



CALIFORNIA DEPARTMENT OF CONSUMER AFFAIRS  
 DIVISION OF LEGAL AFFAIRS  
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## Legal Guide DC-1

# WHAT TO DO IF YOU RECEIVE A DEMAND FOR PAYMENT FROM A CREDITOR OR DEBT COLLECTION AGENCY

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If you owe money to some other person, you are a *debtor* of that person. You “owe” money if you have a legal obligation to pay it. The amount of money you owe is a *debt*. A *creditor* is a someone to whom you owe a debt. If someone owes you money, you are a *creditor* of that person.

If you can’t pay a debt when it’s due, the creditor may try to collect the debt by sending you a *demand for payment*, or the creditor may *assign* the debt to a *debt collection agency*. A debt collection agency is a business that collects debts that were originally owed to other businesses and creditors.

In this Legal Guide, creditors and debt collection agencies are both called “collectors.” “You” means a consumer who is a debtor. Words in *italic typeface* are defined in the Glossary on pages 10-12.

### Article 1 What to Do First

If a creditor or debt collection agency requests or demands that you pay something, it’s important that you do the right things.

The most important thing that you can do, if you receive a demand for payment, is to respond immediately, both by telephone and in writing. The faster you and the collector get into communication with one another, the quicker the matter can be resolved.

This Legal Guide will help you understand your *rights*, *obligations*, and *remedies*, as well as the collector’s *rights*, *obligations*, and *remedies*. This information may help you resolve your situation favorably. The collector’s legal obligations are covered in detail in another Legal Guide (Legal Guide DC-2).

Remember that if you don’t respond to a collector’s demand for payment in some way, you might end up with a court *judgment* against you for the full amount demanded and more. Don’t let that happen! If a court judgment is entered against you, it will be included in your *credit record* and in future *credit reports*. Also, you may be forced to pay the *judgment debt* by an *execution*

on your earnings (garnishment) or on other property you may own, either now or at a later time.

### Article 2 About This Legal Guide

This Legal Guide gives you information that will help you respond to a *demand for payment* from a *creditor* or *debt collection agency*. Here is what it covers:

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Several other Legal Guides may be helpful. One entitled “Summary of the Fair Debt Collection Practices Statutes” (Legal Guide DC-2) covers both the federal<sup>1</sup> and California<sup>2</sup> fair debt collection practices statutes, which only apply to the collection of debts incurred in consumer transactions. A Legal Guide entitled “Debt Collector’s Wrongful Conduct: Some Tort Remedies for Debtors” (Legal Guide DC-3) covers legal principles (called “debt collection torts”) that can apply to the collection of any kind of debt.<sup>3</sup>

If you are named as a defendant in a debt collection lawsuit, most of the information in this Legal Guide still applies. Do not allow a judgment to be entered against you for more than the amount that you actually owe. If a lawsuit has been filed, try to *negotiate* an *agreement* in which the collector promises that no court judgment will be entered against you. The collector may do this in exchange for your promise of payment. On how to do that, read Articles 3 through Article 7 below.

If you are served with court papers and are not certain about what to do, consult an *attorney* or other legal expert for advice. Since you only have a short time to answer a lawsuit, do so immediately. If you don't know where to turn, visit the California Judicial Council's Internet website at [www.courtinfo.ca.gov/selfhelp](http://www.courtinfo.ca.gov/selfhelp).

If this debt is only one among many that you owe, contact a nonprofit *credit counselor* to discuss your problem, and perhaps obtain help in *negotiating* a payment plan with your creditors (see Article 8, Getting Help to Get Out of Debt, page 7 below).

If you have many more debts than you can handle, you may need to consider filing a petition in *bankruptcy*, but only as a last resort. Short of that, you can consult an *attorney* who sets up *wage earner plans* for debtors. A wage earner plan shields you from your creditors while you pay off your debts.

This Legal Guide does not include information about your *credit record* -- such as how you can obtain a copy of your *credit report* and correct any errors -- or what to do if a *lawsuit* is filed against you. To learn about other money and credit issues, see *Surviving Debt*, National Consumer Law Center, [www.consumerlaw.org](http://www.consumerlaw.org); *Money Troubles*, Nolo Press, [www.Nolo.com](http://www.Nolo.com); or *Getting Out of Debt*, Cliffs Notes, [www.cliffsnotes.com](http://www.cliffsnotes.com). Spanish language sources include [www.consumer-action.org:16080/Spanish](http://www.consumer-action.org:16080/Spanish), [www.ftc.gov/ftc/spanishinfo](http://www.ftc.gov/ftc/spanishinfo), and [www.cccsoc.org](http://www.cccsoc.org) (links to other sites).

Debt collectors (including both original creditors and debt collection agencies) are subject to laws that establish standards of fair conduct. Creditors and debt collection agencies are permitted to take reasonable steps to enforce and collect payment of debts. That's because an efficient economy requires a credit process. The debt collection practices statutes promote fair and responsible credit extension and enforcement practices by placing reasonable boundaries on the kinds of activities that creditors and debt collection agencies can employ to enforce and collect debts.

The "fair debt collection practices statutes" also promote fair and responsible debt collection by giving consumer debtors specific rights. These include the right to cut off contacts by a debt collection agency, the right to specify periods when and places where contacts with the debtor may and may not be made, and the right to *dispute* a debt and require a debt collection agency to verify its existence and amount. These rules are discussed in a Legal Guide entitled "Summary of the Fair Debt Collection Practices Statutes" (Legal Guide

DC-2). If you think you are being abused by a debt collector, consult that publication.

### Article 3 Don't Pay More Than You Owe

Not every *demand for payment* is legally *enforceable*. If a claim is not legally enforceable, you have no *obligation* to pay anything. While most claims that are asserted by creditors and debt collection agencies are enforceable, some are not. When you receive a demand for payment, therefore, it's important to think about whether you actually owe the amount demanded.

For many reasons, a collector may have no right to the amount claimed. Some common *defenses* that you can assert against a claim made by a creditor are:

- The debt is owed by someone else, not you. (But you may be liable if you co-signed for it.)
- The debt is too old to be legally enforceable (that is, it is *barred* by a *statute of limitation*).
- The claim is based on an agreement that must be in writing, but there was no written contract.
- You are being billed for an item that you never ordered.
- You ordered an item, but never received it.
- You returned an item, but you were billed for it anyway.
- The contract is one that you have a *right to cancel*, and you properly canceled it (or can still cancel it).
- You are a victim of a *fraud*, and the contract or sale is therefore *void* or *voidable*.

Most of these are *complete defenses* to a claim made by a creditor, which means that you may owe nothing. You may also have a *partial defense* to a claim. In that situation, a collector may be entitled to something, but the collector has asked for more than is owing -- for example, more than you actually *agreed* to pay, or more *interest* than the law allows, or *court costs*, *attorney's fees*, *collection fees*, or other *charges* that are more than the law allows. It's important that you look closely at a request for payment of a debt that you believe you might owe. While most of the amount that is demanded may be owing, a portion may not be owing. It's important that you not pay anything more than the amount that you actually owe.

This Legal Guide does not cover the laws that limit the enforceability of claims, or that authorize or limit fees and charges that may have been added to the original debt. To help you decide whether the claim is enforceable, or whether the extra charges are really allowed by law, you may need to consult a lawyer.<sup>4</sup>

Organizations and sources of information that may be able to help you decide whether a particular claim or portion of it is enforceable or excessive include:

- [California Judicial Council](http://www.courtinfo.ca.gov/selfhelp), www.courtinfo.ca.gov/selfhelp.
- [Consumer Action](http://www.consumer-action.org) (San Francisco), 415-777-9648, www.consumer-action.org (Spanish language, www.consumer-action.org:16080/Spanish)
- [Federal Trade Commission](http://www.ftc.gov), 1-877-382-4357, www.ftc.gov (Spanish language information, www.ftc.gov/ftc/spanishinfo).
- [California Attorney General](http://www.caag.state.ca.us), 1-800-952-5225, www.caag.state.ca.us.
- [California Department of Consumer Affairs](http://www.dca.ca.gov), 1-800-952-5210, TDD 1-800-326-2297, www.dca.ca.gov.
- [Better Business Bureau](http://www.bbb.org), www.bbb.org.
- [National Fraud Information Center](http://www.fraud.org), 1-800-876-7060, www.fraud.org.
- [National Consumer Information Center](http://www.pueblo.gsa.gov), www.pueblo.gsa.gov.
- [National Association of Consumer Agency Administrators](http://www.nacaanet.org), www.nacaanet.org.
- [California Consumer Organizations Network](http://www.consumernet.org), www.consumernet.org.

Most claims asserted by creditors and debt collection agencies are *legitimate*, and the debtor does owe the amount claimed. The reason for nonpayment may be that you, as a debtor, do not have the money you need to make payment. While nonpayment of debt is common, few people incur debt without intending to repay it. While a few people engage in fraud, almost all nonpayment of debt is unplanned, and without fraud. The major causes of nonpayment are illness, marital problems, pay reductions, and job layoffs.

Creditors often extend credit without adequately verifying the identity of the person requesting the credit. This makes it easy for a thief to assume your identity and obtain credit in your name – a form of theft. If someone uses your name to obtain credit, you may not know about

it until you receive a demand for payment from a collector. You ordinarily will have a complete defense to the claim, and you should respond to the demand by contacting the creditor immediately -- as you would for any debt that you do not owe. But you should do a lot more. The thief may continue to use your identity to obtain credit, and your own *credit record* and *credit standing* will be harmed. For ideas on what to do if someone uses your identity, see “Checklist for Identity Theft Victims Who Are Contacted by a Debt Collector” (Legal Guide DC-4); also “Credit Identity Theft: Tips to Avoid and Resolve Problems” (Legal Guide P-3).

#### **Article 4 Communicate With The Collector**

If you receive a *demand for payment* of a debt (commonly referred to as a *dunning letter*), it's usually in your best interests to respond immediately and to do so in writing (or by e-mail). Don't delay, or you may lose important rights.

Some of your rights can only be exercised if you act within 30 days after receiving an initial written notice from a debt collection agency. Some of your legal protections as a debtor only apply if the collector knows your situation (such as when or where you do not want to receive calls from the collector).

Ordinarily, you should approach a collector in one of four ways:

- If you owe the entire amount demanded and can afford to pay the full amount of the debt, tell the collector that you will pay the full amount, either at once, or in periodic *installments* in amounts and at times you can manage (e.g., monthly).
- If you owe part but not all of the amount claimed, tell the collector that you will pay only the amount that is lawfully owing. Tell the collector that you will pay that amount now, or in *installments* in amounts and at times that you can manage -- but that you will do this only if the collector *waives* (forgives) the rest of the amount demanded (what is not owing). It's best to communicate this both orally and in writing.<sup>5</sup>
- If you do not owe anything, tell the collector why you do not owe anything. Do your best to convince the collector that you have no legal obligation. Your goal is to persuade the collector to stop trying to enforce the claim. Explain this by telephone and in writing.
- If you have no ability to pay what you owe, or

almost no ability to pay what you owe, tell the collector that you can't pay anything, or that you will only pay a small amount, but only if the collector waives (forgives) the rest. The collector may be so happy to receive something that it will accept that amount and waive the rest of the debt.

Following are some of the practical steps you can take when you receive a *dunning letter* from a collector:

- If you have fully paid the debt and have a written receipt or canceled check proving so, send the collector a photocopy of the receipt or check, with a letter explaining when and how payment was made. Keep your original receipt or check.
- If you have fully paid the debt, but don't have a receipt, then contact the *original creditor*, and ask for a letter or other documentation (such as a copy or computer printout of your account) that shows that you don't owe the amount requested, and send the collector either a copy of that document, or a copy of your canceled check or other evidence of your payment.
- If you were overcharged for all or part of the alleged debt, then explain. Do this convincingly. If need be, provide additional information and supporting documents (but only send copies). No reasonable effort should be spared in making your *case* to the collector.
- If the claim is a result of identity theft or a mistaken identity, provide the collector with positive identifying information, such as your drivers license number, and your residence addresses for the past few years. Be sure to demand that the creditor keep this information confidential. While this will entail giving up some personal privacy, the benefits to you may be worth the loss of privacy, if you succeed in convincing the collector that you are not the person who incurred the debt.
- If you have a *complete defense* to the claim, it's usually best to present your entire *case* to the collector. Provide all of the important facts and copies of all documents that relate to the defense, as well as references to any laws that you may know about. Also provide any *corroborating evidence* that you can obtain, such as a statement signed by a third person that *substantiates* your side of the dispute. Send copies of documents, and keep the originals.
- Tell the collector exactly why it is asking for too much, or why you owe nothing. Doing this will

protect the accuracy of your own credit record. If the collector knows that you have a partial or complete defense to the claim, the collector must report that information to the credit reporting agency to which the collector has reported credit information.<sup>6</sup> (You can also tell the credit reporting agency directly the reasons why you don't owe the amount demanded.<sup>7</sup>)

- If you *dispute* all or part of the amount demanded, it's important that you do so in writing (or by e-mail). Protesting over the phone won't have the same legal effect. Once you put your dispute in writing, the collector must cease collection efforts until the collector has provided you with written verification that you owe the amount demanded. (Keep copies of all letters and e-mail messages.)
- If the collector refuses to listen to your side of the dispute, ask to talk to the collector's supervisor or manager. If that's not successful, invite the collector to arrange for a neutral third person to *mediate* the dispute. If that doesn't work, you may need help from an attorney. If you have either a *complete defense* or a *partial defense*, a letter from an attorney to the collector that describes the legal basis for your position may persuade the collector to abandon the claim, or reduce it appropriately.
- If you have no income and no property, creditors consider you to be *judgment-proof*. Since you have no property or income, a collector is not likely to collect anything, even if the collector obtains a court *judgment*. If you have no income or property, explain this to the collector, who may abandon collection efforts (give up) if it knows that it will not be able to collect anything.

## Article 5

### Bargain With The Creditor

Don't simply pay what a collector demands unless you know the amount demanded is correct. If it's not correct, don't pay just to get the collector off your back.

Most debtors have some *bargaining power* (control over the situation). That's because any payment ordinarily must come from the debtor, and only the debtor has the power to make payment voluntarily, without a *lawsuit*. Given the fact that you as a debtor have some bargaining power, what can you ask in return?

It depends on the situation. Here, again, you must act wisely. For instance:

- You can offer to pay the original debt in full by a certain date, if the collector agrees to *waive* (forgive) any interest, finance charges, collection charges, attorney's fees, and other added charges. But you have to ask for such a waiver; the collector won't offer it.
- You can ask the collector to *waive* (forgive) any claim that it may have against your property or against a co-signer, if you pay the debt (including interest and charges) in full by a date that you specify. Again, you have to ask for a waiver; the collector won't offer it.
- You can also try to persuade the collector to *waive* forgive interest and added charges if you (a) agree to pay the original amount of the debt by installments, and (b) then carry out your agreement by paying everything you have promised on time.

In order to lay the groundwork for negotiations, tell the creditor or debt collection agency why you haven't paid -- illness, divorce, pay reduction, job layoff, etc., or misconduct by the creditor -- and assure the collector that you will do your best to honor your legal obligations. Don't promise something you can't or won't do. Collectors keep track of "broken promises," which could hurt you down the road.

In deciding upon the approach you will take, remember that you usually can achieve a better result if you offer to pay everything you owe in a single payment. It is also true that most creditors and debt collection agencies are willing to enter into an agreement for payment by *installments* if the amounts paid by the debtor are large enough to justify the expense of processing the payments. An offer to pay by installments will be less attractive to the collector than immediate payment in full; yet, the collector may be willing to enter into such an agreement if the debt is large, or if there are a lot of other debts, or if you are *judgment-proof*.

Where appropriate, ask the collector for certain promises, such as (1) a promise not to report your late payment to the collector's credit reporting agency, and (2) a promise to report your full payment to the collector's credit reporting agency after you have paid it. These may help to improve your credit standing.

Agreements in which there is a *waiver* of a right by the collector must be in writing. On how to do this, see Article 7 below, on entering into *payout agreements*. However, the benefits that you receive in exchange (such as waiver of interest and charges) will be lost if you do

not follow through with your promise by making all of your promised payments on time.

Resolving the problem in a way that is agreeable to both you and the collector will save the collector and you the expense of a lawsuit. In addition, the collector will get your payment earlier. Resolving the problem, in short, will benefit both of you.

In negotiating with the collector, keep in mind what may happen if you do not reach a mutually acceptable settlement (resolution of the problem):

- If the collector is a debt collection agency and the debt is not large, it may do little or nothing at first, and later, if it is asked to collect claims that other creditors may have against you, enforce all of them together.
- The collector may file a *lawsuit* against you, and, if you don't defend it, obtain a court *judgment* against you for the amount of the alleged debt, plus interest, court costs, and, possibly, attorney's fees; but since a lawsuit is expensive for the collector, most collectors only use it as a last resort, if at all.
- If a lawsuit that has been filed by the collector results in a *judgment*, the *judgment debt* will grow steadily larger if (1) you don't pay the judgment debt, and (2) the collector uses the court process to attempt to enforce payment.
- In rare instances, the collector may abandon collection efforts (for instance, if the collector concludes that you are *judgment-proof*, and would like to get the claim off its books).

## Article 6

### It's Not a Good Idea to Hide

The opposite of attempting to *negotiate* a resolution of a problem is pretending that there is no problem, and either avoiding or hiding from (evading) the collector.

A debtor who attempts to evade a collector, or who refuses to respond to a collector's demand for payment or other communications, may injure himself or herself, at least in the long term. For instance, a debtor who refuses to communicate with a creditor or debt collection agency risks the filing of a collection lawsuit and the entry of a court judgment that may ultimately require the debtor to pay a lot more than the amount that was originally owed.

Some people worry excessively about an unpaid

debt, and others avoid thinking about it at all. It is common for people who have lost their jobs or find themselves drowning in debt to hide from their creditors - and the facts from their families - because they are too humiliated to admit the truth. In situations of that kind, it is also common to refuse to open mail or accept telephone calls from collectors. That, however, is dangerous. By refusing to accept or read a collector's letters, a debtor may not know about important facts, such as its intention to repossess property or file a lawsuit, or its willingness to accept lower payments or to waive interest and/or charges if payment is made by a certain date. Also, shielding one's family from the facts can cut off support that may be needed more than ever.

If you don't owe anything and are likely to prevail (win) in a court action, it is equally important to respond to a demand for payment from a creditor or debt collection agency and convince the collector of the facts as early as possible. As time goes by, a collector will invest time and money on the claim, and it will become increasingly difficult for you and the collector to resolve the dispute in a way that is beneficial for both of you.

Telling the collector why you don't owe the amount claimed, if you don't, is particularly important because it will help assure that your *credit record* does not include false information. If you *dispute* the *validity* of the debt, or some part of the amount claimed, the collector is legally required to report that to any credit reporting agency to which it reports the status of the debt.

If your failure to pay has ended up in your *credit report*, you can also *dispute* that item of information to the *credit reporting agency* that issued the report. The credit reporting agency must then reinvestigate the dispute. (You must make a request of that kind in writing.) Taking these steps will help assure that your credit record will not misreport the true facts.

You can call credit reporting agencies or visit them on the Web: Equifax, 1-800-685-1111, [www.equifax.com](http://www.equifax.com); TransUnion, 1-800-888-4213, [www.transunion.com](http://www.transunion.com); and Experian, 1-888-397-3742, [www.experian.com](http://www.experian.com).

### **Article 7** **Writing a Payout Agreement**

Creditors and debt collection agencies attempt to collect debts efficiently. They cannot and do not devote more resources to the collection of debts, on average, than they actually recover from debtors. Creditors and debt collection agencies attempt to collect the most money at the lowest possible cost without undue delay.

In order to achieve that goal, most collectors are

willing to enter into *payout agreements*. These usually provide for the payment of an agreed total amount by monthly payments (installments). A collector will be willing to do this, however, only if the collector believes (1) that the payments are the most the debtor can afford to make, (2) that the payments are large enough to justify the extra cost of processing them, and (3) that you will make the payments as promised.

Payout agreements should be in writing. Putting a payout agreement in writing helps to avoid misunderstandings, and it creates a record of the agreement for later reference. Either an exchange of letters, or a formal written agreement signed by both the debtor and the collector, is ordinarily enough. However, a formal written agreement (of the kind suggested below) is essential if the collector promises to *waive* a portion of the claim, interest, or other charges, on the condition that you, the debtor, make certain agreed payments. Unless you have that agreement in writing, another employee of the collector might try to collect the rest of the debt from you, even if you have made all the agreed payments.

Your payout agreement with a debt collection agency might state as follows:

Date: [\_\_\_\_\_]

[Collection agency] will accept the total amount of [\$500] in full payment of a debt originally owing by [your name] to [the original creditor], [account no.], including all unpaid principal, interest, finance charges, collection fees, attorney's fees, and any other charges that are or may be owing. Payment must be made by cash or certified check, and must be received by [collection agency] at [its address] no later than [June 1, 2003]. If payment is received on or before that date [or within 10 days after that date], nothing more will be owing by [your name] to either [collection agency] or [the original creditor].

[Collector's signature]  
[Your signature]

If you enter into a payout agreement with the original creditor, the agreement can be simpler:

Date: [\_\_\_\_\_]

[Original creditor] will accept the total amount of [\$500] in full payment of all unpaid principal, interest, finance charges, collection fees, attorney's fees, and any other charges that are or may be owing by [your name] to [original creditor], [account no.], including all unpaid principal, interest, finance charges, collection

fees, attorney's fees, and any other charges that are or may be owing. Payment must be made by cash or certified check, and must be received by [creditor] at [its address] no later than [June 1, 2003]. If payment is received on or before that date [or within 10 days after that date], nothing more will be owing.

[Creditor's signature]

[Your signature]

When you use these forms to write your own letter, be sure to insert your correct name, the names and addresses of both the collection agency and the original creditor, and the exact amount that you will pay and the date (or dates) of payment, in place of the words that appear in brackets. Both you and the collector should sign this.

A collector may refuse to agree to a 10-day *grace period*, as suggested in the sample agreements. If the collector won't include a 10-day grace period, then it's essential that you make your payments well in advance of the due dates, otherwise you may be late and, as a result, lose the benefits of your agreement (such as the collector's promise to forgive interest).

Payments to a creditor or debt collection agency should be made by check, bank cashier's check or money order. If a cash payment is made, get a signed receipt, which you should keep for at least four years. Also keep a list of the dates and amounts of all of the payments you make.

Unless a debt collection agency has instructed you to pay the original creditor directly, it's important to send your payments to the debt collection agency and not the original creditor. The debt collection agency may own a claim that is *assigned* to it, and may be entitled to recover from you any losses that it suffers because your payment was made to the original creditor instead of to it.

If a *judgment* has been issued against you, special rules apply. When you fully pay the judgment, the collector (or the original creditor) must file with the court an acknowledgment of payment, which is like a receipt for full payment, except that it must be filed with the court. Ask for a copy of the document that is filed.

If collector has filed an *abstract of judgment* with a county recorder, other rules apply. The collector (or the original creditor) must file with the court, and send you, a signed and notarized "Acknowledgment of Satisfaction of Judgment" document. When you record this document with the county recorder of a county where the collector has recorded an abstract of the judgment, it releases any *judgment lien* against any real property that you may own or may acquire in that county (such as a

home or land). The collector is not required to record this document; you must record it. Since you need to record it in order to be able to sell the property later on, it's best to record it now.

## Article 8

### Getting Help to Get Out of Debt

A professional nonprofit *credit counselor* can help you manage and reduce your debt. *Credit counselors* and *debt management services* work with you and your creditors to simplify your payments, reduce your total indebtedness, and help you bring your expenses in line with your income. Creditors cooperate because these arrangements help them get paid. Creditors can help by suspending payments temporarily, accepting reduced payments, lowering the interest rate, and waiving fees they normally charge.

In order to enter into a debt management program, you ordinarily must agree not to purchase anything on credit. Your credit counselor calculates one monthly payment based on your income, expenses and outstanding debt. An agreed portion is paid to your creditors each month.

Before choosing a credit counselor, it's important to do some homework:

- Ask the company to provide written materials covering its mission, business history, and services provided. Review these before sending the company any payment.
- Anytime you entrust your money to someone else, it is important to investigate its integrity, services, credentials, and business philosophy. Don't sign any contract or pay money until you've done this.
- Check for formal complaints. Companies should have no unresolved complaints on file with the Better Business Bureau, Attorney General's office, and consumer protection agencies.
- Ask if the company belongs to an association that sets standards for its members (e.g., the National Foundation for Credit Counseling (NFCC) or the Association of Independent Consumer Credit Counseling Agencies (AICCCA)).
- Ask if the agency is managed by an independent board of trustees. It's important that someone without a vested interest is keeping an eye on the operation.
- Ask if the agency keeps client funds in a trust account, separate from its operating funds. You don't want your money going to someone other

than your creditors.

- Ask about the types of services offered. Not everyone needs to be in a debt management program. The best agencies will spend time assessing your needs, and providing education and budgeting help when appropriate.
- Ask if the counseling service has adopted a code of ethics, as well as written operating policies and procedures -- evidence of a competent and ethical agency.
- Ask if the agency's services are confidential. Make sure that it will not be selling your information to companies that will try to sell you loans or other financial services.
- Ask if the service has a policy of providing fair and equitable treatment to all creditors. Creditors may not cooperate if they believe that your counselor is playing favorites.
- Ask about counselor training and certification. Determine whether counselors are certified and by whom, and whether they participate in well-structured and continuous training.
- Ask about fees before signing a contract or making a payment. Most counseling is provided at a minimal cost or without charge; some agencies do charge a small administration fee.
- Ask if employees who have access to client funds are bonded (meaning that if an employee should steal money that you have paid for transmittal to creditors, you are protected).
- Ask how frequently payments are made to your creditors. The agency should make payments to creditors at least monthly -- and many make them even more frequently.
- Ask if the agency provides its clients with evidence of its payments to creditors. The agency should give you a monthly statement showing how much and when it has paid each creditor.
- Do not pay before service is received. No ethical credit counseling agency charges mandatory, hefty, up-front fees.
- Determine whether education in good money management is provided. Some agencies provide free educational services, and some offer classes in money management for a small charge.

Most credit counseling is provided by nonprofit

counseling services, which often are supported by creditors. They are listed in telephone directories under Credit and Debt Counseling Services. The National Foundation for Credit Counseling (NFCC) sponsors a Financial Care Network of about 1,450 Neighborhood Financial Care Centers throughout the country. You can consult in person, by telephone, or on the Internet. Locate the credit counseling services closest to you by calling the NFCC's hotline at 1-800-388-2227, or by going to the NFCC's Internet website at [www.nfcc.org](http://www.nfcc.org). Credit counseling is also available from credit counseling agencies approved by the federal Department of Housing and Urban Development, [www.hud.gov](http://www.hud.gov). Credit counseling also may be available from the human resources department of your employer.

Working with a *credit counselor* can be viewed as an alternative to filing a petition in *bankruptcy*. However, if your debts are too large to manage, bankruptcy may be the only workable solution. Since bankruptcy also has disadvantages, it should be used only after you consider all of the negative factors, including its limited benefits (it only discharges *unsecured debts*), its costs (attorneys' and filing fees), and its adverse effect on your future *credit standing* (you may not be eligible for credit, or you may be eligible for only high-cost credit). If your debts can be paid off within several years, you may also consider a *wage earner plan*, which has fewer negative factors since your creditors will be paid.

## Article 9 Some Debt Reduction Strategies

Most credit counselors suggest that you attend first to your taxes, *secured debts*, and high-interest debts, and then to your low-interest debts. Once you complete your payments, your counselor helps you reestablish your *credit standing*. If your debts are a result of spending more than you earn, your counselor will help you decide what changes you need to make in your style of living. Ordinarily this will include bargain-hunting for necessities, and cutting out luxuries.

If your debts are more than you can manage, ask your counselor to discuss all of your options. These may include *bankruptcy* (in which some or all of your debts may be discharged), or a *wage earner plan* (in which your debts are paid by affordable payments made under bankruptcy court protection). Your counselor will explain the advantages and disadvantages of each.

If you have self-discipline, you can get out of debt yourself. Self-help books include **No-Non sense Credit Manual**, ILS Publishing, 800-497-3030, and **Getting**



**Out of Debt**, CliffsNotes, [www.cliffsnotes.com](http://www.cliffsnotes.com). Do-it-yourself websites include [www.stretcher.com](http://www.stretcher.com) and [www.debtorsanonymous.org](http://www.debtorsanonymous.org). A strategy some people use is to pay the minimum on each debt except the one that bears the highest interest rate, and pay as much as you possibly can on that. To determine how quickly the debt will be paid, use Bank Rate Monitor's calculator at [www.bankrate.com](http://www.bankrate.com). You can also try to convert high-interest accounts to low-interest accounts. For sources of low-interest credit, see [www.americaslowestrates.com](http://www.americaslowestrates.com), [www.bankrate.com](http://www.bankrate.com), [www.credit-land.com](http://www.credit-land.com), [www.getsmart.com](http://www.getsmart.com), and [www.lowcards.com](http://www.lowcards.com).<sup>8</sup>

If you have only a few large debts that are still too large to manage, your creditors might help. Sophisticated creditors know that people are more likely to pay their bills and remain loyal customers if they are treated nicely when they fall on tough times, and they are also painfully aware of the negative effect of bankruptcies on their own profits. Some creditors (such as credit-card companies) may waive penalties and late fees, cut the interest rate, suspend your obligation to make payments, or reduce the minimum payments, or even forgive a portion of a debt. Some provide short-term hardship programs for their credit customers on their websites.<sup>9</sup>

Here are other self-help strategies: One, make purchases only with cash. Two, get the most value for your dollar by comparison shopping; weigh the necessity of each purchase. Three, choose less expensive options (e.g., quit smoking, rent movies, bring your own coffee or lunch to work). Four, start a cash reserve to help break the cycle of credit card use; a first goal might be the amount of one paycheck. Five, put money aside for predictable expenses; if you know you will need \$400 for insurance in eight months, put aside \$50 a month starting now.

The fact is that it's never easy to get out of debt. There are no shortcuts.

### **Article 10**

#### **Home and Debt Consolidation Loans**

Debt consolidators (debt poolers) loan money at very high interest rates to pay old debts. It's usually unwise to enter into a *debt consolidation loan*. While the payments may be less, the long-term costs to you (often quite large) can make you worse off. You may think that you have solved your financial problem, when in fact you haven't. Try other approaches first. A nonprofit credit counseling service (Article 8 above) may be able to help you to pay off your debts at a lower cost and without increasing your total indebtedness.

It's also usually not a good idea to take out a loan

secured by your home to pay off ordinary debts. Home loans are expensive. Interest rates, loan origination fees, loan broker fees, real estate appraisal fees, and other fees and charges, are high; they can eat up your equity, and must eventually be paid. If it turns out that you can't make the payments on a loan secured by your home, you will lose your home, and even bankruptcy won't help.

*Sub-prime lenders* should also be a last resort. Sub-prime lenders charge very high interest rates and fees, and impose onerous penalties and other loan terms. They are especially active in minority neighborhoods. They target customers with tarnished credit records. They also cater to those who have good credit records, but are too afraid or lazy to shop around, or who don't know the importance of shopping around. According to Fannie Mae, the government-sponsored mortgage-lending agency, up to half those who take out sub-prime loans could qualify for a prime loan, and pay as much as four percentage points less interest -- a huge saving over the life of a mortgage.<sup>10</sup> If you need to take out a home loan and your credit record is spotty, you may need to pay up to 1-1/2 percentage points above the rate charged to other home borrowers. But avoid loans with above-normal fees or closing costs, prepayment penalties (especially ones extending past the loan's first year), balloon payments, and credit insurance (unless you are certain that you really desire and can afford it).<sup>11</sup>

A home loan may be both economical and safe if your debt load is not too large and the loan terms are fair. If you take out a home loan, borrow no more than you need, and consider whether your family's future income will actually be enough to handle the payments. If the loan is secured by your home, you should qualify for a lower rate of interest than the rate that you are now paying, and the interest that you pay also may be tax deductible.

If you decide to take out a home loan (of any kind), shop for the best deal. Compare interest rates, fees and charges (including commissions and closing costs), prepayment penalties, balloon payments, credit insurance premiums, and other loan terms. Mortgage loan brokers approved by the U.S. Department of Housing and Urban Development are listed at [www.hud.gov/fha/sfh/hcc/hooprof14](http://www.hud.gov/fha/sfh/hcc/hooprof14). A professor of finance (emeritus) lists reputable mortgage loan brokers at [www.mtgprofessor.com](http://www.mtgprofessor.com).

Do not take out a "reverse mortgage" without first discussing the details with your own financial counselor. Entering into a reverse mortgage can be risky. It's like selling your home. Reverse mortgages

vary widely, and its easy to select the wrong plan. To learn more, see **Mortgages for Dummies** (Hungry Minds), [www.hud.gov/buying/rvrsmort.cfm](http://www.hud.gov/buying/rvrsmort.cfm); [www.aarp.org/revmort](http://www.aarp.org/revmort), [www.consumersunion.org/finance/revconwc899.htm](http://www.consumersunion.org/finance/revconwc899.htm), or [www.fool.com/homecenter](http://www.fool.com/homecenter).<sup>12</sup>

## Article 11 Say No To Scams

Some credit counselors offer get-out-of-debt strategies, consolidation loans, or debt management services that don't work -- and that may leave you worse off than before, if the fees are unconscionably high, if the company has you do things that are fraudulent or unlawful, or if the money you pay the company for your creditors is never actually paid over to them. So choosing a credit counselor is important. (On what to consider when you select a credit counselor, see Article 8, Getting Help to Get Out of Debt.)

As with other personal services, it's best to shop around for the counseling service that's most appropriate for you, following the check-list in Article 8. It's especially important to talk with other satisfied consumers and check with the Better Business Bureau in your area. Some organizations call themselves "nonprofit" but nonetheless charge very high fees. Others may simply steal the money you've paid for distribution to your creditors. California law sets administrative fees for consumer credit counselors such as the Consumer Credit Counseling Service in Sacramento at a level of \$20 per month.<sup>13</sup> Use that as a benchmark in judging whether the fees charged by a company whose fees are not regulated are too high.

Since information you give to someone else may be misused, never give anyone facts about yourself until you are certain that it will not be misused.

## GLOSSARY (Terms Used in This Legal Guide)

**abstract of judgment** - a form signed by the clerk of a court, bearing a court seal, that evidences a *judgment*

**acknowledgment of satisfaction of judgment** - a form signed by the *judgment creditor* that states that you (the debtor) have paid the *judgment debt* in full

**agree** - to reach and express a mutual agreement and understanding about something

**allege** (or **assert**) - to claim or maintain that something is true (for instance, that you signed something)

**agreement** - the result of an expression of mutual understanding, including what was agreed to

**assign** - to transfer a claim from the *original creditor* to a *debt collection agency* for collection

**attorney** (or **lawyer**) - a person who has special knowledge about the law and is licensed to give legal advice

**attorney's fees** - fees paid to an attorney, sometimes included as part of a court *judgment*

**bankruptcy** - a federal court process that wipes out most of a debtor's debts in exchange for the debtor's non-exempt property; see also *wage earner plan*

**bargaining power** - control over the situation, sufficient to affect the results

**barred** - prevented; for example, a *statute of limitation* may bar (prevent) the filing of an old claim

**bill** - a written notice from a creditor to a debtor stating a particular amount of money that is owing

**cancel** - to back out of, rescind, extinguish, terminate; a debtor might seek to cancel (rescind) a *contract*

**case** - the reasons and arguments why a party should win a dispute; that party's "side of the dispute"

**charges** - any amount added to a debt, such as *interest*, *court costs*, *attorney's fees*, or *collection fees*

**claim** (or **amount claimed**) - the amount that a collector believes (whether rightly or wrongly) is owing

**claim** (or **assert**) - to demand payment of an alleged debt, or to assert a defense to an alleged debt

**collateral** - property given by the debtor to the creditor to secure payment of the debt (see *secured debt*)

**collect** - to receive and/or enforce payment of a debt

**collection fees** - fees that a collector might try to add to the debt to cover the expenses of collecting it

**collector** - a business or person who attempts to collect a debt; may be a *creditor* or a *debt collection agency*

**complete defense** - where the person against whom a claim is made has no legal *obligation* to pay anything

**compromise** - an *agreement* to settle a dispute by giving up something, as by "splitting the difference"

**contract** - a legally enforceable *agreement*

**corroborating evidence** - facts or documents that help to support a party's side of the dispute (*case*)

**co-signer** - someone other than the debtor who has promised to pay the debt if the debtor does not

**court costs** - certain kinds of court-related expenses of the winning party, which the court may add to the debt

**credibility** - reputation for honesty

**credit** - the right to incur a debt, or the right to delay re-payment of a debt

**credit counselor** - a professional person who is an expert in personal finance and financial problem solving

**credit record** - a history of one's use and re-payment of credit, including any delays in payment, compiled by

a *credit reporting agency*

**credit report** – a summary of a person’s *credit record* prepared by a *credit reporting agency* and sold to prospective creditors and others

**credit reporting agency** – a business (sometimes called a credit bureau) that compiles and sells people’s *credit reports* to other businesses

**credit standing** – a person’s reputation for the payment of debts, as documented in his or her *credit record*

**creditor** – a business or individual who extends credit, or to whom a debt is owed (in this Legal Guide, it usually means the *original creditor*).

**debt** – a legal obligation to pay money, often resulting from a purchase on credit or a loan of money; in this Legal Guide, debt means an obligation that arises from a consumer transaction

**debt collection agency** – a business that collects debts that were originally owing to some other creditor

**debt consolidation loan** – a loans whose proceeds are used to pay the borrower’s debts

**debt counselor** – a professional person who is an expert in personal finance and financial problem solving

**debt management service** – an organization or office that helps debtors work out their financial difficulties

**debtor** – a person who has a legal duty to pay money to someone else

**defame** – to harm someone’s reputation

**defendant** – a person against whom a *lawsuit* is filed

**defense** – where all or part of a claim is not legally enforceable (a *partial defense* or *complete defense*)

**demand for payment** – a creditor’s or debt collection agency’s request for payment of an alleged debt

**dispute** – an objection or disagreement; one disputes a debt by stating in writing that he or she does not owe anything, or does not owe the amount of the *demand*

**dunning letter** – a letter from a creditor or debt collection agency that demands payment of a debt

**enforceable** – where a court would find the claimed debt to be lawfully owed to another, and would issue a court *judgment* that declares that the debtor owes it

**evidence** – an oral or written statement, or a document, photograph or drawing (etc.), that is offered to show that a fact is or is not so

**execution** – the enforcement of a *judgment* by a *sheriff*, pursuant to a *writ of execution*, against the debtor’s earnings, bank account, or other property

**exempt** – earnings or property that is protected by law against being taken to satisfy a *judgment*

**fraud** – one example is a false statement that is made knowingly, intended to be relied upon, and relied upon justifiably by another, with resulting loss

**garnishment of earnings** – a *levy of execution* by a court officer on someone’s earnings, a portion being taken each pay period to pay off the *judgment*

**good faith** – honestly, based on a reasonable belief that something is authorized and legitimate

**grace period** – the number of days after a due date within which you can pay without paying a penalty

**indebtedness** – the total of the debts you owe

**installment** or **installment payments** – monthly or weekly payments to an original creditor or debt collection agency

**interest** – a charge for using or delaying re-payment of money (amount x rate x time = interest charge)

**judgment** – a court document that states the amount that the court has determined that a debtor owes

**judgment creditor** – a party to a *lawsuit*, who was awarded a court *judgment* against another party

**judgment debt** – the total amount that will pay off the *judgment*, including: (a) the original debt; (b) and pre-judgment *interest*, *court costs* and other *charges*; and (c) any interest and court costs after judgment

**judgment debtor** – a party to a *lawsuit*, against whom another party was awarded a *judgment*

**judgment lien** – a security interest in real property, which prevents its sale until the *judgment debt* is paid

**judgment-proof** – where, since the debtor has no income or property, a court judgment is worthless

**harass** – to vex, trouble, or annoy someone continually or chronically

**lawsuit** – a court action or proceeding, as where one person or business (called the *plaintiff*) goes to court to seek money or other relief from the *defendant*

**legitimate** – lawful, authorized, honest, genuine

**levy of execution** – action taken by a court officer to enforce a *judgment* against a debtor’s earnings, bank account or property, pursuant to a *writ of execution*

**lump sum payment** – payment (usually in full) by a single check, money order, or cash payment

**mediate** – to help the parties to a dispute to reach a voluntary *settlement* of the dispute

**negative item** – an entry in a person’s *credit record* (maintained by a *credit reporting agency*) that is adverse to that person

**negotiate** – interact with someone (as by talking with that person), in an attempt to reach an *agreement*

**obligation** – a legal duty owed to another person

**original creditor** – the business to which the debtor first owed the debt, before the business assigned it to the debt collection agency for purposes of collection

**owe** – to be legally obligated to pay money

**partial defense** – where the person against whom a claim is made has a legal *obligation* to pay part of a

claim, but not all of the claim

**payout agreement** – a written agreement between a debtor and collector that expresses the promises of both of them regarding the payment of a debt

**plaintiff** – someone who has filed a lawsuit

**preponderance of evidence** – evidence that is at least a bit more persuasive than the contrary evidence

**prerequisite** – a requirement that must be met before a claim is legally owing, or before some other right exists

**principal amount** – the amount owed, before adding *interest* or other *charges*

**privacy** – a person’s interest in being left alone, or in not having others know things they have no right to know

**remedy** – a legal method of enforcing the payment of a debt, or of enforcing some other right, as by filing a *lawsuit*, or by arranging for a *levy of execution* to enforce the *judgment* of a court

**repossess** – to take possession of property (such as a car) that secures re-payment of a *secured debt* that had not been paid

**right** – an interest protected by law, such as a right to possess property, enforce a contract, recover money, receive information, or enjoy privacy

**right to cancel** – a legal right to back out of, rescind, extinguish, or terminate, a *contract*

**secured debt** – where the debtor has given the creditor a legal right to take certain described property of the debtor (such as the debtor’s car or home), using proper procedures, if the secured debt is not paid

**settlement** – an agreed solution to a problem, usually including payment of money, and release of claims

**settlement offer** – an offer to the other party to resolve a dispute by some kind of a *compromise*

**sheriff** – a court officer whose job it is to enforce court *judgments*, as by a *levy of execution* on earnings

**standards** – rules of conduct, often set by law -- for example, the fair debt collection practices statutes described in Legal Guide DC-2.

**statute** – a rule adopted by a legislative body, such as a law that regulates debt collection activities

**statute of limitation** – a *statute* that limits the time within which a *lawsuit* can be filed to enforce a claim

**subprime lender** – a lender who charges very high interest rates to homeowners with poor credit

**substantiate** – to provide substantial evidence that proves or verifies the truth of something

**transaction** – the entire *contract*, including all *agreements* that are related to its subject or purpose

**unsecured debt** – where the debt is not backed by *collateral*, and the creditor therefore has no right to take the debtor’s property if the debt is not paid

**validation notice** – a written communication from a collector to a debtor that invites the debtor to inform the collector of any *defense* to a claim

**validity** – legitimacy -- for example, whether an alleged debt is *legitimate* (that is, lawful and owing)

**voidable** – subject to *cancellation* (rescission) at the election of a party; if a contract is “void,” it is altogether in valid

**wage earner plan** – an arrangement for the re-payment of creditors under bankruptcy court protection

**waive** – to forgive something, such as *interest*, *court costs*, part of a claim, or a deadline for payment

**writ of execution** – a court order to the sheriff to *levy execution* on the debtor’s earnings and property

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NOTICE: We attempt to make our Legal Guides accurate as of the date of publication, but they are only guidelines and not definitive statements of the law. Questions about the law’s application to particular cases should be directed to a specialist.

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## ENDNOTES

1. The federal Fair Debt Collection Practices Act (Pub. L. 95-109, 15 USC §§ 1692-1692o) establishes debt collection standards for a “debt collector.” Under federal law, a “debt collector” is a person who “regularly collects or attempts to collect, directly or indirectly, debts owed or due [to] another” – that is, originally owed or due to someone other than the business collecting the debt. (15 USC § 1692a(6).) While the California statute applies to the collection of debts by the original creditor and by any debt collection agency, the federal statute only applies to the debt collection activities of debt collection agencies, and not the activities of an original creditor. While the federal statute only applies to debt collection agencies, not original creditors, the practical and legal effect of the federal statute changed on January 1, 2000. Beginning January 1, 2000, creditors who are subject to the California statute must comply with the standards expressed in both the federal statute and the California statute. (Civil Code § 1788.17 (Stats. 1999, ch. 310).) Since the California statute covers both original creditors and debt collection agencies, the result is that companies of both kinds, if they are subject to the California statute, must comply with the legal standards expressed in both statutes.

2. The California Fair Debt Collection Practices Act (Stats. 1977, ch. 907, Civil Code §§ 1788-1788.32) establishes standards that apply to a “debt collector.” Under California law, a “debt collector” is “any person who, in the ordinary course of business, regularly, on behalf of himself or others, engages in ...the collection of consumer debts” (Civil Code § 1788.2(b),(c)). “Consumer debt” is defined as a debt “incurred by a natural person in exchange for property, services or money acquired, on credit, for personal, family, or household purposes,” that is, arising from transactions in which payment is deferred. (Civil Code §§ 1788.2(e),(f).)
3. The general law of California includes several legal doctrines that can give rise to liability by a business or individual that engages in collecting or enforcing debts. One of these is “tort law.” A “tort” is a civil (as opposed to criminal) wrong, other than a breach of contract, for which there is a remedy in the form of a lawsuit for *damages*. (*Nagy v. Nagy* (1989) 210 Cal.App.3d 1262, 1269 [258 Cal.Rptr. 787, 790]. While there is no single tort of “unfair debt collection,” a debt collector can incur tort liability if it commits any of the following torts, depending on the situation: (a) intentional infliction of emotional distress; (b) negligent infliction of emotional distress; (c) invasion of privacy; (d) defamation; (e) interference with an employment relation; (f) malicious prosecution; (g) abuse of process; and (h) a tort arising from a statutory violation (“negligence per se”).
4. Attorneys who represent debtors have access to professional textbooks that help equip them to counsel and represent debtors. These textbooks include: *Debt Collection Practice in California* (Cal. CEB looseleaf 2001); and *Debt Collection Tort Practice* (Cal. CEB 1971, 1997 Supp.).
5. If you send a written inquiry by certified mail, the collector must give you a “timely response” in writing. If a response is not mailed within 60 days of your written inquiry, the collector is not entitled to interest, financing charges, services charges, or any similar charges on the disputed amount from and after the date of your written inquiry. (Civil Code § 1720.)
6. 15 USC §§ 1681s-2; see *Fair Credit Reporting Act*, 4th ed. 1998 (National Consumer Law Center, 1998), § 9.9.
7. 15 USC § 1681i; see *Fair Credit Reporting Act*, 4th ed. 1998 (National Consumer Law Center, 1998), §§ 9.3-9.10.
8. “It could be time to start shopping for a credit card,” Money Wise, *Sacramento Bee*, November 25, 2001.
9. “Dear Debtor, Please Forgive Our Asking ...” *The Wall Street Journal*, May 17, 2002, p. B1.
10. “Predatory Lending in America: Hunting the Loan Sharks,” *Economist*, August 31, 2002, p. 55.
11. Alex Frangos, “You Can Fend Off Predatory Lenders,” Tip of the Week, *The Wall Street Journal*, Sept. 1, 2002.
12. The Motley Fool, “What’s your opinion of reverse mortgages,” *Sacramento Bee*, September 22, 2002, p. D5.
13. California Financial Code section 12100(j); *Sacramento Bee*, January 20, 2002, p. D3. The Consumer Credit Counseling Service in Sacramento is an affiliate of the National Foundation for Credit Counseling (NFCC).