SUNSET EVALUATION REPORT

COLLECTION AGENCIES
Chapter 443, Hawaii Revised Statutes

A Report to the Governor and the Legislature of the State of Hawaii

Submitted by the
Legislative Auditor of the State of Hawaii

Report No. 80–5
February 1980

FOREWORD

Under the "sunset law," licensing boards and commissions and regulated programs are terminated at specified times unless they are reestablished by the Legislature. Nationally, the first sunset law was passed in 1976. Within three years, 30 more states had enacted similar legislation. The rapid spread of sunset legislation reflects increasing public concern with what it sees as unwarranted government interference in everyday activities.

Hawaii's Sunset Law, or the Hawaii Regulatory Licensing Reform Act of 1977, terminated 38 occupational licensing programs over a six-year period. These programs are repealed unless they are specifically reestablished by the Legislature. In 1979, the Legislature assigned the Office of the Legislative Auditor responsibility for evaluating each program prior to its repeal.

This report evaluates the regulation of collection agencies under Chapter 443, Hawaii Revised Statutes. It presents our findings as to whether the program complies with the Sunset Law and whether there is a reasonable need to regulate collection agencies to protect public health, safety, or welfare. It includes our recommendation on whether the program should be continued, modified, or repealed.

Our approach to the evaluation of the regulation of collection agencies is described in Chapter 1 of this report under "Framework for Evaluation." That framework will also serve as the framework for conducting subsequent evaluations. We used the policies enunciated by the Legislature in the Sunset Law to develop our framework for evaluation. The first and basic test we apply is whether there exists an identifiable potential danger to public health, safety, or welfare arising from the conduct of the occupation or profession being regulated. If the program does not meet this first test, then the other criteria for evaluation are not applied. However, if potential harm to public health, safety, or welfare exists, then the other evaluation criteria, as appropriate, are applied.

We acknowledge the cooperation and assistance extended to our staff by the Board of Collection Agencies, the Department of Regulatory Agencies, and other officials contacted during the course of our examination.

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Februrary 1980

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Chapter 1

INTRODUCTION

The Hawaii Regulatory Licensing Reform Act of 1977, or Sunset Law, repeals statutes concerning 38 state licensing boards and commissions over a six-year period. Each year, six to eight licensing statutes are scheduled to be repealed unless specifically reenacted by the Legislature.

In 1979, the Legislature amended the law to make the Legislative Auditor responsible for evaluating each licensing program prior to its repeal and to recommend to the Legislature whether the statute should be reenacted, modified, or permitted to expire as scheduled. This is our evaluation of Chapter 443, Hawaii Revised Statutes, on the licensing of collection agencies, which statute is scheduled by the Sunset Law to expire on December 31, 1980. It should be noted at the outset that the Legislature has already taken action to provide for a new form of regulation for collection agencies through its enactment of Act 76 in the 1979 Regular Session.

Objective of the Evaluation

The objective of the evaluation is: To determine whether, in light of the policies set forth in the Sunset Law, the public interest is best served by reenactment, modification, or repeal of Chapter 443.

Scope of the Evaluation

This report examines the history of the statute on licensing of collection agencies and the public health, safety, or welfare that the statute was designed to protect. It then assesses the effectiveness of the statute in preventing public injury and the continuing need for the statute.

Organization of the Report

This report consists of three chapters: Chapter 1, this introduction and the framework developed for evaluating the licensing program; Chapter 2, background information on the regulated industry and the enabling legislation; and Chapter 3, our evaluation and recommendation.

Framework for Evaluation

Hawaii's Regulatory Licensing Reform Act of 1977, or Sunset Law, reflects rising public antipathy toward what is seen as unwarranted government interference in citizens' lives. The Sunset Law sets up a timetable terminating various occupational licensing boards. Unless reestablished, the boards disappear or "sunset" at a prescribed moment in time.

In the Sunset Law, the Legislature established policies on the regulation of professions and vocations. The law requires that each occupational licensing program be assessed against these policies in determining whether the program should be reestablished or permitted to expire as scheduled. These policies are:

1. The regulation and licensing of professions and vocations shall be undertaken only where reasonably necessary to protect the health, safety, or welfare of consumers of the services; the purpose must be the protection of the public welfare, not that of the regulated profession or vocation.

2. Even where regulation is reasonably necessary, government interference should be minimized; if less restrictive alternatives to full licensure are available, they should be adopted.

3. Regulation shall not be imposed except where necessary to protect relatively large numbers of consumers who, because of a variety of circumstances, may be at a disadvantage in choosing or relying on the provider of the service.

4. Evidence of abuses by providers of the service shall be accorded great weight in determining whether government supervision is desirable.

5. Regulation which artificially increases the costs of goods and services to the consumer should be avoided.

6. Regulation should be eliminated where its benefits to consumers are outweighed by its costs to taxpayers.

7. Regulation shall not unreasonably restrict entry into professions and vocations by all qualified persons.

We translated these policy statements into the following framework for evaluating the continuing need for the various occupational licensing statutes.

Licensing of an occupation or profession is warranted if:

1. There exists an identifiable potential danger to public health, safety, or welfare arising from the operation or conduct of the occupation or profession.

2. The public that is likely to be harmed is a substantial portion of the consuming public.

3. The potential harm is not one against which the public can reasonably be expected to protect itself.

4. There is a reasonable relationship between licensing and protection of the public from potential harm.

5. Licensing is superior to other optional ways of protecting the public from the potential harm.

6. The benefits of licensing outweigh its costs.

The potential harm. For each regulatory program under review, the initial task is to identify the purpose of regulation and the dangers from which the public is intended to be protected.

Not all potential dangers warrant the exercise of the State's licensing powers. The exercise of such powers is justified only when the potential harm is to public health, safety, or welfare. "Health" and "safety" are fairly well understood. "Welfare" means well-being in any respect and includes physical, social, and economic well-being.

This policy that the potential danger be to the public health, safety, or welfare is a restatement of general case law. As a general rule, a state may exercise its police power and impose occupational licensing requirements only if such requirements tend to promote the public health, safety, or welfare. Under particular fact situations and statutory enactments, courts have held that licensing requirements for paperhangers, housepainters, operators of public dancing schools, florists, and private land surveyors could not be justified.[1] In Hawaii, the State Supreme Court in 1935 ruled that legislation requiring photographers to be licensed bore no reasonable relationship to public health, safety, or welfare and constituted an unconstitutional encroachment on the right of individuals to pursue an innocent profession.[2] The court held that mere interest in

1. See discussion in 51 *American Jurisprudence,* 2d., "Licenses and Permits", Sec. 14.

2. *Terr. v. Fritz Kraft,* 33 Haw. 397.

maintaining honesty in the practice of photography or in ensuring quality in professional photography did not justify the use of the State's licensing powers.

The public. The Sunset Law states that for the exercise of the State's licensing powers to be justified, not only must there be some potential harm to public health, safety, or welfare, but also the potential harm must be to the health, safety, or welfare of that segment of the public consisting mainly of consumers of the services rendered by the regulated occupation or profession. The law makes it clear that the focus of protection should be the consuming public and not the regulated occupation or profession itself.

Consumers are all those who may be affected by the services rendered by the regulated occupation or profession. Consumers are not restricted to those who purchase the services directly. The provider of services may have a direct contractual relationship with a third party and not with the consumer, but the criterion set forth here may be met if the provider's services ultimately flow to and adversely affect the consumer. For example, the services of an automobile mechanic working for a garage or for a U-drive establishment flow directly to his employer, but his workmanship ultimately affects the consumer who brings a car in to his employer for repairs or who rents a car from his employer. If all other criteria set forth in the framework are met, the potential danger of poor workmanship to the consuming public *may* qualify an auto mechanic licensing statute for reenactment or continuance.

The law further requires that the consuming public that may potentially be harmed be relatively large in number. This requirement rules out those situations where potential harm is likely to occur only sporadically or on a casual basis.

Consumer disadvantage. The consuming public does not require the protection afforded by the exercise of the State's licensing powers if the potential harm is one from which the consumers can reasonably be expected adequately to protect themselves. Consumers are expected to be able to protect themselves unless they are at a disadvantage in selecting or dealing with the provider of services.

Consumer disadvantage can arise from a variety of circumstances. It may result from a characteristic of the consumer or from the nature of the occupation or profession being regulated. Age is an example of consumer characteristic which may cause the consumer to be at a disadvantage. Highly technical and complex nature of the occupation is an illustration of occupational character that may result in the consumer being at a disadvantage. Medicine and law fit into the latter illustration. Medicine and law were

the first occupations to be licensed on the theory that the general public lacked sufficient knowledge about medicine and law to enable them to make judgments about the relative competencies of doctors and lawyers and about the quality of services provided them by the doctors and lawyers of their choice.

However, unless otherwise indicated, consumers are generally assumed to be knowledgeable and able to make rational choices and to assess the quality of services being provided them.

Relationship between licensing and protection. Occupational licensing cannot be justified unless it reasonably protects the consumers from the identified potential harm. If the potential harm to the consumer is physical injury arising from possible lack of competence on the part of the provider of service, the licensing requirement must ensure the competence of the provider. If, on the other hand, the potential harm is the likelihood of fraud, the licensing requirements must be such as to minimize the opportunities for fraud.

Alternatives. Depending on the harm to be protected against, licensing may not be the most suitable form of protection for the consumers. Rather than licensing, the prohibition of certain business practices, governmental inspection, the posting of bond, or the inclusion of the occupation within some other existing business regulatory statute may be preferable, appropriate, or more effective in providing protection to the consumers. Increasing the powers, duties, or role of the consumer protector is another possibility. For some programs, a nonregulatory approach may be appropriate, such as consumer education.

Benefit-costs. Even when all other criteria set forth in this framework are met, the exercise of the State's licensing powers may not be justified if the costs of doing so outweigh the benefits to be gained from such exercise of power. The term, "costs," in this regard means more than direct money outlays or expenditure for a licensing program. "Costs" includes opportunity costs or all real resources used up by the licensing program; it includes indirect, spillover, and secondary costs. Thus, the Sunset Law asserts that regulation which artificially increases the costs of goods and services to the consumer should be avoided; and regulation should not unreasonably restrict entry into professions and vocations by all qualified persons.

Chapter 2

BACKGROUND

A collection agency collects money due on accounts or other forms of indebtedness. Under the prevailing practice, the collector is compensated by retaining a portion of the amount collected. This usually ranges between one third to one half of the collections. The actual percentage is usually determined by the size of the account and the duration of delinquency.

A collection agency solicits accounts, makes the collection, and remits to the creditor its share of the collections. Until the creditor's share is remitted, the agency is the custodian of the creditor's money. The agency has a fiduciary function. Oftentimes the amounts are substantial.

Creditors generally refer to collection agencies accounts which are long overdue and difficult to collect. This, coupled with the practice of collection agencies' being compensated only when they collect, has led some collectors to resort to expedient, high-pressure methods. Because collection agency practices can become abusive, protection of debtors has been an objective in regulating collection agencies in addition to the original objective of protection of creditors.

According to records of the Department of Regulatory Agencies, there were 32 collection agencies licensed to operate in Hawaii in 1979.

Statutory History

The initial legislation, in 1907, only required a license fee. Subsequent legislation defined the responsibilities of the collection agencies and established more stringent requirements for licensing. For example, Act 229, SLH 1929, added a bond requirement. Act 11, SLH 1941, required collection agencies to report to clients within 30 days after a collection had been made.

In 1955, Act 223 prohibited the licensing of those who had been convicted of embezzlement, fraud, or a felony of moral turpitude. The exceptions were if a person had been pardoned or was able to provide evidence of good conduct for a period of two years immediately preceding the application for licensing. The bond was increased from $3000 to $5000 in Honolulu and from $1000 to $3000 in other counties.

In 1957, Act 261 further expanded regulation of collection agencies. The intent was to "protect the public against the fraudulent practices by collection agencies." The committee report noted that laws are "abused by uncontrolled and 'fly by night' collectors, some of whom collect money and do not account or pay over to the creditors the amounts collected."[1] The Legislature established an advisory board for collection agencies and designated the Attorney General as the commissioner for issuing collection agency licenses.

Subsequent legislation began to focus on the debtor–collector relationship. Act 182 was enacted in 1959 because of legislative concern over abuses, such as requiring debtors to pay attorney fees and collection fees more than once on the same debt. This 1959 amendment prohibited collectors from collecting fees from debtors except in specified cases. It limited attorney fees assessed in collection cases to no more than 25 percent of the unpaid balance. Collection agencies were not permitted to retain any portion of the attorney fees.

It was not until 1970 that a licensing board was established. Act 189 created a seven-member board consisting of two members from the industry and five public members. Legislative committee reports note the "regulatory board is necessary to assure that citizens are protected from unscrupulous harassment."[2]

In 1973, the Legislature enacted added requirements for licensing. Act 187 increased the bonding requirement from $5,000 to $25,000 for the first office of a collection agency. A $15,000 bond was required for each branch office. The act stipulated that applicants for collection agency licenses must have two years of experience as a supervisor or in a credit or collection position in a collecting agency.

In that same year, Act 74 defined various prohibited acts and practices. The aim was to provide additional protection for the debtor. Prohibited acts include threats or coercion, harassment and abuse, misrepresentations, unfair and unreasonable means of collection, and deceptive acts and practices.

In 1978, the Legislature sought to increase "the protection afforded the public against unscrupulous, overzealous, or inexperienced collectors" by requiring each collection agency to be under the direct management and control of a "principal collector."

1. The Twenty-Ninth Legislature, Territory of Hawaii, *House Journal 1957*, p. 814.

2. The Fifth Legislature, State of Hawaii, *Senate Journal, Regular Session of 1970*, p. 1328.

In view of the pending repeal of Chapter 443 under the Sunset Law, the Legislature enacted Act 76 in 1979. Act 76 eliminates the Collection Agency Board and its functions and the licensing requirements. The act retains the bond requirement, and collection agencies must continue to maintain permanent records of transactions, have separate trust accounts for clients' funds, and remit funds to clients on a timely basis. The act also retains as prohibitions those practices prohibited by the "old" Chapter 443.

The Collection Agency Board, under Chapter 443, was scheduled for repeal on December 31, 1979. Act 76 extended the repeal date to December 31, 1980 and postponed the effective date of the new law to the same date. This was done to allow this evaluation to be made prior to the scheduled termination of the regulatory program under the board.

Licensing Requirements and Procedures

Applicants for collection agency licenses must be 18 years of age; citizens of the United States; and high school graduates or the equivalent. They cannot have records of convictions for forgery, embezzlement, obtaining money under false pretenses, larceny, extortion, conspiracy to defraud, or other similar offenses. They must pass a written examination on collection agency laws. Each applicant must post a surety bond of $25,000 for the first of the collection agency's offices and $15,000 for each additional branch office.

In addition, a collection agency must be supervised by a principal collector, an individual determined qualified by the board to assume responsibility for running a collection agency.

The basic authority of the Collection Agency Board is to grant, deny, suspend, or revoke licenses. The statute requires the board to hold one or more meetings every two-month period. During the period 1975–79, the board met 15 times, an average of three times a year. According to board members, meetings are devoted to reviewing applications, interviewing applicants, and handling complaints.

During the period 1973–79, the board licensed 15 collection agencies. Five applicants were denied licenses for failure to post a surety bond.

Chapter 3

EVALUATION OF THE REGULATION OF COLLECTION AGENCIES

This chapter contains our evaluation and findings on the need for regulation of collection agencies and our recommendations concerning regulation. We determine, *first*, whether the conduct of business by collection agencies poses a potential harm to the public; and, *second*, if such potential harm does exist, what form of regulation would be the most appropriate method of providing protection.

Summary of Findings

We find that:

1. There is evidence from complaint data that some form of regulation of collection agencies is warranted to protect creditors as well as debtors from harm.

2. Act 76, SLH 1979, which eliminates licensing and the Collection Agency Board but requires bonds to protect creditors and prohibits certain practices to protect debtors, is an appropriate form of regulation for collection agencies.

The Need for Some Form of Regulation

It is evident from a review of the history of Chapter 443 and the newly enacted Act 76 of 1979 that the Legislature had two objectives in regulating collection agencies: (1) to protect creditors from the potential harm of suffering financial losses from unscrupulous or dishonest collection agencies; and (2) to protect debtors from abusive collection agencies. These are legitimate objectives under which the State has a valid basis to exercise its regulatory powers if the potential harm exists.

Potential harm to creditors. Regulation was originally enacted to protect creditors from financial abuses by collection agencies. Legislative reports refer to collection agencies which do not properly account for or remit collections to the creditor. The creditor is harmed when collection agencies apply the funds collected to their own use or otherwise fail to remit funds. Other abuses occur when the agencies fail to report to creditors on a timely basis or fail to return to the creditor those accounts which they have been unsuccessful in collecting.

Of 19 complaints to the Department of Regulatory Agencies and the Office of Consumer Protection, since 1976, two were initiated by creditors. The irregularities alleged involved accounting for collections and the rates charged for collection. Since the board's establishment, one license has been revoked. In that particular case, at least $60,000, and probably more, had been collected but could not be accounted for. The board appointed a conservator to settle accounts with the creditors.

Potential harm to debtors. Nine complaints were initiated by debtors. Complainants alleged that collectors did not properly identify themselves and that collectors garnished wages in excess of legal limits. There were also complaints that collectors mistook the identity of the debtor, attempted to collect a nonexistent debt or an already settled account, and used other collection practices.

In addition to complaints registered with state agencies, the Legal Aid Society has received approximately 25 complaints since 1976. Those seeking help from the Legal Aid Society alleged illegal collection practices such as harassment and intimidation.

While there are undoubtedly reputable collection agencies which are scrupulous in their dealings with both creditors and debtors, we conclude that potential harm to the public exists and that some form of regulation is warranted if the method of regulation is reasonable and appropriate.

Appropriate Form of Regulation

In the previous section, we concluded that some form of regulation of collection is justifiable. In this section, we consider what would be the most appropriate form of regulation.

We have noted previously that the Legislature properly perceived the purpose of regulating collection agencies as encompassing two objectives: (1) to protect creditors from the potential harm of suffering financial losses; and (2) to protect the debtors from the potential harm of abusive collection practices. These objectives provide the basis upon which an assessment of the method of regulation can be made.

In our framework for evaluation described in Chapter 1, we stated that not all of the potential dangers warrant the exercise of the State's licensing powers. We also stated: "Depending on the harm to be protected against, licensing may not be the most suitable form of protection for the consumers. Rather than licensing, the prohibition of certain business practices, governmental inspection, the posting of bond, or the inclusion of

the occupation within some other business regulatory statute may be preferable, appropriate, or more effective in providing protection to the consumers."

We find that licensing, *per se,* by the Collection Agency Board is not what provides protection to the public. In the case of creditors, protection against potential financial losses is provided through the requirement for the posting of an appropriate bond and, in the case of debtors, protection against abusive collection practices is provided by making such practices unlawful. Both forms of protection can be provided without the necessity of licensing as required under Chapter 443.

Act 76 meets need. The new act which is scheduled to take effect on December 31, 1980 fulfills the need for some form of regulation of collection agencies, and our assessment is that it is the appropriate form. The act eliminates the Collection Agency Board and the unnecessary requirements for licensing but it retains the important requirements of bonding, responsible financial practices, and prohibited acts and practices.

The act continues to require a bond of $25,000 for the first office of a collection agency and $15,000 for each branch office. Collection agencies are required to keep permanent records of collections and disbursements and to report and remit to clients the amounts due within 30 days after the close of each calendar month. Collection agencies are prohibited from commingling funds and must maintain separate trust accounts for clients. These requirements are all in the interest of protecting creditors.

As to debtors, they will continue to be protected by making unlawful specific acts and practices which involve threats or coercion; harassment and abuse; unreasonable publication of indebtedness information; fraudulent, deceptive, or misleading representations; and unfair or unconscionable means of collection.

The act could be strengthened in one respect. While the act specifies that no person may act as a collection agency unless the required bond is filed with the director of the Department of Regulatory Agencies, it does not require the director to be notified if the bond is cancelled. Such notice would enable the director to ensure that the agency affected does not continue to engage in the business of collections. A technical correction should also be made. Act 76 contains a reference to the "board" in its definition of principal collector. Since, under the act, there is no board, the reference to the board should be deleted.

Recommendation

We recommend that Chapter 443, Hawaii Revised Statutes, be allowed to expire as scheduled on December 31, 1980.