supervision should be excluded from the proposed Rule amendments. MD also adopts by reference as though fully set forth in this Comment, its Comments responsive to Question RFA(2).

Question B.310.4(6): Are there alternatives to an advance fee ban exist that would sufficiently address the problem of low success rates in the debt settlement industry? If so, please explain.

MD'S ANSWER TO QUESTION B.310.4(6):

The Commission acknowledges there is a need to "set performance standards" as part of its proposed recordkeeping requirements [NPRM at 96]. The Commission's limited approach, however, stops short of proposing uniform national standards for debt relief services providers, and instead concludes that prohibiting progress fees in advance of completion of services would suffice. The Commission proposes to impose an inexplicably limited, 24 months recordkeeping requirement – which is shorter than the 36 to 60 months duration of services typically required for most near bankrupt clients to become debt free – on the unfounded view that this would reduce abuses and provide sufficiently useful data for law enforcement or regulatory purposes.

Based on MD's extensive experience and proven performance [demonstrated in the confidential portion of its submission, Charts **MD #A-1 through MD #A-17**] it respectfully disagrees with the Commission's proposed approach. The statistical evidence set forth in this submission (and the accompanying confidential portion of this submission), undermines the premise that any advance payment for "debt relief services" is necessary or appropriate with respect to MD, and

the imposition of the same would be misguided, punitive, inconsistent with legitimate business practices, would misalign the respective financial incentives of law firms, their clients, and MD, and that if implemented *as proposed* ultimately would cause significant and harmful unintended consequences for consumers, for legitimate debt settlement service providers to law firms, and for the overall economy.

MD believes that the most efficient and fairest way to regulate the industry for the benefit of consumers and legitimate debt relief service entities and to partially address the unsecured debt crisis in the national economy, would be for Congress to pass legislation that recognizes the debt relief services industry, and for the FTC or the proposed new Consumer Financial Products Agency to establish uniform standards that debt relief service entities must meet. Proceeding in this manner would avoid interfering with, encroaching on, or impinging state judiciary-supervised attorney-client relationships necessary to protect clients' rights, "choices" and "options."[26]

Question B.310.4(7):

(7) As noted, the Commission does not intend that the advance fee ban be interpreted to prohibit a consumer from using legitimate escrow services – services controlled by the consumer – to save money in anticipation of settlement. Is it appropriate to allow the use of such escrow services? Why or why not?

MD'S ANSWER TO QUESTION B.310.4(7):

MD's Comments responsive to Question RFA(2), below, that lawyers and service providers under their supervision should be excluded from the proposed Rule amendments contemplates use of trust accounts to accommodate the normative practice of lawyers. MD further adopts by reference as though fully set forth in this Comment, its Comments responsive to Question RFA(2).

Section 310.5 – Recordkeeping requirements

Question B.310.5(1): No changes to Section 310.5 are included in the proposed Rule, but the application of the Rule to inbound debt relief calls would require some sellers and

[26] *See e.g.*, "Consumer Sovereignty: A Unified Theory of Antitrust and Consumer Protection Law," Averitt and Lande, 65 ABA *Antitrust Law Journal*, Issue 3, Spring 1997 (concluding "Trade regulation law is ultimately about choice, and choice is ultimately about options – getting them, keeping them, and selecting among them").

telemarketers to comply with these requirements for the first time. What would be the costs and benefits to industry and consumers of this result?

MD'S ANSWER TO QUESTION B310.5(1):

Please see the article cited in the NPRM [fn. 227] by former Bureau of Consumer Protection ("BCP") Director, J. Howard Beales, "Each step involves a detailed, fact-specific analysis that must be carefully considered by the Commission." *See* "The FTC's Use of Unfairness Authority: Its Rise, Fall, and Resurrection**,"** http://www.ftc.gov/speeches/beales/unfair0603.shtm **[**NPRM, fn. 227]. Please also see Comments responsive to Question A-3, above.

Section 310.6 – Exemptions

Question B.310.6(1):

(1) Proposed Sections 310.6(b)(5) and 310.6(b)(6) modify the general media and direct mail inbound call exemptions to make them unavailable to telemarketers of debt relief services. Is there a sufficient basis for this modification? Why or why not?

MD'S ANSWER TO QUESTION B310.6(1):

None of the reasons that applied to faxes or intrusive outbound calls to consumers would apply to inbound calls to law firms that advertise their debt settlement legal services to consumers. For a more expansive discussion, please see MD's Comments in Section F, below, in its Answer to FTC Question RFA(2), and its Comments, above, in its Answer to FTC Question A-3. MD further adopts by reference as though fully set forth in this Comment, its Comments responsive to Question RFA(2).

Regulatory Flexibility Act ("RFA")

Question RFA(1): As noted in this NPRM, it is not readily feasible to determine a precise estimate of how many small entities will be subject to the proposed Rule. Please provide any information which would assist in making this determination.

MD'S ANSWER TO QUESTION RFA(1):

MD is not in a position to know the number of small law firms that might be impacted by the proposed modifications to the Telemarketing Sales Rule. The Commission should contact the American Bar Association, which may maintain such information in its membership database, as well as state Bar organizations, which may maintain similar information about size or types of entities in which the licensees practice law.

Question RFA(2): Identify any statutes or rules that may conflict with the proposed Rule requirements, as well as any other state, local, or industry rules or policies that require covered entities to implement practices that comport with the requirements of the proposed Rule.

MD'S ANSWER TO QUESTION RFA(2):

A. SETTLING A DISPUTED UNSECURED DEBT BY A FINAL SETTLEMENT THAT DISCHARGES THE LIABILITY AND EXTINGUISHES AN OBLIGATION IRREVOCABLY AFFECTS LEGAL RIGHTS, DUTIES, AND OBLIGATIONS REGULATED BY THE STATES, NOT THE FEDERAL GOVERNMENT

Ultimate debt "settlements" irrevocably change rights, duties, liabilities, or powers in a contractual relationship, which by definition constitute portions of the practice of law. While there is a right for an individual to represent himself or herself as a consumer, there is no such right for third parties (such as a debt settlement company) to intervene or claim to represent a consumer and to negotiate and finalize a settlement for the consumer.

Consequently, if debt settlement companies are not working *for* lawyers, *or* do not have lawyers on staff properly licensed in the jurisdictions in which the company services near-bankrupt debtors, *or* do not have proper and legitimate referral relationships in the jurisdictions in which a staff lawyer is not licensed but the near-bankrupt debtors require legal representation, all *final settlements* they have negotiated for their customers constitutes the unlicensed practice of law.

The Commission either should refer offending persons or organization to state authorities in the first instance, and request them to investigate and prosecute the alleged offenders, or – if a state's judiciary lacks resources or will to take action – should bring such inattention, inaction, or nonfeasance to the attention of the Commission's oversight Congressional Committees to encourage a federal preemption or other legislation.

B. WHAT CONSTITUTES THE "PRACTICE OF LAW"? WHY SHOULD LAWYERS HANDLE OR SUPERVISE DEBT SETTLEMENTS?

The practice of law entails irrevocably transforming rights, duties, liberties, lack of rights, powers, liabilities, immunities, or disabilities. These are the precise junctures at which the work of a lawyer is performed, and which requires legal judgment that cannot be delegated to non-lawyers.

When a lawyer [engaged for full advocacy] either tries a case to conclusion and after all rights of appeal have expired, or when a lawyer [engaged for advice and limited advocacy] settles disputes with finality, the effect is to materially change these basic relationships: rights, duties, liberties, lack of rights, powers, liabilities, immunities, or disabilities. Knowledge, skill, judgment, and experience gained through legal and ethical training – regulated by licensure in the jurisdiction in which a lawyer practices – define the general parameters of the practice of law. **Conversely, any act or conduct that does not entail irrevocable transformation and that does not *settle with finality*, typically can be performed under a lawyer's supervision without jeopardizing a client's rights, duties, liberties, lack of rights, powers, liabilities, immunities, or disabilities.**

To assure that the amount of supervision is sufficient in all instances, the lawyer may place his or her license (*i.e.*, the privilege to practice law) at risk. The power to suspend or revoke a law license is the ultimate power a sovereign can exert to protect non-lawyer residents

within the sovereign's jurisdiction.[27] A thorough analysis of the legal relationships that are implicated by the practice of law is presented in Appendix **MD #C-2**.

C. THE FTC IS NOT EMPOWERED TO PREEMPT THE STATE REGULATORY AUTHORITY OF THE STATES OVER THE PRACTICE OF LAW

The fact that there may be a corollary cause of action under Section 5 of the FTC Act or under another statute over which the FTC has law enforcement responsibilities – such as the Telemarketing Sales Rule ("TSR") – does not trump, replace, displace, or confer an empowerment or duty to interfere with a state judiciary's *primary* enforcement authority to prosecute the **unauthorized practice of law**. The FTC has no preemptive powers over the practice of law.

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[27] Revocation or suspension of a license to practice law [or revocation or suspension of a Board Certificate attesting to superior skill] is only one of a six deterrents to misconduct or violations of law by lawyers. The six forms of control are: (1) **disciplinary control** (deterrence or punishment [censure, suspension, or disbarment]) **implemented by state judiciary** [and enforced by a court or other body officially assigned to investigate and prosecute alleged violations of professional responsibility set forth **in Rules of Professional Conduct For Attorneys** [a form of regulatory bundling with limited rights of waiver] under authority of a state's highest court (*e.g.,* for failing to safeguard client confidences, failing to diligently provide competent services, abusing an attorney-client relationship, over-charging or entering into an illegal contract, assisting a client in fraudulent conduct, filing frivolous claims or defenses, abusing rules of a tribunal, etc.); (2) **regulatory control** (a) ***in the judicial context*** by a court that may discipline or sanction lawyer misconduct based on Rules of Civil Procedure (*e.g.*, Rules 11 and 37 of the Federal Rules of Civil Procedure), or by the inherent power of any court to control its docket and to punish improper lawyer conduct, or to revoke *pro haec vice* admission; or (b) ***in the administrative context*** by an enforcement agency pursuant to its enabling regulations' embedded rules that govern appearances (*e.g.*, the FTC "Standards of Conduct" that govern acceptable forms of behavior in appearances in a Commission proceeding [16 CFR §4.1(e)(1) and (2)]); [and, under federal law ***in the military context*** via the Code of Military Conduct]; (3) **monetary liability** to compensate [and possibly award punitive damages] based on potential *ex post* complaints filed by an aggrieved client in a civil suit [with broad rights of discovery] in a court of competent jurisdiction (or, perhaps, in arbitration); (4) **criminal liability** for lawyer misconduct constituting fraud, theft, embezzlement, perjury, or conspiracy outlawed in a state's criminal code; (5) **adverse publicity** that brings public condemnation (and potential pariah status), which may result in decreased income due to negative reputational effects; and (6) **legislative control** exercised by a state's Executive Branch empowered to *generate revenue*, *prohibit misconduct* (via expulsion or exclusion), or *punish behavior* (via contempt, monetary sanction, or referral to criminal prosecution). States tend to be protective of these prerogatives and resistant to federal intrusion or usurpation.

D. TYPES OF PREEMPTION:

The "preemption" concept springs from the supremacy clause of the United States Constitution: "This Constitution and the Laws of the United States which shall be made in Pursuance thereof … shall be the supreme Law of the Land: and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State notwithstanding." U.S. Const. art. VI. *See Maryland v. Louisiana*, 451 U.S. 725 (1981). Accordingly, any preemption analysis focuses on whether a state statutory or regulatory scheme must yield to the operation of federal law. Courts recognize three types of preemption.

Express preemption flows from a clear Congressional mandate that a federal statutory provision ousts application of state law in the subject area. *See Jones v. Rath Packing Co.,* 430 U.S. 519 (1977); *Sprint Spectrum LP. v. Mills,* 283 F.3d 404, 415 (2d Cir. 2002); *Foley v. Luster,* 249 F.3d 1281 (11th Cir. 2001). Of course, even with a clear congressional intent to preempt state law, courts are left to determine the scope of the federal preemption. *See Sprietsma v. Mercury Marine,* 537 U.S. 51 (2002); *Shaw v. Delta Air Lines, Inc.,* 463 U.S. 85, 96 (1983).

Implied, or field, preemption arises from the pervasive nature of a federal statutory scheme, reflecting a Congressional intent to occupy the particular field in its entirety. If Congress has regulated a particular activity so extensively so that there is little, if any, room for further state regulation, a court may reasonably conclude that Congress intended to insulate this area completely from state regulation. *See Sprietsma, 537 U.S. 51*; *Cipollone v. Liggett Group, Inc.,* 505 U.S. 504, 516 (1992); *Rice v. Santa Fe Elevator Corp.,* 331 U.S. 218 (1947); *Hines v. Davidowitz,* 312 U.S. 52, 66-67 (1941); *Foley,* 249 F.3d at 1287-88.

When the field is one traditionally regulated by the States, a court will not find field preemption absent a "clear and manifest purpose of Congress" to preempt. *Rice,* 331 U.S. at 230. *See Wisconsin Pub. Intervenor v. Mortier,* 501 U.S. 597, 605 (1991). However, if "occupation of an envisioned field was intended, 'any state law falling within th[e] field is pre-empted.'" *French v. Pan Am Express, Inc.,* 869 F.2d 1, 6 (1st Cir. 1989) [quoting *Silkwood v. Kerr-McGeeCorp.*, 464 U.S. 238, 248 (1984)].

Some federal statutes that otherwise would provide for field preemption include "savings" clauses, that reflect "some level of solicitude for state laws." Amy K. Kelley, *Federal Preemption and State Water Law,* at http://www.ucowr.siu.edu/updates/pdf/V105_A2.pdf. A savings clause generally will end any express preemption analysis, although the presence of such a clause does not affect an implied preemption analysis except to the extent that it suggests that Congress did not intend to occupy an entire field. *See id.; Sprietsma, supra.*

Conflict preemption arises when a federal and state statutory or regulatory scheme collide because compliance with both is impossible. *Sprietsma, 537 U.S. 51*; *Pacific Gas & Electric*

Co. v. State Energy Res. Conservation & Dev. Comm'n, 461 U.S. 190 (1983); *Foley,* 249 F.3d at 1287. Under such circumstances, state law must yield. Similarly, under the doctrine of conflict preemption, state law is preempted if it hinders the interest or objective underlying the federal law. *Id. See also Hisquierdo v. Hisquierdo,* 439 U.S. 572, 581 (1979).

Federal involvement with <u>outbound</u> telemarketing is rooted in the Interstate Commerce Clause of the Constitution. The federal government undoubtedly saw the federal government as the proper governing entity to curtail interstate abuses by telemarketers.

A detailed review of 18 F.C.C.R. 14014 (Federal Communications Commission [“FCC”] Rules and Regulations Implementing the Telephone Consumer Protection Act of 1991) [adopted in June 2003], explains the four reasons why the FCC choose to treat outbound facsimile transmissions differently from telephone calls:

1. **<u>COSTS AND COST-SHIFTING</u>:** Section XIII “Unsolicited Facsimile Advertisements,” addresses the cost rationale for heightened enforcement of facsimiles. “Recipients of these faxed advertisements **assume the cost of paper used**, the cost associated with the use of the facsimile machine, **and** the costs associated with **the time spent receiving a facsimile advertisement** during which the machine cannot be used by its owner to send or receive other facsimile transmissions.” 18 F.C.C.R. pages 14127-28 [emphasis added]. Fax machines use consumables (i.e., paper, ink, replaceable toner components, etc.) and require maintenance, over time. Consequently, “Congress’ primary concern was to protect the public from bearing costs of unwanted advertising.” The FCC termed this “cost shifting” (meaning, the sender was shifting the cost of reproducing the advertisement to the recipient of the advertisement). The Commission also noted, on its own, “**faxes may increase labor costs** for businesses, whose employees must monitor faxes to determine which ones are junk faxes and which are related to their company's business.” *Id.* at 14134 [emphasis added].

2. **<u>INTERFERENCE</u>:** The duration of a facsimile transmission is dependent on factors extraneous to the transmission, such as the type of telephone line used, and most importantly, the type of receiving equipment. For some businesses, when a facsimile was being received from a [then early generation of technology] stand-alone facsimile machine, that reception interfered with and tied-up a telephone line otherwise used for voice communications. The House Report accompanying the TCPA explained that Congress took account of the “**interference, interruptions, and expense” resulting from junk faxes**, emphasizing in the same Report that “[i]n addition to the costs associated with the fax advertisements, when a facsimile machine is receiving a fax, it may require several minutes or more to process and print the advertisement. During that time, the fax machine is unable to process actual business communications.” *Id.* at 14134 [emphasis added]. The early generation facsimile machines were flawed because an unidentified telemarketer could electronically seize the device for the duration of a transmission; there was no way

to stop the unwanted intrusion, noise, and office disruption; and an incoming fax would prevent the recipient from using the shared telephone line in the event of an emergency.

3. **NO OPT-OUT:** "**Unlike the do-not-call list for telemarketing calls, Congress provided no mechanism for opting out of unwanted facsimile advertisements.**" [Emphasis added.]

4. **PROTECTION OF BUSINESSES WARRANTED DIFFERENT LIABILITY RULES:** Some advertisers hire "fax broadcasters, who transmit other entities' advertisements to a large number of telephone facsimile machines for a fee…." In such circumstances, the F.C.C. determined that a special rule was needed to **apportion the liability** between the "facsimile broadcaster and the company whose products are advertised and has supplied the list of fax numbers to the fax broadcaster" that actually sends an unwanted facsimile to a business with which there is no prior relationship. In large measure, the concerns about unwanted facsimile transmissions were driven by businesses, not by residential consumers, which was unlike the circumstance of unwanted calls to consumer-residential telephones, which was the underlying premise for the need for a federal "Do Not Call Registry."

These four factors evidently influenced the FCC to adopt more particularized language concerning the enforcement of faxes, which caused an amendment of the Rules "…to require any fax broadcaster that demonstrates a high degree of involvement in the transmission of such facsimile message to be identified on the facsimile, along with the identification of the sender."

Similarly, a telemarketer could place an automated call that would be disruptive of a family during dinner or other family activity, and might wake-up someone at a late or early hour, without providing any way to demand that the caller discontinue making the disruptive or unwanted calls.

Enabling the FTC to develop rules to stop such telemarketing abuses for outbound calls to business fax machines or to personal telephone numbers, and to institute a federal "Do Not Call" Registry was a proper use of federal power at the time and continues to be so. There is no quarrel with the FTC's powers under those circumstances. The states could not separately make effectual provisions for enforcing abuses by out of state marketers without the FTC's TSR, as presently written. Consequently the delegation to the FTC to exercise its rulemaking authority to stop inbound unwanted calls and faxes was a proper exercise of the grant of Constitutional power, although it did not displace the states' police powers to maintain complementary Do Not Call registries.

On its face, the federal law authorizing the FTC to exercise its authority by limited approval of Congress did not contain an express preemption clause. Accordingly, there is no clear intent that State law can play no role in the telemarketing arena. In fact, the law expressly

preserves the right for states to have complementary "Do-Not-Call" registers, and the TSR also provides for the same. *See* 16 C.F.R § 310.

Seizing upon this statutory delegation to adopt rules governing certain practices may have the force to supplant state law. *See Fid. Fed. Sav. & Loan Assn v. De La Cuesta,* 458 U.S. 141, 153-54 (1982) ("[f]ederal regulations have no less preemptive effect than federal statutes ... A pre-emptive regulation's force does not depend on express congressional authorization to displace state law"). *See e.g.*, 15 U.S.C. § 6103(f)(1), 16 C.F.R. § 310.7 (2009).

An analogy may be made under these circumstances to the correlative powers of the federal Patent and Trademark Office ("PTO") and the states to regulate attorneys. 37 C.F.R. 10, through its sub-parts governs the practice of patent law before the PTO.

Particularly critical for purposes of preemption analysis in the present instance, is the PTO's recognition that "[n]othing in this part shall be construed to preempt the authority of each State to regulate the practice of law, except to the extent necessary for the [PTO] to accomplish its Federal objectives." 37 C.F.R. § 10.1 (2008). *Accord, Sperry v. Florida,* 373 U.S. 379 (1963).

The PTO regulations provide that "[a]ny citizen of the United States who is an attorney and who fulfills the requirements of this part may be registered as a patent attorney to practice before the Office." 37 C.F.R. § 11.6 (2008). The regulations also set forth the requirements that one must satisfy before being admitted to practice before the PTO. *See* 37 C.F.R. § 11.7 (2008). Upon becoming authorized to practice before the PTO under Part 10, the registered practitioner may publish *this* accomplishment: "A registered practitioner who is an attorney may use the designation 'Patents,' 'Patent Attorney,' 'Patent Lawyer,' 'Registered Patent Attorney,' or a substantially similar designation." 37 C.F.R. § 10.34 (2008).

C. STATE REGULATION OF THE PRACTICE OF LAW REQUIRES A "CONFLICT PREEMPTION" ANALYSIS:

Again, by analogy, the PTO "has exclusive authority to establish qualifications and procedures for admitting persons to practice before [it], and to suspend or exclude those patent practitioners from practicing before the PTO." *Kroll v. Finnerty*, 242 F.3d 1359, 1364 (Fed. Cir. 2001). Nonetheless, "the State maintains control over the practice of law within its borders except to the limited extent necessary for the accomplishment of the federal objectives." *Sperry,* 373 U.S. at 402. Consequently, 37 C.F.R. § 10.1. reflects neither express nor field preemption. To the contrary, the regulations in 37 C.F.R. Part 10 *condone* State regulation of the practice of law, as long as a State does not attempt to alter or inhibit the ability of a registered patent practitioner to practice before the PTO. *Sperry*, 373 U.S. 379. A State may not hinder a registered patent attorney from performing the functions granted him by the PTO. *Id.* at 388. Yet, a state's law clearly may reflect that, "the preparation and prosecution of patent applications for others is the practice of

law." *See id.* at 383. Because the federal patent regulations reserve to the states the right to regulate the practice of law, *Sperry* rejects any suggestion that states are prohibited from regulating lawyers in this area at all.[28]

Clearly, any preemption analysis in the telemarketing arena must assess whether there is a *conflict* between the federal TSR and states' rights to regulate what lawyers may do to promote the practice of law in advertising and using in-bound telephone numbers for the convenience of prospective clients, so long as there is nothing "deceptive" or "unfair" in the advertisements. That clearly is the Commission's intent when asserting that charging any advance fee by debt relief providers inherently is "unfair," which thereby would confer correlative authority under the Federal Trade Commission Act, 15 U.S.C. § 45(a)(1). As the data supplied by MD in Confidential Exhibit **MD #A-10** confirms, there is a legitimate business reason for aligning the respective interests and incentives of the service provider with the near-bankrupt debtor, and – in fact – such an advance fee may be essential to properly aligning those incentives and avoiding a debacle for consumers.

D. THERE IS NO CONFLICT BETWEEN THE FTC AND POLICE POWERS OF THE STATES TO REGULATE THE PRACTICE OF LAW

Nothing in regulation of lawyers by state judiciary systems would impinge on the federal interest stated in the TSR related to protecting consumers from unwanted telephone calls or businesses from receiving unwanted faxes. Just as using state regulation as a method to assure a minimum level of competency and adherence to the Code of Professional Responsibility falls within the "practice of law" savings provision in 37 C.F.R. § 10.1 and would not hinder or otherwise conflict with the federal objectives fostered by the PTO, it would not usurp federal authority over "deceptive" or "unfair" practices in the FTC Act, or the TSR, 16 C.F.R. §310. Rather, the continued lawyer disciplinary action addressed in *Kroll* is analogous. *Kroll,* 242 F.3d 1359. There, the Federal Circuit recognized that a State could discipline a state-licensed attorney who was also registered to practice before the PTO for ethical violations arising under state law. *Id.* at 1364. The PTO, which has the right to discipline attorneys authorized to practice before the PTO,

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[28] By analogy to Supreme Court precedents, federal law reflects consistent application of conflict preemption analysis in patent cases. *See, e.g., Bonito Boats, Inc. v. Thunder Craft Boats, Inc.,* 489 U.S. 141 (1989); *Compco Corp. v. Day-Brite Lighting, Inc.,* 376 U.S. 234 (1964); *Sears, Roebuck & Co. v. Stiffel Co.,* 376 U.S. 225 (1964). These "past decisions have made clear that state regulation of intellectual property must yield to the extent that it clashes with the balance struck by Congress in our patent laws." *Bonito*, 489 U.S. at 152. Quite clearly, however, courts recognize that the States may regulate in the patent arena so long as such regulation does not impinge upon the federal interest in patent law.

and the States may share jurisdiction over certain disciplinary matters without fear of Federal preemption. *Id.* at 1365. *See also* 35 U.S.C. § 32.

The states, acting through their judiciary and delegated entities [such as a Bar or Committee] already provide a long standing, strong mechanism to enforce Rules against practitioners whose conduct is not permitted under the state's Rules. Unquestionably, a state "…has a very real interest in regulation of the practice of law," *In re Cowgill,* 307 N.E.2d 919, 921 (1973), to protect the public from incompetent or unscrupulous lawyers, which is why "a state is free to enforce its own licensing regulations." *In re Amalgamated Dev. Co.,* 375 A.2d 494, 497 (D.C.) *cert. denied,* 434 *U.S.* 924 (1977). Further, there is "no federal purpose to protect those whom… [the FTC] does *not* license from further regulation by the state." *In re Cowgill,* at 922. Even though the FTC enjoys a complementary rule to enforce the law against "unfair" or "deceptive" practices there is no conflict with the federal regulatory system for a state to take responsibility for policing its own lawyers, especially because of the exceptional power a state has to suspend or expel a lawyer, which are much more powerful tools than remedial monetary relief possibly available to the FTC. "Congress has never intended that … laws should displace the police powers of the States, meaning by that term those powers which the health, good order, peace and general welfare of the community are promoted." *Chicago Bar Ass'n v. Kellogg,* 338 Ill.App. 618, 629 (1949).

While regulatory approaches vary from state-to-state, long-standing state judicial enforcement of lawyers is recognized in every state, as illustrated in the following three examples:

1. FLORIDA:

The Florida Bar (an arm of the Florida Supreme Court), approves all Rules that regulate lawyers. The Florida Bar with which members must comply as part of the overall Rules of Professional Conduct approved by the Florida Supreme Court has established Rules *just for Internet advertising* that are as follows:

1. Does the advertisement contain any misrepresentations of fact or law? Rules 4 7.2(c)(1)(A), 4-7.2(b)(2).

2. Does the advertisement contain any information that promises results? Rule 4-7.2(c)(1)(F).

3. Does the advertisement contain any statements that describe or characterize the quality of the lawyer's services? Rule 4-7.2(c)(2).

4. Does the advertisement fail to disclose the city of at least one bona fide office location of the advertising attorney? Rule 4-7.2(a)(2). Is the geographic disclosure illegible? Rule 4-7.2(c)(11).

5. Does the advertisement fail to contain the name of at least one lawyer responsible for the advertisement? Rule 4-7.2(a)(1). Is the name illegible? Rule 4-7.2(c)(11).

6. If the advertising law firm employs a fictitious or trade name, does the fictitious or trade name fail to appear on all the firm's advertising, letterhead, business cards, office sign, pleadings, and other firm documents? Rule 4-7.9(c).

7. Only attorneys who are board certified in a particular area of the law may claim to be certified, board certified or claim a specialization or expertise and only in the area of law in which they are certified. A firm cannot claim a specialization.

> *Does the advertising attorney, who is not board certified, claim a specialization or expertise? Rule 4-7.2(c)(6).*
>
> *Does the advertising attorney, who is board certified, claim a specialization or expertise in an area of law other than that in which he or she is board certified? Rule 4- 7.2(c)(6).*
>
> *Does the advertising firm claim a specialization? Rule 6-3.4(c) and Rule 4 7.2(c)(6).*

8. If the advertisement quotes a fee, does it fail to disclose whether the client will be responsible for any costs or expenses in addition to the advertised fee? Rule 4-7.2(c)(7). Is the cost disclosure illegible? Rule 4-7.2(c)(11). If the advertisement appears in a language other than English, does the cost disclosure appear in that language? Rule 4-7.2(c)(10).

9. If the advertisement states that the attorney will not receive a fee unless an award is obtained, does the advertisement fail to disclose whether or not the client will be responsible for costs or expenses in the absence of a recovery? Rule 4-7.2(c)(7). Is the cost disclosure illegible? Rule 4-7.2(c)(11). If the advertisement appears in a language other than English, does the cost disclosure appear in that language? Rule 4-7.2(c)(10).

10. Does the lawyer advertise for legal employment in an area of practice in which the lawyer does not currently practice? Rule 4-7.2(c)(4).

11. Does the advertisement contain any illustrations or photographs that are likely to deceive, mislead, manipulate or confuse the viewer? Rule 4-7.2(c)(3).

12. Does the advertisement contain a visual or verbal description, depiction, or portrayal of persons, things, or events that is deceptive, misleading, or manipulative? Rule 4-7.2(c)(3).

13. Does the advertisement contain any testimonials or endorsements? Rule 4-7.2(b)(1)(J).

14. Does the advertisement fail to disclose that the case or matter will be referred to another lawyer or law firm? Rule 4-7.2(c)(13). Is this disclosure illegible? Rule 4-7.2(c)(11). If the advertisement appears in a language other than English, does the disclosure appear in that language? Rule 4-7.2(c)(10).

Comparable sub-sets of Rules apply to other forms of advertising. What should be clear from just this one "Quick Reference Checklist - Internet Banner Ads (Ads Other Than

Electronic Mail Or Websites)" [published on The Florida Bar's Web site], is that if the Commission believes provision of debt settlement services by lawyers is not a proper exercise of the practice of law, and that it should be federally regulated to prevent advance fee arrangements, and should be subject to burdensome regulations if an inbound toll-free telephone number is provided to prospective clients in permissible advertising, it should attempt to persuade state Supreme Courts to address the matter of the "unauthorized practice of law" by companies that perform debt settlement services without a lawyer's supervision (which would put the endeavor under state-mandated Professional Rules of Conduct).

2. VERMONT:

For another example, specifically in regard to the required supervision of paralegals and paraprofessional assistants working for or under lawyers' supervision, Vermont law provides as follows (in relevant parts):

a. The Vermont Rules of Professional Responsibility

Rule 5.3. Responsibilities Regarding Nonlawyer Assistants With respect to a nonlawyer employed or retained by or associated with a lawyer: … (b) a lawyer having direct supervisory authority over the nonlawyer shall make reasonable efforts to ensure that the person's conduct is compatible with the professional obligations of the lawyer; and (c) a lawyer shall be responsible for conduct of such a person that would be a violation of the Rules of Professional Conduct if engaged in by a lawyer if: (1) the lawyer orders or, with the knowledge of the specific conduct, ratifies the conduct involved….

Rule 1.6. Confidentiality of Information (a) A lawyer shall not reveal information relating to representation of a client unless the client consents after consultation, except for disclosures that are impliedly authorized in order to carry out the representation….

Rule 1.4. Communication … (b) A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation.

Read *in pari materia*, these three provisions confirm that non-lawyer assistants, such as paralegals and paraprofesionals, must conduct themselves in a manner compatible with the Rules of Professional Conduct applicable to the Vermont's lawyers for the law firm's clients in Vermont, one of which is not to reveal information relating to the representation, and another of which is to communicate with the client to explain a matter necessary for the client to make an informed decision.

b. The Vermont Ethics Opinions

Advisory Ethics Opinion 96-11 provides in relevant parts, "Any confidences or secrets obtained as a result of the conference continue to be protected thereafter, and the attorney may not disclose such information…" and "the attorney may not reveal the information obtained during a free initial consultation…."

Advisory Ethics Opinion 96-09 provides in relevant part, "Information imparted to a lawyer by a prospective client seeking legal representation is generally protected from further disclosure or use under DR 4-l0l

Advisory Ethics Opinion 95-16 provides in relevant part, "An attorney may not disclose a client's confidences or secrets even after the representation has terminated…."

Advisory Ethics Opinion 91-06 provides in relevant part, "The names, addresses and other personally identifiable information which may lead to the identification of a particular client… appearing in client files… are secrets within the meaning of DR 4-101(A) since it might be an embarrassment to the client for any number of reasons to have it revealed that he was a client. Other information in the client's file may also constitute confidences or secrets under DR 4-101(A)." Further, "The ABA Standing Committee has issued several Opinions relevant to this issue. Together, the several Opinions conclude: (1) that client information, including eligibility information in the legal services context, is protected under the Disciplinary Rules, either as a confidence or a secret; (2) that there are legitimate needs for auditing programs to determine types of cases handled, results obtained, and whether eligibility requirements are being met; and (3) in deference to accommodating (1) and (2) above, information can be supplied in a manner aimed at preserving confidentiality." In this regard, the initial disclosure was intended to preserve the client confidentiality to the extent necessary and consistent with the relevant Rules of Professional Responsibility.

MD's concern is that, to provide specific identifying information a law firm's clients in Vermont, including their first names and addresses if requested or required by Commission, for example, would violate this Ethics Opinion, which explicitly incorporates by reference, the ABA Standing Committee Opinions (and other ethics opinions listed in this e-mail). Finally:

Advisory Ethics Opinion 85-07 provides in relevant part, "…the lawyer's obligation to guard the client's confidences and secrets **is absolute**." [Emphasis added.]

MD's Legitimate Concerns about Reputation issues:

MD has a legitimate concern regarding the implications of the proposed Rule amendments on attorneys, their clients, and their agents. For example, even if the protections in the Vermont Code of Professional Responsibility and the Vermont Ethics Opinions could be

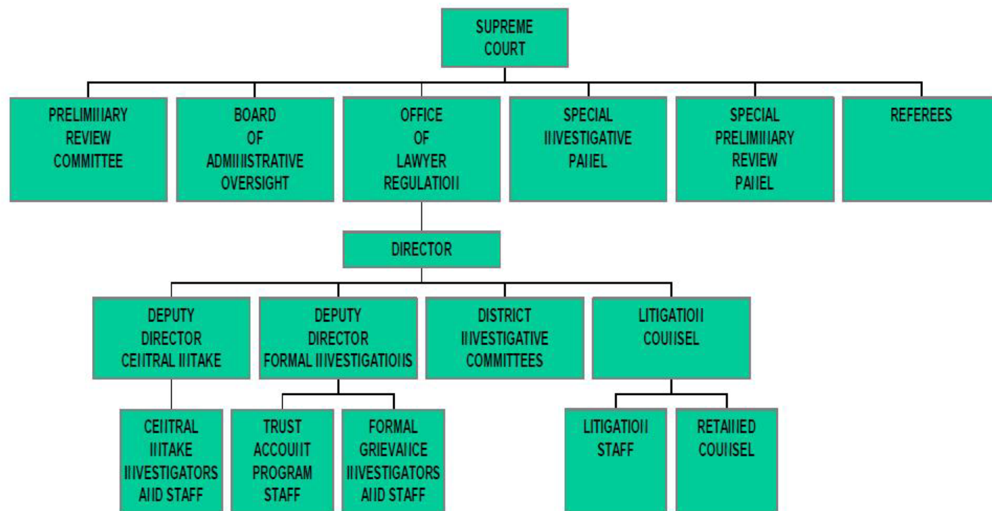
overcome (which would not appear possible), there would remain serious issues of reputation, which constitute intellectual property rights as well as goodwill both of Vermont law firms, their clients, as well as those of MD.

If demanded by Rule amendments or civil investigative demand by the Commission, some clients might be misled by even nominal contact to *assume irregularity or impropriety.* It would be improper for clients of the law firms to be dealt with in a manner that might lead them to jump to a mistaken conclusion that their lawyers or the paralegals they have contact with are or *might* be doing something improper or illegal, or that the client's funds held in the lawyer's trust account to pay off unsecured debts, are or might be at risk. That would create panic for them – completely unnecessarily – and also would besmirch MD goodwill and fine reputation.

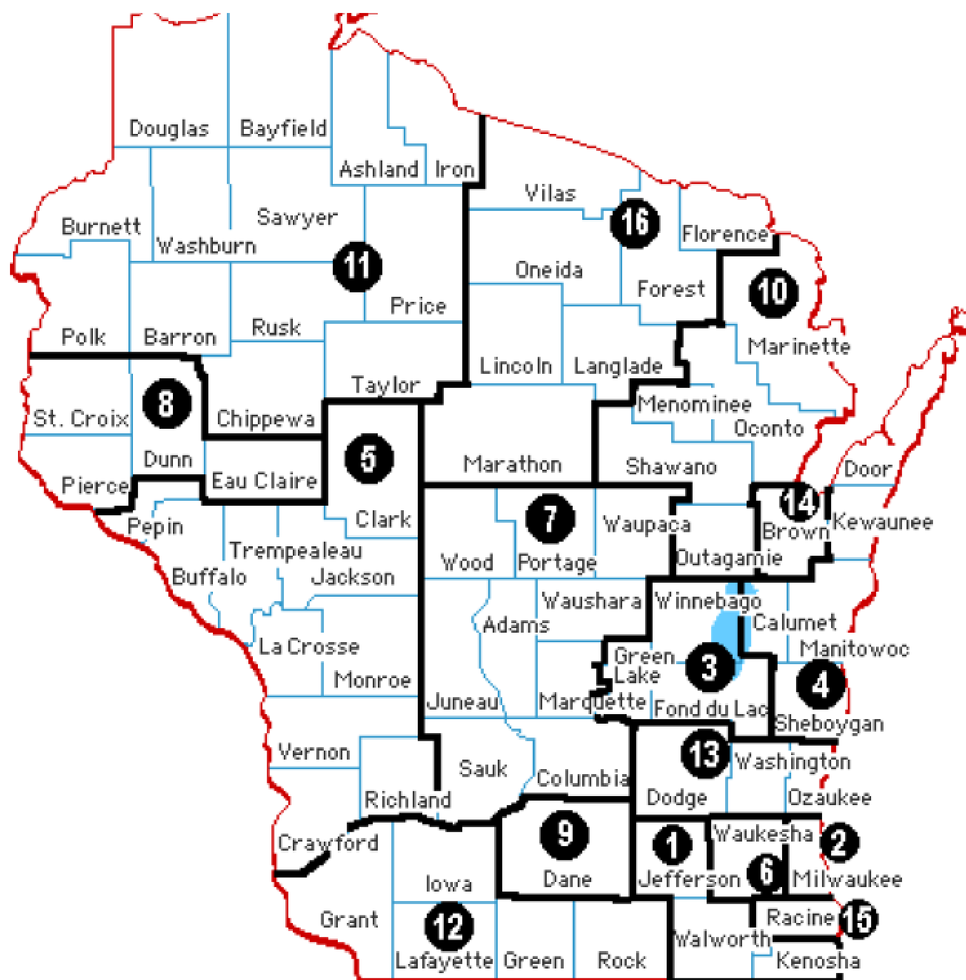
3. WISCONSIN:

ORGANIZATIONAL CHART OF THE LAWYER REGULATION SYSTEM

Lawyer Regulation ("



Using oversight by the Wisconsin Supreme Court, supplemented by lawyers and members of the public who serve on 16 separate Committees, provide “convenient, economical” regulatory oversight of the Bar’s members, as is set forth in the following chart:



Sixteen District Committees – composed of lawyers and members of the public – appointed by the Supreme Court, are an integral part of the Office of Lawyer Regulation’s (OLR) investigative program. The use of the committees ensures local input into the grievance process and provides both complainants and respondents with a convenient, economical means of peer review. Pursuant to Supreme Court Rules 21.06(2) and 21.03(6)(k), the Director of OLR is responsible for supervision of the District Committees.

The Wisconsin Rules of Professional Conduct for Attorneys, Preamble, Section 1, makes clear that "[a] lawyer, as a member of the legal profession, is a representative of clients, an officer of the legal system and a public citizen having special responsibility for the quality of justice."

This "special responsibility" is coextensive with the license to practice law. Section 6 of the Preamble makes it clear: "A lawyer should be mindful of deficiencies in the administration of justice and of the fact that the poor, and sometimes persons who are not poor, cannot afford adequate legal assistance." This goal is fostered by having lawyers inextricably involved in debt settlement services for near-bankrupt debtors by providing clients "…with an informed understanding of the client's legal rights and obligations." Preamble, Section 2.

Consequently, the judicial system and the members of the Wisconsin Bar have a long-standing incentive to proactively assure there is adequate disciplinary control.

E. SUMMARY

The preceding three examples of state power over lawyers – Florida, Vermont, and Wisconsin – are presented to confirm the pervasive level of state police powers over lawyers, and confirms that no conflict preemption applies to empower the FTC to regulate lawyers' practice of law that entails debt settlement for near-bankrupt clients who call lawyers in response to a truthful advertisement for services.

In summary, it is not helpful to near-bankrupt debtors who would prefer to avoid the stigma of bankruptcy (or are ineligible to file under Chapter 13) to restrict their choices and options in the draconian manner proposed by the FTC, intruding into the practice of law and the historical state regulation of lawyers, and expanding the Telemarketing Sales Rule well beyond the legal foundation of its original authorization. In the opinion of J. Howard Beales, III, former Director of the Bureau of Consumer Protection, "…unfairness can be misused, particularly when there is no principled basis for applying it," which is apropos in regard to the materially flawed premise for Rulemaking as explained in these Comments. *See* "The FTC's Use of Unfairness Authority: Its Rise, Fall, and Resurrection," http://www.ftc.gov/speeches/beales/ unfair0603.shtm.

The Commission appears to be attempting to act without empirical analysis to remedy a problem of allegedly insufficient disclosure by "debt relief" firms, using a bludgeon to implement its unsubstantiated view of insufficiently justified performance by those firms. BCP has, quite simply, not met its burden under the modern view of the unfairness doctrine.

MD adopts the arguments presented by the American Bar Association in *American Bar Association v. Federal Trade Commission*, Civil Action No. 09-1636 (RBW) (DC Dist. 2009), as though presented herein, to avoid expanding this analysis further. MD reserves the right to

supplement this submission concerning the ABA's pending action [which deals with pronouncements of intent by Commission staff to regulate lawyers].

Question RFA(3): Do the prohibited practices in the proposed Rule impose a significant impact upon a substantial number of small entities? If so, what modifications to the proposed Rule should the Commission consider to minimize the burden on small entities?

MD'S ANSWER TO QUESTION RFA(3):

Throughout the preceding Comments, MD repeatedly has pointed out that the proposed Rule amendments would impose a significant impact on small law firms, on their clients, and on their agents, such as MD. MD has recommended adopting threshold "standards" in conjunction with the CFPA to apply to debt settlement entities that operate on a national scope. This would assure that clients funds will be held safely in trust accounts that are audited, and that the service providers possess training, facilities, have a scale or infrastructure and breadth of operations necessary to perform for the duration of the multi-year process necessary for clients under contract [which should be with a law firm] to accumulate funds to pay off discounted debts in the event of a significant, durable client hardship.

APPENDIX

MD Exhibit #C-1……… Chart; "Cumulative Net Savings By Duration of the Engagement"

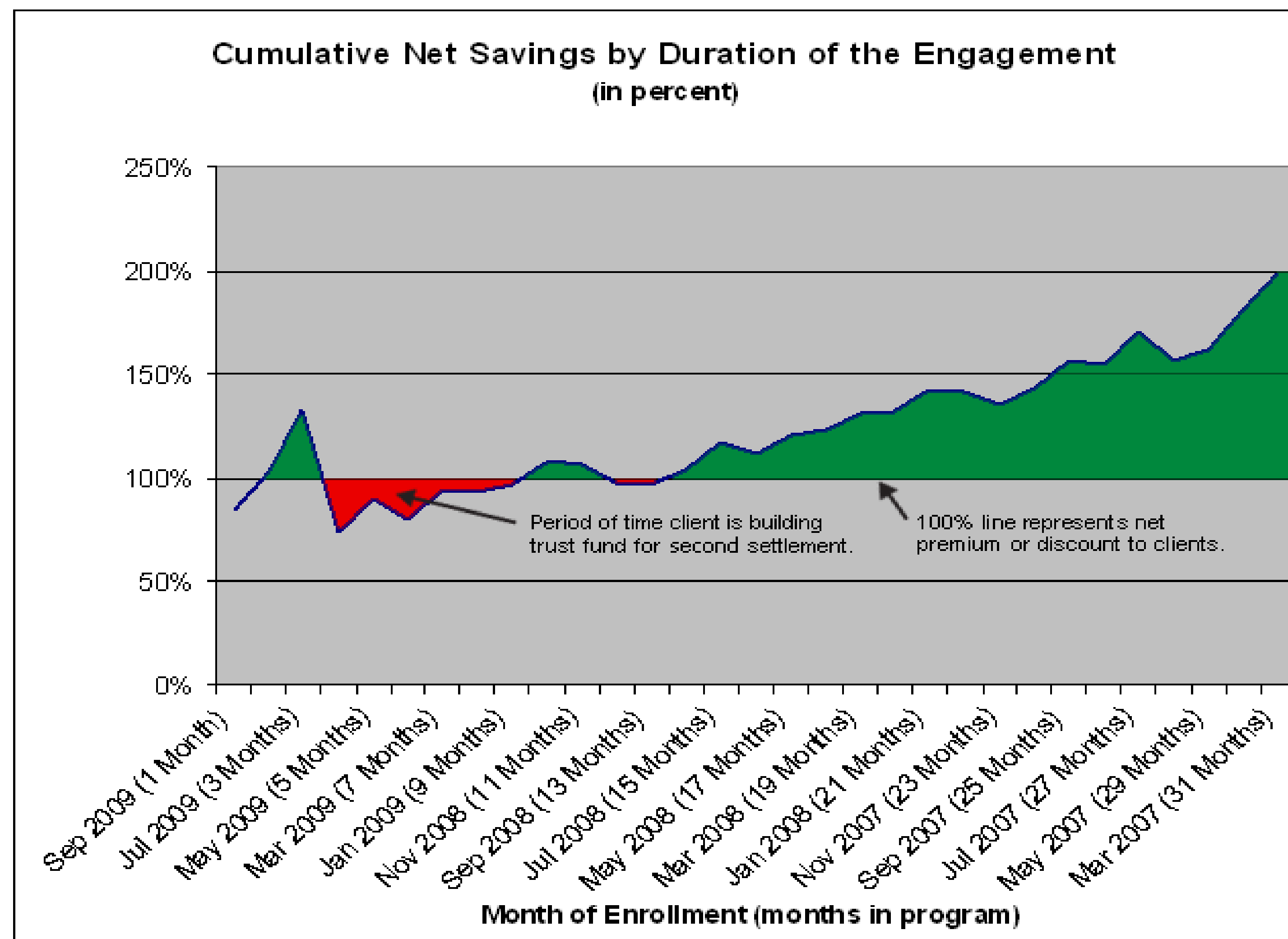
MD Exhibit #C-2……… "Hofeld's Analysis of Legal Relationships Defines The Practice of Law"

Respectfully submitted,

Stephen E. Nagin
for Morgan Drexen, Inc.

Cumulative Net Savings By Duration of the Engagement

Month Enrolled	Savings Percentage
Sep 2009 (1 Month)	85%
Aug 2009 (2 Months)	103%
Jul 2009 (3 Months)	133%
Jun 2009 (4 Months)	74%
May 2009 (5 Months)	90%
Apr 2009 (6 Months)	80%
Mar 2009 (7 Months)	95%
Feb 2009 (8 Months)	93%
Jan 2009 (9 Months)	97%
Dec 2008 (10 Months)	108%
Nov 2008 (11 Months)	106%
Oct 2008 (12 Months)	98%
Sep 2008 (13 Months)	97%
Aug 2008 (14 Months)	104%
Jul 2008 (15 Months)	117%
Jun 2008 (16 Months)	112%
May 2008 (17 Months)	121%
Apr 2008 (18 Months)	123%
Mar 2008 (19 Months)	131%
Feb 2008 (20 Months)	132%
Jan 2008 (21 Months)	142%
Dec 2007 (22 Months)	141%
Nov 2007 (23 Months)	136%
Oct 2007 (24 Months)	143%
Sep 2007 (25 Months)	157%
Aug 2007 (26 Months)	155%
Jul 2007 (27 Months)	171%
Jun 2007 (28 Months)	157%
May 2007 (29 Months)	162%
Apr 2007 (30 Months)	181%
Mar 2007 (31 Months)	199%



The above chart represents the total law firm client savings as a percentage of total fees of all law firm clients with at least one settlement. A cumulative net savings greater than 100% indicates the total combined client benefits are greater than the total combined fees paid by that group. The data is grouped based on the law firm client's initial engagement date (i.e. each data point on the x-axis represents the total combined cumulative net savings of all law firm clients with at least one settlement that started in the month identified). The number of months in parenthesis represents the number of months that group of law firm clients have been in the settlement negotiation process. The more time the client is engaged in the settlement negotiation process, the greater the likelihood of acheiving mulitple settlements, and the greater the cumulative net client benefit from the process. This trend is demonstrated by looking to the earliest starting data group (March 2007) and noting this group has the largest cumulative net savings after 31 months in the settlement process.

* Represents the group of all law firm clients with at least one settlement who were enrolled in March 2007. The law firm clients within this group have been engaged in the process for 31 months.

HOHFELD'S ANALYSIS OF LEGAL RELATIONSHIPS DEFINES THE PRACTICE OF LAW:

In the seminal book, *Fundamental Legal Conceptions as Applied to Judicial Reasoning* (1923), highly regarded legal scholar Wesley Newcomb Hohfeld provided as his durable legacy, the clearest concept of what really defines legal relationships. His analytical framework forms the basic framework for all modern jurisprudence and succinctly explains when some activity, advocacy, advice, or representation requires legal training and judgment.

Mr. Hohfeld created the following **table of entitlements and burdens** [to which colored type is added to facilitate a better understanding of the relationships depicted]:

Right (Claim of Right)	**Liberty**	**Power**	**Immunity**
Duty	**No-Right**	**Liability**	**Disability**

In the four-column chart, immediately above, the top row presents four types of *legal concepts*. The bottom row presents the legal position entailed for the other party in each of four judicially recognized *correlatives* of primary rights and obligations.

This table also can be viewed diagonally to demonstrate judicially recognized opposing concepts (*i.e.*, two legal positions that negate each other), sometimes called **the Correlativity Axiom**:

Right (Claim of Right)	**Liberty**	**Power**	**Immunity**
Duty	**No-Right**	**Liability**	**Disability**

In the correlativity axiom, the concept of a **right** (set forth in the first column, above) actually is a set of various rights *ad infinitum*. Each of these rights is discrete, distinct, and separable from other rights held against a particular person or entity. A "right" is held against interference or for assistance and never provides a claim to anything except to uphold the actual right. [A lesser concept is a "privilege" (which is a non-absolute right) that can co-exist with another privilege. For example, the privilege to practice law co-exists with the attorney-client evidentiary privilege, whereas the Right of Due Process is an absolute right.]

When applied to a specific "right" an automatic duty or outcome is entailed. This concept of a right is the equivalent to a preemptory force. Supererogatory obligations, such as those beyond the call of duty (*e.g.*, charitableness or other abstract virtues), are not *duties* in the eyes of the law, and as such, entail no correlative rights. Because Hohfeld's analytical framework depicts rights and legal protections that arise in relationships of correlativity or mutual entailment (as an inevitable consequence), it is not concerned with moral or social justification of rights, liberties, powers, or immunities. [These simply are (or may be) present outside of the legally recognized element of a "right."]

The concept of **liberty** (in the second column, above) is established both in the second paragraph of the Declaration of Independence: "We hold these truths to be self-evident, that all men are created equal, that they are endowed by their Creator with certain unalienable Rights, that among these are Life, **Liberty** and the pursuit of Happiness" as well as in the Preamble to the Constitution of the United States: "We the People of the United States, in Order to form a more perfect Union, establish Justice, insure domestic Tranquility, provide for the common defence [sic.], promote the general Welfare, and secure the Blessings of **Liberty** to ourselves…."

A **liberty** is an absence of any duty to abstain from some action. A person who acts in line with a liberty would be shielded from encroachment by possession (albeit imperfectly) by some basic rights (such as rights set forth in the Bill of Rights, and in the criminal law parlance, against assault, battery, trespass, etc.). The person against whom a liberty is held has no-rights concerning the activity to which the liberty relates. Consequently, a liberty is, in effect, the absence of a duty not to do some act, as well as a right recognized by law, the correlative of which is the general duty of everyone not to prevent the exercise of a liberty (*e.g.*, the liberty to earn a living in your own way by dealing with other persons who are willing to deal with you, provided there is no violation of some law that prohibits doing so, and provided that your livelihood does not infringe the rights of other persons). By contrast, "permission" to act or not act entails a duty on others not to interfere; it is a form of liberty in that a person is under no duty not to perform the act.

The concept of **power** (set forth in the third column on the previous page) is one's ability to alter legal (or moral) relations. Because numerous court decisions refer to a "right," the word sometimes may be misused for what really is meant to be a conclusive "power" to do something. [The definition of state power is not the same as a legal power (*i.e.*, the power given to a person under law by a governing entity).]

Lastly, the concept of **immunity** (set forth in the fourth and final column on the previous page) is a shield against the power to change one's legal position with respect to any entitlements covered by the immunity. It should be noted that the Bill of Rights confers extensive immunities that disable the legislative branch of government from enacting certain types of laws that would overpower individual rights.

Hohfeld's analysis clarifies the legal position of parties and most accurately predicts the effect of alterations in respective legal positions. Using this matrix to analyze what constitutes the practice of law is much more probative than relying on circular logic such as, *the practice of law is what lawyers are licensed to do*, or as one state's Rule of Professional Conduct, Rule 5 proclaims: "the performance of activity that constitutes the unauthorized practice of law." Similarly, the "Scope" language that precedes many states' Rules of Professional Conduct states: "principles of substantive law external to these Rules determine whether a client-lawyer relationship exists." The reference to substantive law, such as the

Telemarketing Sales Rule, that may deal with a unique factual predicate of scant guidance to other facts or circumstances provides little clarity or rigorous analysis.

Hohfeld's "table of entitlements" and "correlativity axioms" provides fundamental underpinnings to legal doctrines. These form a solid foundation to any discourse concerning what constitutes the practice of law (regardless of how a state court might express the concept in the temporal holdings in judicial decisions based on particular facts, or how a state's highest court may express the concept in rules of professional conduct by reference to what may be "unauthorized" or to the "substantive law" based on external decisions that form the law).

Consequently, Hohfeld's analytical framework forms the best and most proper basis on which to define the practice of law and is consistent with the words "other considerations" expressed in Rules or Professional Conduct.

COMPARISON TO FINALITY IN OTHER RULES PROVIDES VERIFICATION THAT HOHFELD'S RIGOROUS ANALYSIS IS A UNITY PRINCIPLE OF PRACTICAL APPLICATION:

By way of demonstrating unity and harmony with other societal undertakings comparable to the profound changes conferred by the privilege to practice law, one can examine what constitutes the acts or practices that constitute the science of medicine, by simply understanding the difference between a prescription medication and a dietary supplement available at a pharmacy.

For example, pursuant to 21 CFR §101.93(f), a dietary supplement may make certain statements:

> *Permitted structure/function statements.* Dietary supplement labels… may… describe the role of a nutrient or dietary ingredient intended to affect the **structure or function** in humans or that characterize the documented mechanism by which a nutrient or dietary ingredient acts to maintain such **structure or function**, provided that such statements are not disease claims under paragraph (g) of this section. *If the label* or labeling of a product marketed as a dietary supplement *bears a disease claim* as defined in paragraph (g) of this section, *the product will be subject to regulation as a drug* unless the claim is an authorized health claim for which the product qualifies. [Emphasis added.]

Pursuant to 21 CFR §101.93(g):

> *Disease claims.* (1) For purposes of 21 U.S.C. 343(r)(6), a "disease" is damage to an organ, part, structure, or system of the body such that it does not function

properly… or a state of health leading to such dysfunctioning…; except that diseases resulting from essential nutrient deficiencies… are not included in this definition.

(2) FDA will find that a statement about a product claims to diagnose, mitigate, treat, cure, or prevent disease (other than a classical nutrient deficiency disease) under 21 U.S.C. 343(r)(6) if it meets one or more of the criteria listed below. … In determining whether a statement is a disease claim under these criteria, FDA will consider the context in which the claim is presented. *A statement claims to diagnose, mitigate, treat, cure, or prevent disease if it claims, explicitly or implicitly, that the product:*

(i) Has an effect on a specific disease or class of diseases;

(ii) Has an effect on the characteristic signs or symptoms of a specific disease or class of diseases, using scientific or lay terminology;

(iii) Has an effect on an abnormal condition associated with a natural state or process, if the abnormal condition is uncommon or can cause *significant or permanent harm*;

(iv) Has an effect on a disease or diseases through one or more … factors… that … suggests *an effect on a disease or diseases*.

The difference, then, between a dietary supplement (available without a prescription) and a drug (which requires a prescription by a properly licensed practitioner) is [in essence] a claim that the latter will "mitigate, treat, cure, or prevent a disease." Such a claim would not just "affect" or "maintain" a structure or function of the body, it would have a beneficial effect on a disease or an abnormal condition that could cause significant or permanent harm.

In the language of the law, the *power* to sell or use a drug requires a prescription by a licensed physician because of potentially *irreversible effects* it may have on a structure or function of the human body. The reason for that regulatory requirement is because improper use of a drug could lead to a liability for the seller that did not dispense pursuant to a prescription. The fact that a drug is something a doctor prescribes, or is something listed in a compendium of "drugs" is not what underlies the true concern.

A state's interest in regulating dispensing of drugs is the fact that efficacy and safety of a substance that mitigates, treats, cures, or prevents a disease requires knowledge, skill, judgment, and experience of an allopathic or osteopathic physician who has satisfied the requisites for state licensure.

The unity of analysis between underlying principles in law and medicine brings the practice of medicine in harmony with the practice of law, because **the underlying principles establish the purpose of state licensure**, which can be properly applied and evaluated in a robust manner using the Hohfeld framework to reveal clarity, elegance, and analytical precision.

The analogy to what constitutes the practice of medicine (with respect to use of prescription drugs) is consistent with what constitutes the practice of law (with respect to changing effects of legal rights/duties, liberty/no-right, power/liability, and immunity/disability). States regulate the practice of medicine, not the federal government, because there is no federal preemption and there is a long-standing history of state regulation. The same is true for the practiced of law.