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August 26, 2022

FOR ELECTRONIC DELIVERY
Commissioner Christopher S. Shultz
California Department of Financial Protection and Innovation
regulations@dfpi.ca.gov

Re: Comments on Draft Text for Proposed Second Rulemaking under the California Debt Collection Licensing Act

Dear Commissioner Shultz:

In response to the California Department of Financial Protection and Innovation's invitation for comments, Hinshaw and Culbertson LLP appreciates the opportunity to provide comments regarding the proposed second rulemaking under the California Debt Collection Licensing Act ("DCLA"). Hinshaw regularly works with clients in connection with state licensing and compliance matters. Through this work, we hope to help identify challenges debt collection businesses will face in light of limiting the employee licensing exemption to W-2 employees.

We understand that the intention of the most recent draft regulations implementing the application requirements under the DCLA is to clarify the scope of the DCLA in helpful ways. Specifically, the proposed regulation clarifies that employees of licensed debt collectors are not required to be licensed under the DCLA when acting within the scope of their employment. However, the definition of "employee" creates certain challenges for business practices, especially in light of today's economy.

As drafted, the definition of "employee" is proposed to only include individuals whose manner and means of performance of work are subject to the right of control of, or are controlled by, a person and whose compensation for federal income tax purposes is reported, or required to be reported, on a W-2 form or international equivalent, issued by the controlling person. As it reads, an "employee" of a licensed debt collector will be exempt from the debt collection license requirement only to the extent the individual is a W-2 employee or international equivalent of the licensee.

Limiting the Employee Definition to W-2 Employees Restricts Use of Company Service Agreements.

Limiting the employee exemption to W-2 employees does not take into account certain business practices to fulfill staffing needs. It is common business practice for companies to utilize service agreements by which parties agree that individuals employed by one entity will offer employment services to another in exchange for payment. This is a common arrangement by companies with a multi-entity structure. For example, a parent and its subsidiary may enter into a service agreement by which the parties agree that the subsidiary will utilize and supervise the activity of employees of the parent. Even though the employee is controlled by the subsidiary, the individual is not the subsidiary's W-2 employee. The proposed definition of "employee" would restrict a licensed debt collection company from utilizing service agreements with affiliated companies to fulfill staffing needs.

Service agreements are also used by U.S. based companies with international operations where local custom and laws make it challenging for individuals to be W-2 employees of the company. The employees are supervised and controlled by the U.S. based company. However, the individual is technically the international equivalent of a W-2 employee of the international entity. The proposed definition of "employee" would restrict the use of services agreements in this context as well.

Limiting the Employee Definition to W-2 Employees Creates Additional Challenges in Current Labor Market.

Additionally, as many are aware, the pandemic greatly affected the job industry. Low unemployment rates and labor shortages have forced businesses to change strategies in terms of searching for additional methods of meeting labor needs. This has resulted in the growth of the gig economy and use of contract workers, which has offered several benefits to small businesses. It allows for companies to scale up or down to meet its business needs and provides budgeting flexibility in terms of operating expenses. While these individuals are responsible for reporting income, gig employees and contracted workers may not be W-2 employees of the company they are performing services for.

The proposed definition of "employee" would restrict a debt collection company from addressing labor challenges through the use of workers who are not traditional W-2 employees. For example, it would prohibit the use of employees placed through staffing agencies who maintain responsibility for issuing the W-2 form. As a result, debt collections companies that are unable to not address staffing issues by hiring W-2 employees, run the risk of being under staffed and not fulfilling business obligations. This would likely have a greater impact on smaller debt collection companies more so than larger competitors.

Debt Collectors Can Effectively Supervise Non-W-2 Employees.

Debt collection companies can responsibly and effectively exercise supervision over employees, regardless of whether it issues a W-2 form for the employee. This has been achieved through the use of sound policies and procedures addressing the individual's duties and responsibilities. It has also been accomplished by requiring individuals to meet company work

standards, to sign company policies and disclosures, to attend training, and to complete testing. Even though the individual may not be a debt collector's W-2 employee, the company can still be responsible for the individual's compensation decisions, work evaluations, and termination decisions.

The Regulations Should Be Revised to Avoid Limiting Employees to W-2 Employees of Licensed Debt Collectors.

We respectfully request that the employee license exemption not be limited to W-2 employees of a licensed debt collector. Generally, states that clarify that employees of licensed debt collectors or collection agencies are not required to obtain the license do not limit the exemption to W-2 employees of the licensed entity. These laws may be helpful guidance for revising the proposed regulations.

For example, Washington law governing collection agencies states that "[n]othing contained in this section shall be construed to require a regular employee of a collection agency or out-of-state collection agency duly licensed under this chapter to procure a collection agency license." Wash. Rev. Code § 19.16.110. Washington law also excludes from the definition of collection agency "any individual engaged in soliciting claims for collection, or collecting or attempting to collect claims on behalf of a collection agency licensee if the individual is an employee of the licensee" and "any individual collecting or attempting to collect claims for not more than one employer, if all the collection efforts are carried on in the name of the employer and if the individual is an employee of the employer." Wash. Rev. Code § 19.16.100(5). "Employee" is defined in the supporting regulations as "a natural person employed by a licensee and shall not be deemed a 'collection agency' or a 'branch office' as defined in Wash. Rev. Code § 19.16.100(5)(a) so need not have an additional license or certificate to perform collection activities on behalf of the licensee whether working from a business office or from the employee's virtual office." Wash. Admin. Code § 308-29-010(5).

Oregon law requiring collection agencies to register with the Oregon Department of Consumer and Business Services excludes the following from the definition of "collection agency":

> (A) An individual who engages in soliciting claims for collection, or who collects or attempts to collect claims on behalf of a registrant under ORS 697.005 to 697.095, if the individual is an employee of the registrant.
>
> (B) An individual who collects or attempts to collect claims for not more than three employers, if the individual carries on all collection efforts in the name of the employer and the individual is an employee of the employer.
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> . . .
>
> (N) An individual employed by another person that operates as a collection agency unless the individual operates as an independent collection agency while a collection agency employs the individual.

Or. Rev. Stat. § 697.005(1)(b)(A), (B), (N). The supporting regulations define "employed" as "working for a salary or wages." Or. Admin. R. 441-810-0000(2).

The approach in other states is to provide a similar exemption for employees without defining "employee" or similar term. For example, Arizona exempts employees of collection agency licensees from obtaining the license. A.R.S. § 32-1004. "Employee" is not a defined term. Similarly, Nevada law exempts "employees of a collection agency whose activities and duties are restricted to the business premises of the collection agency" from holding a license. Nev. Rev. Stat. § 649.025. "Employee" is not a defined term.

Wyoming law requires a license in order to conduct a collection agency or to act as a debt collector or solicitor within the state "except that a debt collector or solicitor acting in the course of his employment for a collection agency licensed in Wyoming is not required to have an individual license." Wyo. Stat. Ann. § 33-11-102. "Employment" is not a defined term.

A number of states refer to a "regular employee" in connection to the licensing exemption. For example, the Nebraska Collection Agency Act provides that "[n]othing contained in this section shall be construed to require a regular employee of a collection agency duly licensed as such in this state to procure a collection agency license." Neb. Rev. Stat. § 45-601. Maryland law governing collection agencies provides that the license requirement does not apply to "a regular employee of a licensed collection agency while the employee is acting within the scope of employment." Md. Code, Bus. Reg. § 7-301(b). Michigan law requiring collection agencies to be licensed excludes from the definition of collection agency "a regular employee who collects amounts for 1 employer if all collection efforts are carried on in the name of the employer." Mich. Comp. Laws Serv. § 339.901(1)(b)(i). "Regular employee" is not a defined term in the applicable state law.

In light of the above, we respectfully ask that definition of employee in the proposed second rulemaking under the DCLA be removed or revised to resemble other state definitions of "employee" to mean a natural person working for a salary or wages.

Conclusion

We appreciate that the proposed second rulemaking are intended to clarify the scope of the DCLA and its application requirements. We also appreciate the ability to provide comments. We hope that our experience working with clients in the licensing space and the challenges their businesses face offer a compelling reason not to limit the employee licensing exemption to W-2 employees of the licensed entity.

Thank you for taking our comments into consideration. Should you have any questions or require anything further, please telephone me at [redacted] or send me an email via [redacted].

Very truly yours,

HINSHAW & CULBERTSON LLP

[redacted]

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