

Supreme Court No. 84858-1

SUPREME COURT OF THE STATE OF WASHINGTON

CERTIFICATION FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF WASHINGTON

IN

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

Plaintiffs,

vs.

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

Defendants.

PLAINTIFFS' REPLY BRIEF

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I. INTRODUCTION

The preponderance of Defendants' Answering Brief is committed to advancing and arguing disputed underlying questions of fact regarding Defendants' conduct. Fact-finding, however, is not a proper mission of an appellate court. The factual predicates underlying the questions posed by the trial court are essentially found in the trial court's Certification to the Washington State Supreme Court. The issue before this Court being the appropriate interpretation of Washington statute, not resolution of underlying disputed factual issues, Plaintiffs will resist the natural impulse to demonstrate the factual inaccuracy in Defendants' characterization of its debt adjusting activities.¹

¹ The trial court, where such matters are properly resolved, has not issued factual findings. A case management order authorizing general discovery into the merit of claims advanced in the Amended Complaint has yet to be issued. This matter comes to the Court, rather, on the trial court's certification of questions of unresolved local law under Washington's Federal Court Local Law Certification Procedures Act, chapter 2.60 RCW. The record on such certification consists of "[a] stipulation of facts approved by the federal court showing the nature of the case and the circumstances out of which the question of law arises or such part of the pleadings, proceedings and testimony in the cause pending before the federal court as in its opinion is necessary to enable the supreme court to answer the question submitted . . ." RCW 2.60.010(4).

II. ARGUMENTS

A. A Consumer's "Consent" to Settlement is Immaterial to the Applicability of the Debt Adjuster Statute or the Purposes Served by that Statute.

Defendants do not dispute that chapter 18.28 RCW is a remedial statute aimed at protecting consumers, and as such, must be liberally construed to accomplish its purposes. RCW 1.12.010; *Sebastian v. Dep't of Labor & Indus.*, 142 Wn.2d 280, 284, 12 P.3d 594 (2000).

The statute's purposes are transparent:

- To constrain for-profit companies in the amount and timing of fees that may be charged to already heavily indebted consumers (RCW 18.28.080);
- To protect consumers from deceptive practices of for-profit debt adjusting companies through mandatory contract requirements, imposition of mandatory duties, and prohibitions of certain activities (RCW 18.28.100, RCW 18.28.110, RCW 18.28.120, and RCW 18.28.130);
- To safeguard consumers' payments, where periodic payments are required under the program, through trust requirements (RCW 18.28.150); and
- To provide for vigorous public and private enforcement of the Act (RCW 18.28.165; RCW 18.28.185; RCW 18.28.190; and RCW 18.28.200).

Common to these concerns animating Washington's Debt Adjusting statute are dangers intrinsic to permitting the "for-profit" business of assisting indebted consumers in the management of their debts. This central concern is evidenced by RCW 18.28.010(2), which limits the term "Debt adjuster" to those entities engaged in debt adjusting for compensation.

Nothing in these statutory purposes or in the provisions of the statute itself is suggestive that the statute is meant to reach only those Debt Adjusters that call upon a debtor to relinquish authority to approve payments or settlements with creditors.

Nonetheless, Defendants attempt to exclude consumers from the protections afforded by chapter 18.28 RCW where a consumer's "approval" of a settlement or other payment to a creditor is required. Defendants do not attempt to reconcile this interpretation with the statute's purposes or with the principle of liberal construction governing interpretation of remedial statutes.

Defendants' interpretation, moreover, is irreconcilable with RCW 18.28.130. RCW 18.28.130 prohibits a debt adjuster from signing a settlement agreement. Washington's Debt Adjusting statute, far from limiting its proscriptions to companies that effectuate settlement without

consent of the debtor, prohibits debt adjusters from performing such activities.

B. The Applicability of the Debt Adjusting Statute is Not Dependent on “Receipt” of a Debtor’s Funds.

Defendants propose that the term “debt adjusting,” as defined in RCW 18.28.010(1), should be limited to situations where a company has actual receipt of a debtor’s payments required under the subject debt reduction plan and the company, itself, pays creditors using received funds. This interpretation, too, is irreconcilable with the plain language of RCW 18.28.010(1).

RCW 18.28.010(1) defines “debt adjusting” as “the managing, counseling, settling, adjusting, prorating, or liquidating of the indebtedness of a debtor, or receiving funds for the purpose of distributing said funds among creditors in payment or partial payment of obligations of a debtor.” (emphasis added). The statute is plainly disjunctive. Receipt of a debtor’s funds for purposes of distributing those funds among specified creditors qualifies as debt adjusting. Such receipt of funds, however, is not a necessary activity.

The first rule in statutory interpretation is that “the court should assume that the legislature means exactly what it says.” *Davis v. Dep’t of Licensing*, 137 Wn.2d 957, 963-64, 977 P.2d 554 (1999) (quoting *State v.*

McCraw, 127 Wn.2d 281, 288, 898 P.2d 838 (1995)). RCW 18.28.010(1) plainly renders receipt of funds a non-essential activity.

Defendants, it should be noted, do not attempt to reconcile their interpretations with the statute's purposes. The statute's concern for already indebted consumers being charged predatorily high fees or heavy frontloaded fees that place them further into debt is equally at work when the debt adjuster provides for a third-party colleague to act as custodian of funds, as when that debt adjuster serves as custodian itself.

When engaging in statutory interpretation of matters involving consumer protection, courts avoid interpretations that permit creative subterfuge. *See Panag v. Farmers Ins. Co. of Wash.*, 166 Wn.2d 27, 42, 204 P.3d 885 (2009). Defendants' interpretation of RCW 18.28.010(1), in this regard, effectively guts Washington's Debt Adjusting statute of its consumer protection value by affording ready means of subverting the statute through the simple act of associating a business partner to receive the debtor's funds.

It may be noted that even where a state's debt adjusting statute makes receipt of the debtor's funds an express precondition for the statute's applicability, Courts have held that debt settlement companies may not evade the statute by simply arranging for a third-party associate to receive

those funds. *See generally Nationwide Asset Services, Inc. v. DuFauchard*, 164 Cal. App. 4th 1121, 79 Cal. Rptr. 3d 844 (Cal. App. 2008).²

Finally, Defendants cite the 1996 version of Webster's Collegiate Dictionary for the proposition that "settle" can mean "to close (as an account) by payment often of less than is due." From this, Defendants infer that debt adjusting requires the act of payment by the debt adjuster to

² As the *Nationwide* court explained:

The customer funds are never in the actual possession of [NAS]. An independent business entity (Global) manages these dedicated customer accounts under a contract with the Colorado bank, withdrawing funds from the accounts in payment of the management fees it assesses on the customers. Upon deposit of enrollment fees from the customers, plaintiffs negotiate with the creditors for a settlement on the outstanding debt. At the direction of [NAS], Global then makes electronic transfers from the customer bank accounts to the creditors for the amount of the negotiated settlement. Global also makes electronic transfers from the accounts to plaintiffs in payment of the various fees for their services.

...
If Nationwide indeed [has] managed to "receive" the money of their customers in all but name, then their conduct is precisely that which the statute has targeted. There would not be any reason to permit them to evade the statute's salutary requirement of subjecting their practices to defendant's licensing oversight for the protection of consumers. "The law respects form less than substance." [. . .] It is no different than deeming an employer-induced resignation to be a "constructive" discharge in order to prevent the employer from making an end run around discrimination laws.

Nationwide, 79 Cal. Rptr. 3d at 846, 848.

effectuate the settlement. *See* Defendants' Answering Brief, p. 20. Defendants' interpretation is not an effort at liberal construction to achieve the purposes served by the Debt Adjusting statute. Defendants' interpretation, further, ignores the full range of activities constituting "debt adjusting" as defined in RCW 18.28.010(1).³ Finally, Defendants' interpretation collides with the plain language of RCW 18.28.010(1), which declares receipt and payment of funds to be a sufficient but nonessential activity constituting "debt adjusting."

C. The Trust Provisions Found at RCW 18.28.150 Comport With The Plaintiffs' Interpretation of RCW 18.28.010(1).

Factors guiding the Court in determining the plain meaning of a term include "related provisions and the statutory scheme as a whole." *Christensen v. Ellsworth*, 162 Wn.2d 365, 373, 173 P.3d 228 (2007). Washington's Debt Adjusting statute, in this regard, contains a provision requiring that any payment received from a debtor be held in trust. From this, Defendants conclude that the Debt Adjusting statute is inapplicable, in its entirety, unless one is engaged in receiving payments from one's clients.

³ RCW 18.28.010(1) broadly defines "debt adjusting" to include a variety of activities, including "the managing, counseling, settling, adjusting, prorating, or liquidating of the indebtedness of a debtor, or receiving funds for the purpose of distributing said funds among creditors in payment or partial payment of obligations of a debtor."

The subject provision, RCW 18.28.150, provides in relevant part: “Any payment received by a debt adjuster from or on behalf of a debtor shall be held in trust by the debt adjuster from the moment it is received.” RCW 18.28.010(1) provides that the receipt of funds for the purpose of distributing those funds among specified creditors is itself “debt adjusting.” It is unremarkable, therefore, that the Debt Adjusting statute contains provisions governing how such funds must be handled, if received. RCW 18.28.150 is in harmony with RCW 18.28.010(1) in that each contemplates that a debt adjuster may be directly engaged in receiving a debtor’s funds. RCW 18.28.150, significantly, does not mandate that payments be received. The provision simply directs how “any payment received” must be handled.

It is noteworthy that Washington’s Debt Adjusting statute does contain a provision specifying “Contract requirement[s]” of all debt adjuster contracts. RCW 18.28.100. The “Contract requirement” provision contains no requirement that payments must be received by the debt adjuster or that that all debt adjusting contracts provide for a trust. Plaintiffs’ interpretation of RCW 18.28.010(1), thus, harmonizes with related provisions of the Debt Adjusting statute and the statutory scheme as a whole.

D. The Legislative History of Chapter 18.28 RCW Supports Plaintiffs' Interpretation.

Where, as here, the plain language of the statute reveals its legislative purpose and meaning, a court does not resort to legislative history. Defendants concede, moreover, that available legislative history is very sparse. Legislative history, nonetheless, is not at odds with Plaintiffs' interpretation of Washington's Debt Adjusting statute.

Debt adjusting was broadly understood as "the process by which consumer debtors attempt to restructure their debts without the aid of the bankruptcy court." State of Wash. Leg. Budget Committee Budget Comm., Performance Audit of Debt Adjusting, Licensing and Regulatory Activities, Report No. 77-13, Jan. 20, 1978 at p. 8 (on file with Wash. State Archives, H.B. 86 (Wash. 1979)).⁴ This is precisely the goal of debt reduction

⁴ Defendants cited HB 18 for the following:

Basic Method of Operation – Debt Adjusters. Debt Adjusters, through referral, advertising or other means, endeavor to make contact with those individuals having substantial and overdue personal bills. They then endeavor to establish a contractual relationship between themselves and the debtor, under terms of which the debtor transmits to the debt adjuster the maximum monthly payment possible. In return, the debt adjuster endeavors to work out a repayment plan, under terms of which the debtor's payment is divided among his outstanding creditors. Monthly checks representing portions of the debtor's payment to the debt adjuster are written by the debt adjuster to the creditors. For

programs heavily marketed to indebted consumer by modern-day “debt settlement” companies, such as Freedom Debt Relief.

Debt adjusting plans, as promoted in 1967, the year of the statute’s adoption, commonly involved negotiations with creditors for acceptance of a debt management plan involving monthly payments by the debtor to the debt adjuster, who would pay the debts using those proceeds in accordance with the debt management plan. See Bench, Lawrence T. *Commercial Debt Adjustment: An Alternative to Consumer Bankruptcies?*, 9 B.C. L. Rev. 108 (1967), available at <http://lawdigitalcommons.bc.edu/bclr/vol9/iss1/6>, at p. 108. The legislative concerns at work at the time of the statute’s adoption, however, were not derived from the peculiarities of debt adjusting plans that happened to be in vogue in 1967.

Animating the adoption of debt adjusting statutes, in Washington and elsewhere, were the dangers inherent in permitting the “for-profit” business of assisting already heavily indebted consumers. The dangers being addressed through adoption of the debt adjusting statute are precisely the dangers presented by modern-day debt adjusters, whose debt

this service, the debt adjuster charges a usual fee of 15 percent of all payments made to him by the debtor.

See Defendants’ Answering Brief, p. 28 (quoting State of Wash. Leg. Budget Comm., Performance Audit – Debt Adjusting, Licensing and Regulatory Activities, Rep. No. 77-13, at 8 (1978)).

management plans now typically involve debtors' monthly payments being sent to an associated third-party custodian and efforts to leverage a lump sum settlement of debt using those proceeds. The evils being addressed in 1967 by state legislatures through adoption of debt adjuster statutes were aptly described at that time: "The adjusters often charged exorbitant fees, as much as thirty percent of the total indebtedness listed by the debtor. Many times the adjuster made no attempt to secure the acceptance of the creditors before the debtor began paying in his money." *Commercial Debt Adjustment*, 9 B.C. L. Rev. at 109.

"[I]t was common practice for the debt adjuster to withhold the initial payments until he had collected his entire fee." *Id.* at 109. "If the debtor became disillusioned and cancelled the plan, he found he still owed the adjuster the total percentage of listed indebtedness, even though little or no money may have actually reached the creditors. As a result, the debtor had merely added another creditor, and was more likely than ever to consider bankruptcy." *Id.* at 109.

These dangers, which prompted states' adoption of debt adjusting statutes, are equally at work when the debt adjuster contracts with a business colleague to act as custodian of the debtor's payments, as when the debt adjuster itself directly serves as custodian of those funds.

E. Recent Efforts by Sister States to Amend Their Debt Adjusting Statutes Highlight the Correctness of Plaintiffs' Interpretation.

Defendants note that Maine, Iowa, and Kentucky, confronted with abuses in the debt settlement industry, have revised their debt adjusting statutes to rein in those consumer abuses. Without further explanation, Defendants imply that Washington's Debt Adjusting statute lacks applicability to debt settlement companies without unspecified legislative changes. *See* Defendants' Answering Brief, p. 27.

Legislative revisions by Maine, Iowa and Kentucky, in fact, demonstrate the correctness of Plaintiffs' interpretation of Washington's Debt Adjusting statute.

Iowa's Debt Management Act, Iowa Code § 533A.1(2) previously defined "debt management" to include as a requirement: "the receiving therefrom of money or evidences thereof for the purpose of distributing the same to the debtor's creditors in payment or partial payment of the debtor's obligations for a fee." Iowa Code § 533A.1(2) (2006). Iowa revised its Debt Management statute in 2009 to conform with Washington's Debt Adjusting statute by making receipt of money a non-essential but sufficient condition for the statute's applicability. Iowa's statute now defines "Debt management" as: "when done for a fee any of the following:"

- a. Arranging or negotiating, or attempting to arrange or negotiate, the amount or terms of a debt owed by a debtor to a creditor.
- b. Receiving from a debtor, directly or indirectly money or evidences thereof for the purposes of distributing the same to one or more creditors of the debtor in payment or partial payment of the debtor's obligations.
- c. Serving as an intermediary between a debtor and one or more creditors of the debtor for the purpose of obtaining concessions from the creditors.
- d. Engaging in debt settlement.

Iowa Code § 533A.1(2) (2010) (emphasis added).

Maine's statute, both in its current form and in its earlier 2003 version, conforms with Washington's Debt Adjusting statute in that the receipt of funds is a sufficient but non-essential activity to constitute "debt management services." Maine's statute, similarly, includes "settling . . . or otherwise altering the terms of payment of the consumer's obligation" as an activity subjecting a company to consumer protections afforded by that act. Me. Rev. Stat. Ann. Tit. 32, § 6172 (2003).⁵

⁵ "Debt management service" means:

- A. The receiving of money from a consumer for the purpose of distributing one or more payments to or among one or more creditors of the consumer in full or partial payment of the consumer's obligation;
- B. Arranging or assisting a consumer to arrange for the distributing of one or more payments to or among one or

Similarly, Kentucky's prior debt adjusting statute did not include "settling" in its definition of "debt adjusting." The statute was revised in 2010 to, among other things, include "settlement" as an activity constituting "debt adjusting."⁶ In both versions of Kentucky's statute,

more creditors of the consumer in full or partial payment of the consumer's obligation;

C. Exercising control, directly or indirectly, or arranging for the exercise of control over funds for a consumer for the purpose of distributing payments to or among one or more creditors of the consumer in full or partial payment of the consumer's obligation; or

D. Acting or offering to act as an intermediary between a consumer and one or more creditors of the consumer for the purpose of adjusting, settling, discharging, reaching a compromise on or otherwise altering the terms of payment of the consumer's obligation.

Me. Rev. Stat. Ann. Tit. 32 § 6172 (2003) and current (emphasis added).

⁶ Prior to 2010, Kentucky defined debt adjusting as follows:

(2) "Debt adjusting" means doing business in debt adjusting, budget counseling, debt management, or debt pooling service, or holding oneself out, by words of similar import, as providing services to debtors in the management of their debts, to do any of the following:

(a) Effect the adjustment, compromise, or discharge of any account, note or other indebtedness of the debtor;

(b) Receive from the debtor and disburse to the debtor's creditors any money or other thing of value; or

(c) Solicit business and advertise as a debt adjuster[.]

“Debt Adjusting” was defined in the disjunctive, such that receipt of the debtor’s funds was not a requisite to the statute’s applicability.

Finally, Defendants observe, through footnote, that some states have adopted the UDMSA [Uniform Debt-Management Services Act] and note that “[t]he Washington Legislature itself has been considering enactment of the UDMSA.” *See* Defendants’ Answering Brief, pp. 29-30, fn. 14. The 2009 bill referenced by Defendants, in fact, was referred to

Ky. Rev. Stat. Ann. § 380.010(2) (2006).

In 2010, the Kentucky Legislature amended the definition of debt adjuster as follows:

(3) “Debt adjusting” means doing business in this state in debt adjusting, budget counseling, debt management, debt modification or settlement, foreclosure assistance, or debt pooling service, or holding oneself out, as acting or offering or attempting to act as an intermediary between a debtor and his or her creditors for a fee, contribution, or other consideration, or by words of similar import, as providing services to debtors in the management, settlement, modification, or adjustment of their debts, to do any of the following:

(a) Effect the adjustment, compromise, settlement, modification, or discharge of any account, note or other indebtedness of the debtor;

(b) Receive from the debtor and disburse to the debtor’s creditors any money or other thing of value; or

(c) Solicit business and advertise as a debt adjuster[.]

Ky. Rev. Stat. Ann. § 380.010(3) (2010).

committee where it died. The bill's quick death, if anything, suggests a legislative view that Washington's Debt Adjusting statute is sufficient, as is.

F. RCW 18.28.090 Establishes Consumer's Entitlement Under RCW 19.86.090.

RCW 18.28.090 provides that "[i]f a debt adjuster contracts for, receives or makes any charge in excess of the maximums permitted by this chapter, except as the result of accidental bona fide error, the debt adjuster's contract with the debtor shall be void and the debt adjuster shall return to the debtor the amount of all payments received from the debtor or on the debtor's behalf and not distributed to creditors."⁷ This provision unambiguously establishes, as a matter of public policy, a remedy of full disgorgement and return of all fees to the debtor.

The provision serves as a strong deterrent against violation of the statute. The provision also ensures that companies that engage in predatory fee practices do not financially prosper from their wrongdoing.

The District Court certified the following question: "Where a debt adjuster's contract with a debtor is void under RCW 18.28.090 because the

⁷ Whereas Plaintiffs recognize this Honorable Court is not applying the law to facts, Plaintiffs pursuant to RCW 18.28.090 are seeking at the District Court below "[a] final order and/or judgment against Defendants, jointly and severally, that Class Members are entitled to an amount equaling all payments made, less those amounts distributed to creditors."

debt adjuster has charged a fee in excess of that permitted by RCW 18.28.080(1), and the debt adjuster is required to return to the debtor the amount of all payments received from the debtor, does RCW 18.28.090 permit an equitable offset be applied against those payments in recognition of any reduction in the debt negotiated by the debt adjuster?”

The question certified by the Court appropriately recognizes RCW 18.28.090 as the statutorily declared remedy for violation of fee provisions and correctly perceives alleged benefits secured by the debt adjuster to be an effort at equitable offset.

Defendants disregard the question certified by trial court and attempt an artful argument that renders RCW 18.28.090 meaningless. Defendants reason that consumer victims of predatory fee practices have suffered no “injury” permitting them to advance a claim so long as the offending debt adjuster has secured a debt reduction equal to or greater than the predatory fees charged. Defendants draw this conclusion, because, Defendants say, the consumer would be in the same financial position. The wrongdoer and not the debtor, Defendants further reason, is entitled to the full financial benefit of any reduction in the consumers’ debt and may effectively secure that financial benefit for itself through illegal fees amounting to the savings in debt. *See* Defendants’ Answering Brief, pp. 32-34.

Defendants' reasoning defies the plain language of RCW 18.28.090 and the purposes served by that provision. To establish an injury for a Consumer Protection Act claim,⁸ no monetary damages need to be proven. A nonquantifiable injury will suffice, including the loss of use of property. *Mason v. Mortg. Am., Inc.*, 114 Wn.2d 842, 854, 792 P.2d 142 (1990). Where injury has occurred, the consumer may seek injunctive relief as well as damages for injury suffered.

RCW 18.28.090, in this regard declares contracts void where fee violations occur. Injury or loss has, therefore, occurred for purposes of RCW 19.86.090 both because fees paid were not owed and because fees paid exceeded those that were lawful. RCW 18.28.080, therefore, in conjunction with RCW 18.28.090, establishes the consumer's injury.

RCW 19.86.090 permits an injured consumer to seek both injunctive relief and damages for injury suffered. The remedy statutorily set forth in RCW 18.28.090 (whether deemed injunctive or compensatory) constitutes a clear statutory declaration of the relief to which a Washington consumer is entitled. Defendants' position renders RCW 18.28.090 a

⁸ "To prevail in a private CPA claim, the plaintiff must prove (1) an unfair or deceptive act or practice, (2) occurring in trade or commerce, (3) affecting the public interest, (4) injury to a person's business or property, and (5) causation. *Panag v. Farmers Ins. Co. of Wash.*, 166 Wn.2d at 37 (citing *Hangman Ridge Training Stables, Inc. v. Safeco Title Ins. Co.*, 105 Wn.2d 778, 784, 719 P.2d 531 (1986)).

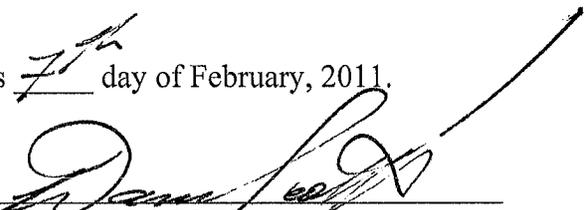
nullity and ignores deterrence and equitable considerations underlying that provision.

As to the question of law posed by the trial court concerning the appropriateness of an equitable offset to the mandates of RCW 18.28.090, Defendants offer no response to the arguments advanced in Plaintiffs' Opening Brief. For the reasons stated in that brief, the statute unambiguously effectuates a remedy of full disgorgement. Equitable considerations cannot controvert the statutory remedy set forth in RCW 18.28.090.

III. CONCLUSION

Plaintiffs, therefore, respectfully request that this Court answer the questions posed by the District Court in the manner set forth in Plaintiffs' Opening Brief.

Respectfully submitted this 7th day of February, 2011.



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CERTIFICATE OF FILING AND SERVICE

I, Kristy L. Bergland, hereby certify that on the 7th day of February, 2011, I caused to be sent for filing one original and one copy of the Plaintiffs' Opening Brief via U.S. mail to:

Supreme Court State of Washington
Temple of Justice
P.O. Box 40929
Olympia, WA 98504-0929

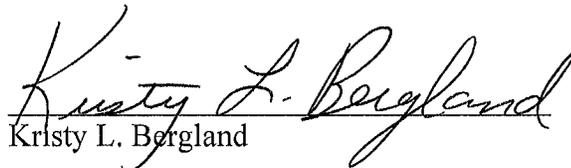
I also caused to be served true and correct copies of the same to the following persons via U.S. mail:

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I certify under penalty of perjury under the laws of the state of Washington that the foregoing is true and correct.

EXECUTED this 7th day of February, 2011, at Spokane,
Washington.


Kristy L. Bergland