

Internal Revenue Service
Appeals Office
One Cleveland Center #815
1375 E. Ninth Street
Cleveland, OH 44114

Number: **201128038**
Release Date: 7/15/2011

April 19, 2011

A
B

Certified Mail

Dear _____ :

This is a final adverse determination regarding your exempt status under section 501(c)(3) of the Internal Revenue Code (IRC). It is determined that you do not qualify as exempt from Federal income tax under IRC Section 501(c)(3) effective January 1, 2000.

Our adverse determination was made for the following reason(s):

You are not operated exclusively for charitable, educational, or other exempt purposes as required in § 501(c)(3). You did not engage primarily in activities which accomplish one or more of the exempt purposes specified in § 501(c)(3). Treas. Reg. § 1.501(c)(3)-1(c)(1). More than an insubstantial part of your activities were in furtherance of a non-exempt purpose. Furthermore, you also operated for the benefit of private interests. Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii). I.R.C. § 501(c)(3) precludes federal income tax exemption if net earnings inure to the benefit of private shareholders or individuals.

Contributions to your organization are not deductible under section 170 of the Code.

You are required to file Federal income tax returns on the form indicated above for tax periods beginning on and after January 1, 2000 for any open tax years. File your return with the appropriate Internal Revenue Service Center per the instructions of the return.

Department of the Treasury

Person to Contact:

Employee ID Number:

Tel:

Fax:

In Re:

Form Required to be Filed:

EIN:

C

Tax Period(s) Ended :

UIL:

0501.03-08

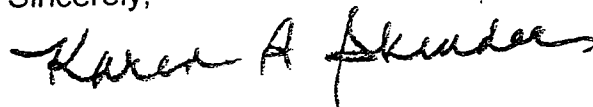
If you decide to contest this determination under the declaratory judgment provisions of Code section 7428, a petition to the United States Tax Court, the United States Court of Claims, or the district court of the United States for the District of Columbia must be filed within 90 days from the date this determination was mailed to you. Contact the clerk of the appropriate court for rules for filing petitions for declaratory judgment. To secure a petition form from the United States Tax Court, write to the United States Tax Court, 400 Second Street, N.W., Washington, D.C. 20217.

Processing of income tax returns and assessments of any taxes due will not be delayed should a petition for declaratory judgment be filed under section 7428 of the Code.

You also have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures such as the formal appeals process. The Taxpayer Advocate is not able to reverse legally correct tax determinations, nor extend the time fixed by law that you have to file a petition in the U.S. Tax Court. The Taxpayer Advocate can however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. If you want Taxpayer Advocate assistance, please contact the Taxpayer Advocate for the IRS office that issued this letter. See the enclosed Notice 1214, *Helpful Contacts for Your "Notice of Deficiency"*, for Taxpayer Advocate telephone numbers and addresses.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,



Karen A. Skinder
Appeals Team Manager

Enclosure: Notice 1214 Helpful Contacts for your "Notice of Deficiency"

Internal Revenue Service

Department of the Treasury

Date: February 23, 2006

Taxpayer Identification Number:

Form:
990

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

Certified Mail - Return Receipt Requested

Dear :

We have enclosed a copy of our report of examination explaining why we believe revocation of your exempt status under section 501(c)(3) of the Internal Revenue Code (Code) is necessary.

If you accept our findings, take no further action. We will issue a final revocation letter.

If you do not agree with our proposed revocation, you must submit to us a written request for Appeals Office consideration within 30 days from the date of this letter to protest our decision. Your protest should include a statement of the facts, the applicable law, and arguments in support of your position.

An Appeals officer will review your case. The Appeals office is independent of the Director, EO Examinations. The Appeals Office resolves most disputes informally and promptly. The enclosed Publication 3498, *The Examination Process*, and Publication 892, *Exempt Organizations Appeal Procedures for Unagreed Issues*, explain how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

You may also request that we refer this matter for technical advice as explained in Publication 892. If we issue a determination letter to you based on technical advice, no further administrative appeal is available to you within the IRS regarding the issue that was the subject of the technical advice.

If we do not hear from you within 30 days from the date of this letter, we will process your case based on the recommendations shown in the report of examination. If you do not protest this proposed determination within 30 days from the date of this letter, the IRS will consider it to be a failure to exhaust your available administrative remedies. Section 7428(b)(2) of the Code provides, in part: "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted its administrative remedies within the Internal Revenue Service." We will then issue a final revocation letter. We will also notify the appropriate state officials of the revocation in accordance with section 6104(c) of the Code.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Case Manager

Enclosures:
Publication 892
Publication 3498
Report of Examination

The Examination of XXXXX.

XXXXX, (hereinafter referred to as either "XXXXX" or "XXXXX" or sometimes as the "organization") is a XXXXX, non-stock corporation allegedly organized to provide educational services to the public. XXXXX filed Forms 990 (Information Return of an Organization Exempt from Income Tax under Section 501(c)) on a calendar year end for taxable years XXXXX (see attached Forms 990 as Exhibit I).

On September 25, 2003, the Internal Revenue Service (hereinafter referred to as either "IRS" or "Service") issued a Letter of Examination for the year ended XXXXX for the purpose of determining whether XXXXX is an organization exempt from income tax under I.R.C. § 501(c)(3) (see attached Exhibit 2). Attached to the examination letter was a detailed list of documents requested by the Service from XXXXX in order to commence the examination (see attached in Exhibit 2). The IRS subsequently extended its examination of XXXXX to include XXXXX's activities in the years 2000 and 2002. During the course of its examination, the IRS issued 66 document requests (see attached listing of these requests as Exhibit 3). Also, the IRS issued 12 summonses (see attached listing of summonses issued for XXXXX in Exhibit 4) related to XXXXX activities and conducted numerous contacts of individuals, vendors, regulatory authorities, and industry leXXXXXers.

This report details the Service's findings resulting from its examination of XXXXX.

TAX YEARS ENDING XXXXX

ISSUES PRESENTED:

1. Whether XXXXX is operated exclusively for exempt purposes described within Internal Revenue Code section 501(c)(3):
 - a. Whether XXXXX is engaged primarily in activities that accomplish an exempt purpose?
 - b. Whether more than an insubstantial part of XXXXX activities are in furtherance of a non-exempt purpose?
 - c. Whether any part of the net earnings of XXXXX inured to the benefit of any private shareholder or individual?
 - d. Whether XXXXX was operated for the purpose of serving private rather than public interests?

BACKGROUND INFORMATION

The Precursors to XXXXX: XXXXX, XXXXX, the Credit Counseling Industry and the Formation of "Clone" XXXXX Companies including XXXXX

XXXXX, (sometimes referred to as "XXXXX") was formed as a "clone" entity of XXXXX, (sometimes referred to as "XXXXX"), a credit counseling organization formed by XXXXX.¹ XXXXX is one of 11 "clones" of XXXXX formed between XXXXX (see Exhibit 6 for the US Senate Report that illustrates the "XXXXX", referred to in this Report as the XXXXX "clones"). All 11 of these entities were formed by family, friends and/or business associates of XXXXX. As discussed in greater detail, infra, XXXXX, a former employee of XXXXX, was instrumental in founding and operating XXXXX. XXXXX was the original company whose business model and practices were co-opted into "clone" organizations. The common operational element in XXXXX and its clones was the use of XXXXX's for-profit company, XXXXX (subsequently named XXXXX in XXXXX) for back office service ("customer service") operations in which large amounts of fees were paid by XXXXX and its clones. See the US Senate Report in Exhibit 6 and XXXXX Bankruptcy Examiner's Report in Exhibit 27.

When XXXXX was formed in XXXXX, its mission allegedly was to provide credit counseling and educational services to consumers with debt problems. However, XXXXX quickly became involved in aggressively marketing to and establishing debt management plans² for consumers with credit card debt. Accordingly, XXXXX's primary activity was the operation of a large call center in XXXXX (along with offices in XXXXX and in XXXXX, for a period of time) whose function was to enroll consumers in debt management plans. As a result of XXXXX's aggressive advertising, large "lead" inventories were being generated by XXXXX (see Exhibits 10 and 42 in which XXXXX states that she distributed XXXXX leads to XXXXX spin-off CCAs, including

¹ XXXXX, a native of XXXXX and a graduate of the University of XXXXX, founded XXXXX through nominees, including his wife, XXXXX and the wives of his friends/business associates. XXXXX controlled and participated in XXXXX's activities in XXXXX through XXXXX. (See attached Exhibit 6 as well as Exhibit 9-- excerpts from XXXXX's deposition). XXXXX, through his employment at and ownership in credit counseling and loan companies, XXXXX substantial experience in the debt consolidation industry. Many of his high school and college friends became his close business associates in virtually all of his endeavors including XXXXX.

² A debt management plan (sometimes referred to herein as a "DMP") is a tool used to restructure unsecured debt. Restructuring debt through a DMP allows a consumer to consolidate unsecured debt, ostensibly lower his interest rates and monthly payments, obtain re-aging of his debts, and/or curtail collections calls, penalties and over-limit fees. Typically under a DMP a consumer signed a contract agreeing to make monthly payments to the credit counseling organization, which then made arrangements with the consumer's end-creditors and distributed payments to them. XXXXX, and the subsequent clone organizations including XXXXX, then charged consumers an initial "contribution" fee and monthly processing fees.

Form 886-A, Examination Report of XXXXX (attached to 30-day Letter)

XXXXX).³ Due to the need to service the surplus, time-sensitive lead inventories, "clone" credit counseling organizations were formed by loyal, close business associates, friends and family of XXXXX. These loyal associates to XXXXX contracted each "clone" CCA, via Fulfillment Agreements, to have its back office services to be conducted by XXXXX, XXXXX's for-profit company.⁴ Over 4 years, millions of dollars in fees were funneled to XXXXX by XXXXX and its clone CCAs (see the Senate Report in Exhibit 6).

XXXXX and XXXXX executed separate Fulfillment Agreements with XXXXX, whereby XXXXX provided back office administrative fulfillment functions in which XXXXX, and eventually XXXXX also, paid substantial fees to XXXXX for these services.⁵ Accordingly, XXXXX handled all communications with consumers enrolled in DMPs and the consumers' creditors, including setting up repayment terms, fielding inquiries from the consumers, making outgoing calls to creditors, updating the consumer's information, collecting payments from the consumer (other than the initial "contribution" payment) and disbursing payments to creditors.

In addition to distributing payments to creditors, XXXXX solicited "fair share" contributions from credit card companies. The term "fair share" refers to a payment made by the credit card companies who are receiving payments pursuant to a DMP. Typically, credit card companies pay a fair share, which is a stated percentage of debt, to credit counseling organizations that set up DMPs; the amount paid is determined by each creditor in advance. Credit card companies generally will only make "fair share" payments to organizations recognized as exempt under section 501(c)(3) of the Internal Revenue Code. XXXXX collected and disbursed "fair share" payments to XXXXX.

As stated, the XXXXX business model was duplicated in "clone" credit counseling organizations with the assistance of XXXXX, XXXXX, and other XXXXX companies. Staff and documents from XXXXX, start-up loans from XXXXX's company, XXXXX, and DMP leads from XXXXX, were co-opted to start XXXXX.

³ Leads are defined as information on a potential client who could enter into a debt management plan.

⁴ Initially, XXXXX used its own employees to conduct what can be referred to as "back office account management functions" which chiefly are administrative operations to implement and maintain payment processing and accounting and negotiations with creditors for consumers on a DMP. However, in XXXXX, less than three years after XXXXX commenced operations, XXXXX incorporated a wholly-owned for-profit corporation, XXXXX, (sometimes referred to as "XXXXX" or "XXXXX") and XXXXX's back office account management functions were transferred to XXXXX pursuant to an Asset Purchase Agreement.

⁵ XXXXX and XXXXX Fulfillment Agreement terms are similar, if not exact (see XXXXX Fulfillment Agreements from the Federal Trade Commission files in Exhibit 53 and the XXXXX Fulfillment Agreements with XXXXX/XXXXX in Exhibit 11). These Fulfillment Agreements also provide that if XXXXX or XXXXX defaults on the Agreement, XXXXX has the right to take over all of the DMP clients, and collect from them, including the fair share payments. According to the Fulfillment Agreement, upon default, XXXXX would be able to collect the "fair-share" payments via transferring the DMP to another 501(c)(3) XXXXX client CCA (i.e. a CCA that XXXXX also has contracted with via a Fulfillment Agreement).

XXXXX's Historical Corporate Information

XXXXX was formed on XXXXX, as a non-stock corporation in the State of XXXXX under the name "XXXXX." (hereinafter "XXXXX") (see the Articles of Incorporation attached as Exhibit 12). The Articles of Incorporation assert that the organization's purpose is "To assist indigent debtors in improving their finances through educating them as to better means of managing their money and seeking for them, if appropriate, an extension or other reorganization of their debts." The Articles of Incorporation bear the signature of XXXXX, XXXXX's attorney.

Subsequently, on XXXXX, XXXXX changed its name to "XXXXX" (hereinafter "XXXXX") (see Articles of Amendment as attached on Exhibit 12). On XXXXX, the corporate name (XXXXX) was changed again to the organization's current name, XXXXX, (see the Articles of Amendment as attached on Exhibit 12). Per the documents filed with the State of XXXXX Department of Assessments and Taxation, the Articles of Amendment filed on XXXXX, bear the purported signatures of XXXXX, as President, while the amendment filed on XXXXX, bears the signature of XXXXX, as President, authorizing the corporate name changes.

On or about XXXXX, XXXXX, now XXXXX submitted a Form 1023, Application for Recognition of Exemption under section 501(c)(3) of the Internal Revenue Code, to the IRS. The Form 1023 bears the purported signature of XXXXX as President of the organization. (see the attached complete Form 1023 with all attachments as Exhibit 13). The organization was granted exemption from Federal income tax by the IRS under the provisions of I.R.C. section 501(c)(3) by a letter dated XXXXX. XXXXX is located at XXXXX, XXXXX.

XXXXX was founded by XXXXX, who had formerly been an employee of XXXXX.

Form 1023 Application Representations

In the Form 1023 application, Part II, line 1, XXXXX stated that it was formed to help reduce personal bankruptcy by (i) educating the public about personal money management skills and (ii) assisting predominantly low-income individuals with their financial problems. To accomplish these objectives, XXXXX indicated in its Form 1023 Application that it planned to engage in three main activities.

Asserted Activity 1: Public Information. According to statements made in the Form 1023 Application, XXXXX planned to prepare videos, pamphlets, and other educational materials on budget, buying practices, and the sound use of consumer credit and to disseminate this information to the general public. These materials were to be provided free of charge to religious organizations, civic groups, labor unions, businesses, and educational organizations. In addition to the provision of educational materials, the Form 1023 also indicated that XXXXX planned to conduct financial planning workshops

Form 886-A, Examination Report of XXXXX (attached to 30-day Letter)

by providing knowledgeable speakers free of charge to these groups. According to its Form 1023 Application, XXXXX's principal targets for this activity would be lower-to-middle income families. After the first year, the organization expected this activity to comprise 20% of its time.

Asserted Activity 2: Counseling. The 1023 Application further states that trained "financial counselors" would provide personal financial counseling on budgeting and the appropriate use of consumer credit to consumers. According to the Application, these individuals would also receive copies of the public information discussed above. XXXXX indicated that it expected a substantial number of its clients to be low-income referred to them from clergy, employers, labor unions, creditors, finance companies, and creditors. The organization stated that it expected that this activity would constitute approximately 60% of its time.

Asserted Activity 3: Budget Plan. The third activity described in the Form 1023 Application was making a budget plan available to its clients. The activity was described as follows "As part of the counseling program, clients will receive information about the availability from XXXXX of budget plan services." Under the program, XXXXX indicated that it would intercede with creditors in order to persuade them to accept partial periodic payments. According to the Form 1023, the clients would make fixed payments to XXXXX who, in turn, would disburse these funds to the creditors. The organization indicated that a maximum of 20% or less of its "counselors" time would be devoted to budget plan preparation.

Expected Source of Funding:

According to the Form 1023 Application, XXXXX expected more than two-thirds of its revenue to come primarily from creditors participating in the budget plans, with some contributions coming from religious groups, civic groups, labor unions, businesses, and educational organizations who would be participating in the public information activities. XXXXX claimed in its application that revenues in the form of fees would be charged to financially able clients who participate in the budget plans. The anticipated fee would be \$3 per month per creditor per client to a maximum fee per client of \$30 per month. According to the Application, XXXXX planned to charge fees to non-indigent clients described as those with incomes above government poverty thresholds for the budget plan service. However, XXXXX asserted that the fees would be waived or reduced for indigent clients and no clients would be denied budget plan service if unable to pay. XXXXX expected that approximately 25% of its revenue would come from client fees. XXXXX indicated that at least half of the creditors were expected to make a fair share contribution of 5% - 15% of each monthly payment. The breakdown of the budget figures in the Form 1023 supplemental information section showed that expected fair share revenue would constitute 65%, 73%, and 72% of the organization's total revenue for the 19 , 20 , and 20 years, respectively. The Form 1023 Application also stated that XXXXX would not charge any initial administrative fee for the budget plan clients.

Expected Source of Clients and Criteria for Participation:

According to the Form 1023 Application Part II line 3), XXXXX planned to reach those who need financial assistance through periodic mailings to clergy, employers, labor unions, finance companies, and creditors. The Form 1023 Application also stated that XXXXX planned to place small advertisements in the Yellow Pages and other local media but its principal method of publicizing its services would be through its financial and budgeting workshops.

According to the Form 1023 Application, no criteria would be utilized in selecting individuals for the one-on-one budget counseling sessions or the workshops other than the person's willingness to attend the workshops and counseling sessions, and also to complete a detailed financial questionnaire for the counseling session. XXXXX indicated that participants in the budget plan would be expected to be in a position to pay a minimum of 2% of their total debt each month since most creditors require this amount.

Board Membership:

In the Form 1023 Application, the members of the Board of Directors were listed as follows: XXXXX – President/Treasurer/Director; XXXXX – Secretary/Director; XXXXX – Vice President/Director. The Application further states that XXXXX would serve as Chief administrator and would assist XXXXX with the conduct of workshops. The Application represented that counseling and budget plan development work would be done by XXXXX and a full-time budget counselor to be hired. The 1023 Application package may have shown the purported signature of XXXXX.

The Form 1023 application included the organization's by-laws. Article I, Clause 2, of XXXXX's by-laws state that

a majority of the board shall consist of independent public representatives. A director shall be considered independent if he or she is not a "disqualified person" as that term is defined in Sec. 4946(a) of the Internal Revenue Code. A director shall be considered a representative of the public if he or she is a member of any group or organization which may have an interest, as referral source, prospective client, or otherwise, in the corporation's services." (See the By-laws in the Application in Exhibit 13).

Form 1023 Filing:

The Form 1023 Application Package was prepared and filed by XXXXX's attorney, XXXXX. XXXXX handled the entire incorporation and exemption application process for XXXXX (see Exhibit 12 for copy of articles of incorporations showing signature of XXXXX and his law firm named for mailing purposes. (see Exhibit 13 for copy of IRS correspondence being mailed to XXXXX). Also, see Exhibit 16 for

XXXXX's deposition, page 147, in which he indicated that the Form 1023 application was prepared by XXXXX.

Because XXXXX received an "advance ruling" under sections 501(c)(3) and 509(a)(2) as a publicly supported organization, it filed a Form 872-C, Consent Fixing Period of Limitation Upon Assessment of Tax Under Section 4940 of the I.R.C., which allows the IRS to solicit information on public support and determine if XXXXX meets the qualifications of a non-private foundation under section 509(a)(2). The Form 872-C bears the purported signature of XXXXX, as President of XXXXX. (see Exhibit 13). Subsequently, on XXXXX, the IRS received the Form 8734, Support Schedule for XXXXXvance Ruling Period, signed by XXXXX's Chief Financial Officer, XXXXX. (see Exhibit 14). XXXXX listed most of its revenues from 19 - 20 as "Gross receipts from admissions, merchandise sold or services performed or furnishing of facilities in any activity that is not a business unrelated to the organization's charitable, etc. purpose" with the exception of \$ listed as gifts, grants and contributions for 19 and investment and other income of \$ and \$ for 20 , 20 , and 20 respectively. (see Form 8734 in Exhibit 14).

The Examination of XXXXX's Activities

FACTS

XXXXX Board members, Officers, Directors and Key Employees; Board Minutes

Forms 990:

Per the information set forth on the Forms 990 filed with the IRS since inception, the individuals who have served as the Directors and Officers of XXXXX are as follows (see attached Part V or Forms 990 for 19 -20 as Exhibit 15):

19 :
XXXXX, President
XXXXX, Secretary
XXXXX, Vice President
XXXXX, Director

20 :
XXXXX, President
XXXXX, Secretary
XXXXX, Vice President
XXXXX, Director

20 :

Form 886-A, Examination Report of XXXXX (attached to 30-day Letter)

XXXXX, President
XXXXX, Secretary
XXXXX, Vice President
XXXXX, Director

20 :
XXXXX, President
XXXXX, Secretary
XXXXX, Vice President

XXXXX was listed in the Forms 990 as director but the board minutes provided did not list him as a director or officer. See the Minutes in Exhibit 17.

Key Employees and Founder:

XXXXX (hereinafter "XXXXX") was the founder of XXXXX (see the testimonies of current Executive Director, XXXXX on 1/21/2004 Deposition, Page 104, as Exhibit 18; XXXXX, XXXXX COO, 5/12/2004 Deposition, Page 323, as Exhibit 19; XXXXX, current President of XXXXX and Controller of XXXXX, Deposition, Page 228 and 330, in Exhibit 20; and XXXXX, the wife of XXXXX, in Exhibit 21). XXXXX also stated that he founded XXXXX. (see his Deposition in Exhibit 16) XXXXX remained in a controlling capacity through June, 2003 (see XXXXX, the Executive Director hired by XXXXX in 2002, Testimony in Exhibit 22: XXXXX testimony, Pages 212-214, Exhibit 16; and XXXXX 1/13/2004 Deposition, Page 94 in Exhibit 18). XXXXX ran weekly, regular Managers' Meetings to dictate expectations and procedures (see XXXXX Deposition on 3/9/2004, Page 185, in Exhibit 18 and XXXXX Testimony in Exhibit 22). XXXXX removed himself as an employee at the end of 2000, but hired himself as a consultant for XXXXX immediately after employment (see XXXXX Deposition on Page 330, Exhibit 20: XXXXX testimony in Exhibit 22; and XXXXX Deposition on Pages 212-214, Exhibit 16).

XXXXX controlled all decisions including purchases, marketing, and sales procedures (see XXXXX testimony in Exhibit 22). XXXXX installed XXXXX as Executive Director despite having no apparent authority to do so (see XXXXX 3/9/2004 Deposition on Page 20, as Exhibit 18 and XXXXX Testimony in Exhibit 22). No officer, director or employee of XXXXX supervised XXXXX's actions or decisions (see XXXXX 3/9/2004 Deposition, Page 185, in Exhibit 18; XXXXX Deposition in Exhibit 16; and XXXXX Deposition in Exhibit 22). The "consulting" agreement with XXXXX was finally terminated in June, 2003 by XXXXX, the new Executive Director (see XXXXX 3/9/2004 Deposition, Page 185, in Exhibit 18).

XXXXX (now deceased) and his estate (XXXXX lawsuits refer to his estate as the defendant in litigation) is currently being sued by XXXXX for misappropriating funds for his personal and private benefit while in control of XXXXX. The Complaint (see Exhibit 23) alleges XXXXX was in control through 2003 (see Page 2, numeral 3 of the complaint reads in part..... "Defendant, XXXXX ("XXXXX") is an individual

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residing in XXXXX, XXXXX at XXXXX. At all times relevant to XXXXX's claims against XXXXX, XXXXX was acting either as Executive Director of XXXXX or as a consultant exercising managerial control of XXXXX's day-to-day operations").

Selection of Board Members:

All of the Board members selected through XXXXX, were put in place by XXXXX. The original Board of XXXXX, XXXXX and XXXXX were asked personally by XXXXX to serve as Board members to start "his business" (see XXXXX testimony in Exhibit 21; XXXXX testimony in Exhibit 24; and XXXXX testimony in Exhibit 25). XXXXX was the girlfriend (and future wife) of XXXXX and XXXXX and XXXXX were close personal friends of XXXXX. XXXXX and XXXXX testified that they had absolutely no activity as a Board member for XXXXX. They did not attend meetings nor were they privy to any of the activities of XXXXX (see XXXXX testimony, Exhibit 21, and XXXXX, Exhibit 24).

XXXXX, the President of XXXXX in XXXXX and XXXXX, was also installed by XXXXX (see XXXXX's testimony in Exhibit 26). XXXXX instructed both XXXXX and XXXXX to sign documents to utilize their signature as the corporate signature of XXXXX (see XXXXX testimony in Exhibit 21 and XXXXX in Exhibit 26). XXXXX had no authority in his entire board membership tenure over any XXXXX decisions or activity. XXXXX stated that XXXXX gave all directions.

XXXXX, another board member in XXXXX, was contacted numerous times during the examination and failed to agree to an interview by the IRS.

XXXXX stated that he did attend infrequent board meetings of XXXXX (see his testimony in Exhibit 25). XXXXX was flown in from XXXXX to XXXXX or another meeting location. XXXXX could not recall any discussions of XXXXX matters at these meetings. XXXXX did state that he did see some budgets late in his tenure (around 2002-2003) but never made a decision as a board member. XXXXX does not remember conducting any due diligence for the selection of XXXXX as a back office service provider. XXXXX stated that his companies, XXXXX and XXXXX, did receive "leads" for potential clients from XXXXX and XXXXX. XXXXX said the Board approved the leads to be sent (see his testimony again in Exhibit 25). XXXXX and XXXXX personally exchanged leads for undisclosed amounts of money (see XXXXX testimony in Exhibit 22 which stated that XXXXX would compile the listings for XXXXX and receive large amounts of money for the list in an envelope).

XXXXX Corporate Minutes:

A summary of XXXXX corporate minutes from XXXXX (see attached as Exhibit 17), discloses the following:

On XXXXX, pursuant to a written consent of directors in lieu of meeting, the following actions were taken:

- a) articles of incorporation filed with the Department of Assessments and Taxation was appended to the minutes
- b) bylaws regulating the conduct to the business and affairs of the corporation were adopted
- c) the following officers were elected until a successor was elected - XXXXX, President & Treasurer; XXXXX Vice-President; and XXXXX, Secretary.
- d) the official seal was adopted
- e) officers of corporation were authorized to open and maintain appropriate accounts for the deposit and dispersal of funds
- f) officers were authorized to reimburse those persons who expended sums for the organization of the corporation for reasonable charges and expenses
- g) officers were authorized to take all action necessary and appropriate to rent or purchase office space, execute contracts, purchase corporate books and ledgers, open depository accounts and to commence the business of the corporation.
- f) Fiscal year of corporation to commence January 1 and conclude December 31
- i) Regular meeting of the board of directors to be held each year at 11:00AM on the first day of March in each year
- j) officers authorized and directed to take all necessary actions to cause the corporation to be recognized and maintained exemption under 501(c)(3) of the Code.
- k) corporate name changed to XXXXX and officers authorized to amend the articles of incorporation.

The minutes were signed by XXXXX, XXXXX, and XXXXX.

On XXXXX, the directors of the corporation took the following actions by written consent in lieu of meeting by unanimous vote at a special meeting of the board:

- a) Consideration of the out-sourcing proposal – it was proposed that the corporation approve and ratify the out-sourcing of the corporation's budget plan administration services to XXXXX, a for-profit corporation. Copy of draft contract appended to the minutes. The board considered the following data and information, among others, a) a report prepared for VISA which recommended that credit counseling agencies concentrate on their core service of counseling clients and that they out-source their back-office and budget plan operations to third parties.
- b) “ The proposed arrangement with XXXXX, should produce substantial financial savings to the corporation over the cost of administering the client budget plans in house or out-sourcing the work to other third parties. An analysis of projected in-house costs and the costs of comparable services from other outside providers, including an oral proposal from a XXXXX debt processing company of \$50 per client per month, disclosed that the proposed arrangement with XXXXX, offers significant savings to the corporation over any other known alternative.”

“The following resolution is hereby adopted:

Form 886-A, Examination Report of XXXXX (attached to 30-day Letter)

WHEREAS, it is deemed in the best interests of the corporation that the back-office and budget plan administrative services of the corporation be out-sourced to another entity; and

WHEREAS, the terms and conditions of the proposal presented to the corporation by XXXXX, are found to be preferable to competing proposals presented to the corporation; it is, therefore,

RESOLVED, that the terms and conditions of the outsourcing proposal presented by XXXXX, are hereby ratified and approved; and it is

FUTHER RESOLVED, that the appropriate officers of the corporation are hereby authorized and directed, on behalf of the corporation, to cause the corporation to enter into a written contract with XXXXX, reflecting the terms and conditions of the proposal presented to the corporation and the draft contract appended hereto, with such non-substantial changes as may seem to them to be appropriate and in the best interests of the corporation, and to cause such contract to be implemented according to its terms."

The minutes were unsigned.

On XXXXX, the directors of the corporation took the following actions by written consent in lieu of meeting by unanimous vote at the annual meeting of the Board:

a) Election of directors and officers – The following persons were elected until his or her successor is elected and qualifies – XXXXX, Director, President, and Treasurer; XXXXX, Director and Vice President; XXXXX, Director and Secretary.

b) Ratification of Actions – "All actions of the directors and officers of the corporation taken in good faith in the best interest of the corporation since February 16, 1999, are hereby ratified, adopted, and approved."

The minutes were signed by XXXXX and XXXXX.

On XXXXX, the directors of the corporation took the following actions by written consent in lieu of meeting by unanimous vote at the annual meeting of the Board:

a) Election of directors and officers – The following persons were elected until his or her successor is elected and qualifies – XXXXX, Director, President, and Treasurer; XXXXX, Director and Vice President; XXXXX Director and Secretary. b) Ratification of Actions – "All actions of the directors and officers of the corporation taken in good faith in the best interest of the corporation since March 1, 2001, are hereby ratified, adopted, and approved."

The minutes were not signed.

On XXXXX, the directors of the corporation took the following actions by written consent in lieu of meeting by unanimous vote at the annual meeting of the Board:

Form 886-A, Examination Report of XXXXX (attached to 30-day Letter)

a) Articles of amendment – the corporations articles of incorporation to be amended to change the name of the corporation to “XXXXX, ” and to create two class of members, one class consisting of clients of the corporation and the second consisting of the directors.

The minutes was signed by XXXXX, XXXXX and XXXXX

On XXXXX, the board of directors took the following actions by written consent in lieu of meeting by unanimous vote at a special meeting:

- a) Election of Director and Officer:
- b) “The resignation of XXXXX as President, Treasurer, and director hereby acknowledge, ratified, and accepted. XXXXX is hereby elected to those positions to serve in his place and stead until her successor is elected and qualified.”

The minutes were signed by XXXXX, and XXXXX.

Original Board Member Involvement (Lack Thereof)

As noted earlier in this report, XXXXX’s proposed activities were outlined in detail in its Application for Exemption filed with the IRS in March, 1999, and referenced some activities that were to be conducted by members of XXXXX’s board of directors.

On page 5 of the Supplemental Information/Form 1023 of the Application (see attached as Exhibit 13), a footnote indicates that XXXXX would not begin operations until after it received exemption and that budget figures for 1999 were based on the assumption that operations would begin on July 1, 1999. Based on this footnote, the examination team concluded that at the time the Application was submitted, XXXXX had no employees except for its founders who were listed as officers and directors. In order to determine whether the activities presented in the Application represented the expectations or an accurate account of how the organization intended to operate, the examination team interviewed the purported founders of XXXXX.

As discussed below, the individuals who are listed in the Form 1023 Application and various corporate documents as founders/officers and directors have claimed in their testimonies that they never attended or participated in any meetings before the Application was filed or after XXXXX commenced operations (see the testimony in attached Exhibit 21 for XXXXX and Exhibit 24 for XXXXX). XXXXX also stated that she did not sign some documents that purportedly bear their signature and signed some documents, at the request of XXXXX, without knowledge of their contents (see XXXXX testimony in Exhibit 21). The founders also indicated they never discussed how the organization would be formed or organized; they never discussed or planned the activities that XXXXX would conduct; and that they never discussed, reviewed or had any knowledge of the information that was presented in the Form 1023 Application (see Exhibits 21 and 24). They also state that they were not aware of the various roles that were attributed to them in the Application including those relating to workshop and counseling activities, and that they were never involved in the operations of XXXXX,

with the exception of XXXXX' 2 month employment with XXXXX, before or after it became operational (see Exhibits 21 and 24). Both of the purported "founders" of XXXXX, XXXXX and XXXXX, testified that they had no prior credit counseling experience (or financial or business experience).

XXXXX was the fiancé and eventual wife of XXXXX, the founder of XXXXX. XXXXX stated that she never attended any Board meetings or any other functions of XXXXX. XXXXX stated that XXXXX "business" was the business of XXXXX, her eventual husband, and that she was asked to sign documents by him. XXXXX stated that she did not know the contents of the documents, nor did she read the documents prior to signing. XXXXX signed them at the request of her fiancé, XXXXX, and she was not given an explanation of why she needed to sign.

The Application for Exemption, Form 1023, was purportedly signed by XXXXX, as President. However, XXXXX has claimed that she did not sign the, Form 1023 Application. She has further indicated that she may have been asked that her name be used for corporate documents by her late husband, XXXXX to start XXXXX/XXXXX. She was asked by her husband to be on the Board but never attended meetings, nor did she have any knowledge of the business or perform any duties for XXXXX. She had never met XXXXX who was involved in the application process. She has never met or heard of XXXXX, another initial board member and only knew of XXXXX as his sister's boyfriend in

Advertising, Marketing and Solicitation Activities Identified During Examination

XXXXX was extensively involved in the telephone solicitations of consumers to participate in its debt management program or debt management plan (hereinafter "DMPs"). A debt management plan or "DMP", which was only available to individuals with unsecured debt, allowed a consumer to make one consolidated monthly payment to XXXXX for disbursement to the consumer's various creditors. Most creditors generally offer reduced interest rates to consumers who pay through a debt management program.

An example of how a typical DMP in the year 2000 worked is as follows: The consumer has 4 creditors. The consumer's proposed monthly payment is \$217, computed based on debt load and guidelines established by the creditors. The \$217 is the monthly amount that will be disbursed to the creditors. In addition to the amount for the creditors, the consumer pays a monthly fee of \$25 for a total monthly payment of \$242. According to the DMP agreement the client agree to "make a voluntary monthly contribution of six-dollars \$6.00 per account that XXXXX is handling", "or a total sum of \$25.00 monthly, whichever is greater". Thus, for this example, the monthly contribution is computed as follows: 4 creditor payments processed per month at \$6 each ($4 \times \$6 = \24 Monthly Consumer Processing Fee). Since the minimum of \$25 is greater than the \$24, the client monthly fee would be \$25. The consumer is also charged a one-time "contribution" of \$242. The one-time "contribution" amount is equivalent to one of the consumer's monthly payment including the monthly processing fee. XXXXX keeps the one-time

Form 886-A, Examination Report of XXXXX (attached to 30-day Letter)

“contribution” and all subsequent monthly processing fees. (See Exhibit ED-1 for a copy of the Client Information Sheet).

Based on records and information provided by XXXXX, records provided by third parties, and interviews conducted with third parties, XXXXX engaged in a number of advertising and marketing activities during the years XXXXX and XXXXX. Specifically, XXXXX utilized radio and internet ads to advertise its services. XXXXX’s clients were primarily procured through the process of lead generation. A lead is a consumer response to an advertisement or promotion in which the consumer has provided a name, address, phone number, and has a minimum of \$2,000 in unsecured debt. The leads were then used by XXXXX “counselors,” hereinafter referred to as employees, to contact the consumers with regards to XXXXX’s services. In its response to IDR DEB-38 (See Exhibit ED-2) which requested information on all media type, vendors, and related expenses that were associated with lead generation, XXXXX indicated that it advertised using principally radio and Internet banner ads.

XXXXX outsourced most of its advertising functions relative to radio, and internet advertisements to XXXXX, , a for-profit company owned by XXXXX. In addition to XXXXX , , XXXXX also used other vendors whose advertising services were procured through XXXXX . Through these vendors, XXXXX used radio stations to conduct advertising campaigns. The radio stations were given copies of XXXXX scripts both in 60 second and 30 second versions for advertisement purposes.

Indicated below is a summary of its advertising/marketing activities used to promote its services

Per XXXXX , letter dated XXXXX, in 2000, XXXXX purchased leads from XXXXX, totaling \$. XXXXX facilitated the billing and collection of this amount. (See Exhibit ED-3)

Radio. In XXXXX, XXXXX entered into an agreement with XXXXX for the use of radio on a per-inquiry basis to generate credit-counseling leads for XXXXX use. According to the agreement, XXXXX would provide XXXXX “exclusive direct marketing radio advertising service using radio stations, networks, and other radio programming services.” XXXXX was billed for each billable inquiry defined as any caller with a minimum of \$2,000 of unsecured debt who requested information from XXXXX and provide their name, address, and phone number. See Exhibit ED-4 for copies of leads/advertising agreements.

A typical radio commercial for XXXXX on a script dated 2/17/00 (see attached as Exhibit ED-5), consisted of the following:

“Does it seem like your credit card balances aren’t getting any smaller? If your interest rate is over 18-percent, it could take you more than 32 years to pay off that debt. If you can’t get ahead, now there’s a non-profit organization to help

Form 886-A, Examination Report of XXXXX (attached to 30-day Letter)

you – even if you're not a homeowner, even if you're way behind in your payments. It's called XXXXX. Call them at 1-800-_____.

XXXXX negotiates with your creditors for you. They can reduce your monthly payments by as much as 50-percent, XXXXX can help you pay off your debts in little as one quarter of the time you could on your own. And you'll make just one, lower monthly payment.

If you're over two-thousand in debt, call XXXXX now to receive a free debt consultation. 1-800-_____. It's completely confidential and there is no obligation.

It's hard to pay off high-interest-rate debts. To make a real dent, you need help. Call XXXXX now 1-800-_____. That's 1-800-_____."

An example of a thirty second spot dated 2/6/02 is as follows:
"Do you feel like your debt problems are beyond help? Now there's a non-profit organization that can help you reduce your monthly payments as much as 50-percent. It's called XXXXX. XXXXX can help reduce or even eliminate your interest rates. And they'll consolidate your bills into one lower, monthly payment. If you have more than two-thousand dollars in debt, call XXXXX now for a free debt consultation. Not available in all states. Call 1-800-_____. That's 1-800-_____." See Exhibit *ED-5* for copies of scripts for radio advertisements, lead summary, and billing reports.

Internet Campaigns. In 2001, XXXXX also generated leads for XXXXX by conducting an internet advertising campaign. The campaign featured a banner advertisement on the internet on a cost-per-click basis. According to XXXXXs, Inc., the advertisements that ran on the internet were banner advertisements that linked consumers who clicked on the banner to XXXXX's website. As described in a memo dated December 13, 2004, the advertisements were "simple text ads that cycled through two or three panels that said something like:

XXXXX Click Here." See Exhibit *ED-3* for copy of memo.

Print: XXXXX also conducted a print campaign for XXXXX in the TV Guide which ran in the XXXXX issue. The campaign was discontinued because XXXXX thought it was too expensive. The text of the advertisement was as follows:

- Reduce or Eliminate Interest Rates
- Reduce Monthly Creditor Payments
- Consolidate Numerous Bills Into One Easy Payment
- Eliminate Late Charges and Over-the-Limit Fees
- Free Consultation

See Exhibit *ED-5* for a copy of the print advertisement

XXXXX also purchased leads from various lead generation companies that generated leads through a series of campaigns done via the internet. The campaign primarily consisted of advertisement banners placed on various websites to attract individuals interested in debt consolidation. By clicking on the banners, the consumer was provided a form to provide information such as name, amount of debt, etc. Lead generation companies generally sell such leads on the market to buyers. XXXXX purchased leads from several lead generation companies.

According to the response to IDR DEB-18, XXXXX paid a total of \$ for advertising and leads for the year XXXXX which represented approximately 26% of XXXXX's total expenditures. (See Exhibit ED-6 for copy of IDR response) According to a memo from XXXXX, in 20 , XXXXX purchased leads from XXXXX totaling \$. (See Exhibit ED-3) The Income Statement for 20 listed total advertising expenses of \$. The 20⁰ Income Statement listed an amount of \$. (See Exhibit ED-50 for Income Statements). Leads/advertising expenses for 20 and 20⁰ represent 27% and 22% of XXXXX's overall expenditures respectively.

Enrollment of Consumers in DMPs by XXXXX's Employees

Employees' Qualifications and Training. Leads that were acquired were distributed to XXXXX's employees for phone contact with the consumers. According to Information Document Request (IDR) number DEB-53, XXXXX employed 27, 45, and 61 "counselors" in XXXXX and XXXXX respectively, (see Exhibit ED-7). Employees classified as "counselors" represent 87%, 87%, and 84% of XXXXX overall staff for XXXXX, and XXXXX respectively. For the years under examination, employees classified as "counselors" and "Floor Managers" represent an average of 89% of XXXXX overall staff. See Exhibit ED-8 for percentage worksheet.

The position description indicated the following data for a "Credit Counselor". See Exhibit ED-9 for copy of position description.

Job title – Credit Counselor
Department – Sales
Reports to: Sales manager

The position description for XXXXX's "Credit Counselor" listed the following duties and responsibilities:

1. Makes a large volume of outbound phone calls to contact potential customers
1. Provides detailed information about XXXXX and about its debt consolidation program
3. Communicates the benefits and features of the program as they will benefit the customer
4. Forward an application to the customer to ascertain relevant creditor information

Form 886-A, Examination Report of XXXXX (attached to 30-day Letter)

2. Consults pre-negotiated creditor guidelines to arrange for payments adjustments so that the payments are feasible for the client and agreeable to creditors
6. Calculates the amount of unsecured debt to create a payment plan and estimates the time needed for debt repayment
7. Opens account for the client
8. Keeps record of account activity

The qualifications for the position were listed as follows:

“Qualifications To perform this job successfully, an individual must be able to perform each essential duty satisfactorily. The requirements listed below are representative of the knowledge, skill, and/or ability required.”

Education and/or experience: No prior experience training is necessary for the position of financial consultant.

Language skills: Ability to read and comprehend simple instructions, short correspondence, and memos. Ability to write simple correspondence. Ability to effectively present information to clients and communicate with other employees.

Mathematical Skills: With the use of a calculator, must be able to add, subtract, multiply and divide in all units of measure.

Reasoning Ability: Ability to apply common sense understanding to carry out detailed but involved written or oral instructions. Ability to deal with problems involving a few concrete variables in standardized functions.

The position description also listed several competencies. Such include the following:

- a) Oral communication – speaks clearly and persuasively in positive or negative situations
- a) Quantity – meets productivity standards; strive to increase productivity; works quickly

It appears that the position description may have been changed at a later date to change the department from “sales” to “credit counseling”, and the report to field: from “Sales Manager” to “Manager”. The qualifications for the position were also removed, as well as the competencies.

In the personnel file folder for XXXXX a basic job description of a financial counselor was included in the file and states the following:

Financial Counselor- Provides credit counseling to individuals and families in need of financial assistance. To make a large volume of outbound calls contacting potentials clients of ours who have expressed an interest in our debt management program. Communicate the benefits of the service and ultimately enroll the new account.

Skills needed: Must have excellent communication and organizational skills. Good follow up and time management skills needed. Light administrative duties as needed.

Form 886-A, Examination Report of XXXXX (attached to 30-day Letter)

Hours: Mon-Thurs 9am-6pm, Fri. 9am-4am

Reports to: Sales Manager

Compensation: Based salary plus incentives awarded based on sales performance

The position description was attached to a fax dated XXXXX and was being sent by XXXXX one of the personnel in XXXXX's human resource department. See Exhibit ED-9 for copy of faxed job description.

In the personnel file for XXXXX was a letter for confirmation of employment dated XXXXX which states the following "This letter is to confirm the terms of your employment at XXXXX. As described to you in the interview, the position of financial counselor is responsible for inside telephone sales and other duties involving credit counseling at XXXXX." See Exhibit ED-9 for copy of letter

XXXXX's advertisement for "credit counseling representatives" in the classified section of a newspaper dated 2/15/01 was labeled as "sales," a title which was printed at the top of the advertisement itself. The advertisement contained the following - "Collections, telemarketing and inside sales background a plus. All sales people are welcome to apply. \$35K 1st year attainable." Another advertisement printed in the Gazette Classified on October 4, 20 , bearing the title "sales" solicited employment applications by using the following language "a non-profit credit counseling organization located in XXXXX is seeking inside telephone sales representatives." The advertisement included the following information:

- a) No experience necessary
- b) No cold calling
- c) Salary up to \$24,000 to start plus bonus

The organization stated that it was seeking self-driven, resourceful individual with a strong desire to succeed. (See Exhibit ED-10 for copies of the classified XXXXX).

In the personnel file folder for XXXXX, a Telephone Questionnaire used by XXXXX was noted. Information solicited and provided on the questionnaire included the following:

- a) "Do you have Sales experience?"
- b) If so, what type of sales have [you] been involved in?"
- a) "Let me give you some information regarding the position. XXXXX is a non-profit credit counseling organization. The inside telephone sales position entails calling on individuals and families who have applied to our organization for financial assistance. There is no cold calling involved. All sales are pre-screened, inside and over the telephone." {See Exhibit ED-11 for copy of Telephone Questionnaire}

No minimum level of education was required for applicants to be hired. No certification, license, or prior experience in the field of counseling was required.

In IDR DEB-008, (see Exhibit *ED-12*), XXXXX was asked to describe any initial training that it provides to new hires. In response, XXXXX stated the following: "In 2001, XXXXX provided formal training to its financial counselors. Employees in other positions received training as needed on an informal, as-needed basis. In response to IDR DEB-41 which requested information on the initial training provided to employees, XXXXX indicated that its newly hired "counselor" underwent a three-day training program. In the interview of XXXXX, then a current employee of XXXXX, he indicated that he began his employment with XXXXX in July, 1999, and at that time received one week of training. (See Exhibit *ED-49*). On page 182 of XXXXX's deposition (in Exhibit *I6*), XXXXX indicated that the length of the classroom training was about seven business days. Therefore, based on testimonies received, it appears that employees received three to seven business days of training before they were allowed to have contact with the consumers.

In response to IDR DEB-41, XXXXX provided us with a copy of the training manual and other materials used in its training session. The training manual consisted of the following sections. See Exhibit *ED-13* for copy of training manual.

- A) **Credit Bureaus and Reports** – A 2 ¼ page document which attempts to provide employees with an understanding of credit reports and how they are used. Also included in this section was a one page document explaining the variations and similarities between the various credit cards i.e. VISA, Master Card, Discover Card, and American Express.
- B) **Debt Consolidation** – Approximately 2 ½ pages of information about defining secured debt and unsecured debt, required information that clients MUST have in order for XXXXX to assist the person with their personal finances. Such include creditor name, complete address, city, state and zip; complete account number, creditor telephone number, and account balance. The final page of this section provides a list of debt types that XXXXX can handle. The instruction on the page to the employees reads as follows "Once you have established contact with the customer you must first be sure they possess the "type of debt" that XXXXX can handle".
- C) **Sales Process** – According to the manual, the sales process was broken down into six steps before a sale is complete and the counselor receives credit for that sale. The steps were as follows: 1. New Leads –using leads employee attempts to contact consumer 2. Fax out – once the employee has successfully given the "Sales Presentation" documentation is sent to the client for completion 3. Fax in – completed documentation is faxed back to employee 4. Payment set - employee contacts consumer to discuss creditor benefits and set a date for monthly payment to XXXXX 5. Follow up – once the payment was set contact with consumer was made every seven days to ensure that payment is received 6. Payment in – Once the payment has arrived, the consumer file is completed and submitted for processing.

A "what to do" list focusing on organizational skills, as well as a copy of the DMP agreement package used by XXXXX were also included in the training materials.

D) **Counselor Scripts :**

The training materials also contained a section titled "Counselor Scripts" which primarily represent the scripts and job aid materials used in the training and used when speaking with the consumer. The following scripts were listed as scripts to be used when speaking with the consumer.

- a) Message Script – used when attempting to contact a new customer. A one paragraph message left for the customer to return the employee's call.
- b) Sales Presentation – used when the 1st contact is established with a new customer
- c) Fax out received message script - used when the consumer agreement has been faxed to customer and the employee has not received the completed forms.
- d) Sales Close - used when the completed consumer agreement has been returned to the employee.
- a) First payment procedure - used when the customer has made the first payment.

Examples of other training materials identified in this section include the following (listed by title):

- 1) Determining the Customers' Need
- 1) XXXXX Inbound call procedure
- 2) XXXXX Follow-up Procedures
- 4) Broken Promise Script
- 5) How to be a successful Telephone Sales Representative
- 6) Donations and Contributions
- 7) Overcoming objectives

- E) **Explanation of Benefits:** This section of the training manual listed and described each benefit that the consumer may receive from the debt management program. Such include reduction or elimination of interest rates, lower monthly payments, stop late fees and penalty charges, , re-aging delinquent accounts, stop creditors and/or bill collector calls; convenience of one monthly payment, avoid creditor lawsuits and garnishments; opportunity for a complete debt consolidation loan; and avoid filing for bankruptcy. Also, included in this section was the script titled "Donations and Contributions" used to solicit "contributions" from the consumers.

- F) **Overcoming Objections** – Contained various questions that the consumer may ask and a scripted response for each.
- D) **Leads Tracking Code;Email** - Provides information regarding distribution of leads, the actions that are required for each lead and the appropriate tracking code to be used for each. Also included, were tracking forms, and examples of various email letters that could be sent to the consumer.
- E) **Requests and Forms:** - This section of the training materials contained various request forms used internally on a regular basis, as well as sample letters generated by the administrative assistant as mailed to consumers to follow-up on various steps of the DMP process.
- I) **Area Codes Numeric Listing:** List of cities and respective area codes
- J) **Client Welcome Package:** Contained a copy of the welcome package which was mailed to consumers who enrolled in the debt management program.
- K) **Glossary of Terms:** Glossary of credit terms printed from the American Express website
- L) **Telephone and Voce Mail System:** - Contained information regarding the operations of the telephone system such as the telephone features, and how to log into and off the system.
- M) **Creditors Benefits Directory:** - Table consisting of each creditor and their policy regarding interest rate, late fee, over-limit, re-age, and minimum payment.

Examples of scripts and information that were used is contained in Exhibit *ED-14*.

The Sales Presentation script was the primary script used to promote the sale of the DMPs to the consumers, since it was used for the initial contact with the consumer and served to introduce the debt management program by explaining the program and discussing all the benefits. The remaining scripts were used to address various situations as specified by the titles of each script or to provide sale strategies to the employees. The training material instructed the employees to determine the customers' needs by locating their "HOT BUTTON" as "The hot button will tell you exactly which approach or sales presentation you will use with the customer." The hot buttons include the following items: lower interest rates; lower payments; improving credit; restoring credit; debt consolidation loan; wants to purchase a home or new car in the future; wants to avoid legal action/lawsuits from creditors. According to the script "The customer will

have at least one, if not many of these hot buttons. The more hot buttons you find, the easier it will be to close the sale!"

Along with the sales presentation script, the employees were trained in the use of other various scripts to be used during contact with the customer. For example, the script titled "How to be a successful Telephone Sales Representative" provided the following information to the employees: "As new employees we have all accepted this position with one common goal. To make money. Each and every employee hired here at XXXXX has the same and equal opportunity to make a terrific salary, bonus and commission. The reason for this is that XXXXX distributes all new business and leads equally, fairly and without impartiality. This means everyone has the same chance. If you are determined to be successful then you will. Below you will find helpful hints and suggestions to help you along the way. XXXXX's top salespeople utilized these items on a daily basis, and we hope you will too."

The suggested tips include the following: 1) Follow your scripts. "One of the most common mistakes made by new salesperson is that they may deviate from the script and attempt to explain the program in their own words. When this happens the salesperson usually gets lost and hesitates with the client, leaving out important information. The scripts are guaranteed to work for you if they are followed correctly." 2) Voice Tone: "You should practice following the scripts so you do not sound like you are reading from a script." "Your sales presentation should sound natural and not like you are reading it." 3) Time on the phone: "Studies have found that the most successful salesperson spend on average no more than 11 minutes on any telephone call. Some client may require less or more time. However, if 11 minutes have lapsed you need to ask yourself if the conversation is going anywhere. If not, end the call as quickly as possible and call someone else. Do not let uninterested customers waste your valuable time."

For example, in the script titled "Overcoming Objections" employees were provided with a list of commonly asked questions and a response to each. The opening paragraph of the handout indicates the following "Having the ability to overcome objectives from a potential customer plays an important role in any sales process." [emphasis added]. Employees were trained to know the answers to the questions. Examples of the questions and answers include the following:

a) Why can't you just mail me the information? "Please understand that the information I'm sending you is time sensitive material. Your debts are increasing daily. By faxing you the information you will be able to complete it and fax it right back to me. This way I can determine what your payment will be and contact you right away and go over your benefits."

b) Why is it so urgent I send the fax back to you? "At this point I have a spot reserved for you on our debt management program. As a trained credit counselor, it is my responsibility to obtain all the necessary information possible to begin getting you out of debt. Remember the balances are increasing daily so the longer we wait to receive your fax, the more money you owe to your creditors."

XXXXX placed great emphasis regarding the importance for the employees to follow the scripts. In the "Counselor Script" section of the training manual, the first page emphasized to the employees the importance of following the scripts. The paragraph read as follows: "Following each script "word for word verbatim" is a very important part of training and will lend to your success here at XXXXX. Deviating from the scripts, or attempting to phrase these scripts in your own words will impair your ability to communicate our program effectively with the customer, and may have a negative effect on your overall performance and productivity." See Exhibit ED-13 and Exhibit ED-14 for copies of Training manual and scripts

One of the points that were listed in the material titled, How to be a successful Telephone Sales Representative, was the instruction to "Follow your scripts!" In the managers weekly meeting dated 7/08/02 the following was indicated: "as managers, it is your responsibility to make sure that each counselor is following the script verbatim". "Managers need to effectively coach each individual and turn them into a good sales representative". The weekly minutes dated 7/22/02, indicated that one of the reasons for one employee's termination was that he did not follow the script. In the Managers' Weekly Meeting dated 7/22/02 the following instruction was provided to the managers:

- o "If while monitoring a counselor, you here [hear] them say something incorrect, don't sit at your desk shaking your head
 - Have them put the client on hold
 - Make them pull out their script and follow it word for word".

See Exhibit ED-15 for copy of Managers Weekly Meeting for 2002

On page 277 of XXXXX Deposition, he agreed that employees were trained to conduct a sales presentation. He further stated on page 278 that the credit counseling industry, whether it was XXXXX, XXXXX, or XXXXX was all sales oriented. (See Exhibit 16, Page 277 to 278 of XXXXX's Deposition)

Employees' Compensation. Information Document Request (IDR) number DEB-001, question 17, was issued requesting that XXXXX list and describe each criterion used to award bonuses to various categories of employees. In response, XXXXX stated that "In order to monitor and motivate the counselors' work, XXXXX has found the most reliable indicator of performance is the extent to which clients enroll in XXXXX's budget plan program and make voluntary payments toward XXXXX XXXXX's work." See Exhibit ED-16 for a copy of the IDR response.

Employees were required to sign a Performance Agreement at the time of employment. The agreement states the following:

"I acknowledge that at the time of my hire I was made aware of the salary ranges that are commensurate with account achievements. I do understand that if I attain a certain salary range and then fall below the standards to maintain that range, XXXXX has the right to reduce my salary to the appropriate salary range based

on my performance. I understand that upward and downward mobility with regard to salary is based on the consistency with respect to the total number of monthly accounts that I achieve. I understand that the purpose of this procedure is to provide flexibility with regard to compensation and salary according to my production achievements. I also understand that management reserves the right to base salary adjustments on not only the quantity of my work but also the quality. I understand that poor work quality can result in salary reduction as well." See Exhibit ED-17 for a copy of this agreement in AM personnel file.

Base salary was calculated on the number of clients per month that the employee enrolled in the debt management program, and the amount of contributions (first pays) that the employee brought in. Employees were required to enroll a minimum number of persons in the program each month. Depending on these factors, salary was adjusted upward or downward. According to XXXXX's Salary Path for Credit Counselors, compensation is broken down into four levels. [See Exhibit ED-18 for Salary Path for Credit Counselors and spreadsheet showing adjustments of salaries based on receipts and number of enrolled consumers].

Level One: relates to the "counselor trainee" for the first 30-45 days of employment. Training salary was \$18,000 annually. The quota for the first month was 40-50 new accounts. For 40-44 accounts this would increase their salary to \$22,000; for 44-49 accounts this should increase their salary to \$23,000; and 50+ accounts would increase their salary to \$25,000.

Level Two: relates to credit counselors who were in the 2nd and 3rd month of their employment. The established quota was 40 - 50 accounts. Enrolling 40-44 accounts would increase their salary by an additional \$2,000 per year and 45-50 would increase salary by an additional \$3,000 per year. Producing less than the required minimum resulted in warnings and/or terminations.

Levels Three and Level Four were similar to level three compensation level relative to the incremental increase in salary.

In addition to a base salary, employees were paid a commission or bonus for performance above a certain level. According to XXXXX response to IDR DEB-001, question 17, regarding bonus compensation or awards offered to employees, a "counselor" could receive bonuses from any of the three bonus programs. If the "counselor's" monthly totals for initial payments from the clients were at least \$15,000 and ranked within the three highest totals for a given month within his or her group, the highest ranking total receives a bonus of \$1,500, second place was \$1,000 and third place was \$750.

If the total monthly initial payments (first pays) amount brought in by the employee exceeded \$10,000, the employee would get a bonus of 5% of the first pays over \$10,000. A counselor who received more than \$24,500 in initial payments received a

paid weekend vacation trip that included airfare, hotel, and \$500 in spending money. See Exhibit ED-16 for copy of IDR response – DEB-001, question 17.

For example, The Managers weekly Meeting dated XXXXX listed the bonus structure as follows (see Exhibit ED-15):

\$13,000 = \$250 bonus
\$14,000 = \$500 bonus
\$15,000 = \$1,000 or \$1,500 bonus “(most likely a \$1,000 bonus)”

XXXXX also operated a mid-month contest based on each group of counselors. The highest dollar amount over \$7,500 won \$500, and the second highest won \$250.

According to the response to IDR DEB-001, question 17, (see Exhibit ED-16) managers from time to time had their own contest generally based on the performance of the counselors in each group overseen by the manager. The weekly meeting dated 9/9/02 indicated that “Managers are paid depending on how many people in their group hit \$13,000 or better”. See Exhibit ED-15.

Copies of notes from meetings conducted at XXXXX showed that XXXXX paid extremely close attention to the amount of overall “contributions” achieved by the company and to the production of each “counselor”. For example, the Managers Weekly Meeting dated XXXXX, indicated that “In the month of May, we broke \$700,000”; “BR broke \$17,000”. The managers Weekly Meeting dated XXXXX stated that:

Managers need to keep track of the Daily Goals with counselors.
They need to have a certain amount of money set and faxes out each day.
If a counselor does not reach the daily goal, managers need to place emphasis on extra effort.

The meeting dated XXXXX indicates the following:

There are 3 days left in this month
There are only about 15 people in the \$10,000-13,000 range
Managers need to encourage counselors and let them know that it is possible to hit their goals (See attached Exhibit ED-15 for these notes).

The employee’s production was the main factor used in preparing an employee performance review. Several personnel files were reviewed and the following noted.

Salary and Performance Review memo dated XXXXX – “XXXXX concluded the month of June with 40 accounts for \$14,509.00. Very good based on office averages. XXXXX’s salary will be adjusted upwards to 36K. With this increase comes the responsibility of reaching no less than 15K in sales per month, always!”

Form 886-A, Examination Report of XXXXX (attached to 30-day Letter)

Employee review dated August 6, 2001 had the following comment "XXXXX concluded the month of July with \$14,142.00. 3 month average is \$15,710.00. XXXXX's sales have now become inconsistent. He should never fall below \$17K in sales and must do so to continue salary increases." Personnel file for XXXXX (see Exhibit ED-19)

In the personnel file folder for XXXXX, on a Salary adjustment Form dated the following information was noted "Avg 8607 XXXXX's highest month was 9639. Must reach 11,500 or dismissal in Jan." "NeeXXXXX 13K in April or termination Avg 14K to reinstate salary" On 11/26/00 XXXXX's salary was reduced from \$24,000 to \$22,000. Personnel file for XXXXX (See Exhibit ED-20)

The minutes of the Managers Weekly Meeting dated XXXXX specifically states that "Any counselor who has been here at least 2 full months and does not break \$6,000, will be terminated". (see Exhibit ED-15)

A memo dated XXXXX in XXXXX's personnel file indicated the following when her salary was decreased from 34K to 31K "XXXXX concluded the month as 12,184.00. 3 month average is 12,966.00. XXXXX's sales have declined. She has not surpassed 15K since December 2001. XXXXX must reach no less than 13K in May or termination." Personnel file for XXXXX (See Exhibit ED-21)

Employee Telephone Sessions with Consumers. XXXXX operated a call center and in its response to IDR DEB-53 (see attached in Exhibit ED-7) stated that in XXXXX, and XXXXX, its operating hours were 9:00am to 6:00pm, Monday through Thursday, and from 9:00am to 4:00pm on, on Fridays. Overtime hours were offered until 8:00PM Monday through Friday and from 10:00am to 2:00pm on Saturdays. The phone lines were worked by employees who handled both inbound and outbound calls to and from consumers. Primarily, all of XXXXX initial contacts with consumers were done via the telephone.

In the order script which was apparently used to screen calls the following paragraph was noted: (See Exhibit ED-44)

"If State = KS, ID, MI, NC, IL:

"Thank you for calling XXXXX. Unfortunately, due to regulations in your state, XXXXX is unable to offer services to you. Thank you for your interest." The call was then terminated without any further action.

In response to IDR DEB-001, question 20, XXXXX provided various scripts, used by its employees during phone contact with consumers. The employees were trained to follow the scripts and the following paragraph cited from the training manual showed the level of emphasis that was placed on following the scripts:

"Following each script "word for word verbatim" is a very important part of training and will lend to your success here at XXXXX. Deviating from the scripts, or

attempting to phrase these scripts in your own words will impair your ability to communicate our program effectively with the customer, and may have a negative effect on your overall performance and productivity." (See Exhibit ED-13)

The sales presentation script was used at the time of initial contact with the consumer. Reading from the script, the employee at the very beginning was to verify information which included name, address, access to fax, approximate amount of debt and whether they were current, about to fall behind or delinquent. According to the "XXXXX INBOUND CALL PROCEDURE" script, if the employee is receiving an inbound call, one of the initial paragraphs before soliciting any information is to tell the consumer the following "Certainly, XXXXX offers debt management, credit counseling and loan referral programs." The employee then asked the consumer for the types of bills that they need assistance with and if the consumer was not sure, the employee provided a list of the types of bills that XXXXX handles. The employee then was to proceed to solicit information which included, name, address phone number, email address, fax number and reason customer was inquiring about the program.

After receiving the data from the consumer on the types of bills, the employee informed the customer that based on the information that was provided, XXXXX can certainly help. Once the consumer is qualified in terms of types of debt, amount of debt, and State of residence, the employee, following the script, would read the following:

"Mr./Ms. _____, based on the information you have given me, we can certainly help. Our Debt Management program is tailor made for your situation! The program is designed to reduce the amount of time it will take you to pay off your bills in full and become debt free."

Reading from the script, the employee then explains that XXXXX would contact each of the customer's creditors to have them lower the customer monthly payment and lower the interest rate on the accounts. The consumer was told "By reducing the interest rates this will allow you to eliminate your debt up to 10 times faster. As of now, very little of the money that you send to your creditors goes towards your balances because most of your money is being applied towards high interest charges. That means you're probably making little or no progress on paying off your debts." If the customer was delinquent, the employee would inform the delinquent customer about additional benefits such as stopping of late fees, over the limit fees, harassing collection calls and the "re-aging" of accounts to current.

The employee then asked the customer to provide information on some of the creditors owed so that specific benefits could be quoted. Once the creditor information was received, the script instructed the employee to review the benefits of joining the program with the consumer. "This program makes it much easier for you. Instead of you paying your bills directly, you will send one payment to us and we will distribute that money to the creditors for you. The payment you make to us should be more affordable than what you're paying now. You will continue to receive regular monthly statements from your creditors that you should keep for your records to track our progress while on

our program. If you were to continue to pay minimum payments to these bills by yourself without our program it could take you 20 years or more before you become debt free. Our average client will have their bills paid in full in just 3-6 years depending on the amount of debt. Also, our average client will save thousands of dollars a year in interest charges."

In addition, to the benefits cited above, customers were also told that XXXXX has "direct relationship with a number of national lenders". Therefore, while on the program XXXXX would track their payment history and if they were successful in making the first seven payments on time, the customer would be referred to one of the lenders that XXXXX works with for a full debt consolidation loan

The Sales Presentation script instructed the employees to obtain the list of creditors. However, the script did not instruct the employees to gather information on the consumer's monthly expenditures during the call. Upon completion of the sales presentation, the employee faxed several pages to the consumers with instructions to return pages 4, 5 and 6. Page 1 - Fax cover page, Page 2 - Client Benefits; Page 3 & 4 - Consumer Agreement; Page 5 - Authorization to Release Information; Page 6 - Creditor Information Sheet. Consumers were required to complete and return pages 4, 5, and 6. (See Exhibit ED-22) The instruction sheet itself in the package did not mention or discuss the budget worksheet. However, the budget worksheet itself had the following statement at the top of the form: "**Complete and return this form only if you have any accounts with the following creditors**" (see Exhibit ED-23). The names of eleven creditors were listed on the form. The fax cover for the package indicated that a total of six pages (including the cover) were being faxed. The six pages are individually identified above and as noted, the budget worksheet was not referenced as a part of the six pages that were being faxed. There was no evidence to show that this form was included in all or any packages sent to consumers or only to those persons who had accounts referenced on the form. Additionally, the form merely asked for categories monthly net income and list of monthly expenses. The form was not beneficial to the consumer with regards to budgeting or other aspect relative to control of spending. The form was not used in an evaluative manner or any other manner relative to credit counseling. Thus, XXXXX did not deem this information necessary for the "consultation" process and neither did XXXXX utilize this information to determine eligibility for the DMP or to determine whether or not the consumer could afford the payment to the creditor, or the one-time "contribution" or monthly payment to XXXXX.

The next portion of the script dealt with the fee information and states the following: "As I mentioned, XXXXX is a non-profit organization. Our funding comes directly from the banks, creditors and our clients. XXXXX will request a contribution of 1 to 3% of the total amount we handle for you. This amount will not exceed one of your payments through the program and will be included in your first payment. To assist us with the monthly maintenance on your account we ask that you make a contribution of \$6.00 per account per month. This simply allows us to cover our administrative costs such as contacting your creditors, processing your payments, telephone, postage, etc. These amounts are already calculated into your monthly payments, so you will never

receive any bill from our company for any services that we provide you." While the script discussed a "contribution" of 1-3%, the agreement itself states that "contribution" being requested was "equivalent to approximately 3% of the total debt". While the earlier script only highlighted the monthly fee of \$6.00 per account, it did not indicate that the monthly fee was \$6.00 per account or \$25.00 whichever, was greater. However, the agreement itself did indicate that the monthly fee was the greater of \$6.00 per account or \$25.00. The script apparently was revised at a later date to incorporate the \$25.00 maximum. At some point in time XXXXX established a maximum monthly fee of \$70.00.

The agreement did not limit the "one-time "contribution" to 3% of total load or the monthly payment, whichever was less. The agreement merely indicated that the 3% "contribution" was approximately equal to one of the consumer's payment on the DMP. See Exhibit ED-15 for copies of agreement in the fax package to the potential DMP client.

If a consumer said that they could not afford or will not pay a contribution to XXXXX, the employees would read the following from a script. "The contribution you make to XXXXX simply allows us to cover the costs we incur on your behalf. The amount of money we will be able to save you in just 2 months will more than cover any donations that you pay. Our average client saves over \$2000.00 per year in interest rate reductions alone! Without our clients' contributions, XXXXX would not remain in business to be able to assist you, and other individuals in your situation." (See Exhibit ED-24 for XXXXX FAQ Script).

There were several other scripts that the employees used depending on the questions that the consumer might ask or the situation encountered by the employee. The employee would read the response in the script to address various questions or scenarios or follow the instructions contained in the script. The following are examples various scenarios in the script. (See Exhibit ED-24)

- B) For example, if a consumer asked "Why can't you just mail me the information" as opposed to faxing, the employee would read the following from the script "Please understand that the information I'm sending you is time sensitive material. Your debts are increasing daily. By faxing you the information you will be able to complete it and fax it right back to me. This way I can determine what your payment will be and contact you right away and go over your benefits."
- B) If a consumer asked "Why is it so urgent I send the fax back to you? - Response: "At this point I have a spot reserved for you on our debt management program. As a trained credit counselor, it is my responsibility to obtain all necessary information possible to begin getting you out of debt. Remember your balances are increasing daily so the longer we wait to receive your fax, the more money you owe to your creditors."

The employees were trained to be extremely persistent in obtaining a fax number for the information to be faxed to the consumer within the next few minutes. The employee asked the consumer to review the yellow pages to find a public fax nearby such as Kinko's, Mailboxes, etc., as well as post offices and libraries. Consumers were told that the forms could be obtained from XXXXX's website but because the site was very busy and occasionally very difficult to get through, they recommended that the information be faxed.

If the fax was sent out but was not received, XXXXX employees would make three attempts to contact the consumer and use three different scripted paragraphs. For example a portion of the second message reads as follows: "I am calling in reference to the information faxed out to you on _____ regarding debt consolidation. To keep your spot on our program it's very important that the information is faxed back sometime today." See Exhibit ED-14.

Once the fax was received, employees used a script titled: "XXXXX SALES CLOSE" The script instructs the employee to "CONTACT THE CLIENT A.S.A.P. - WHEN YOU RECEIVE A FAX THIS IS PRIORITY #!!! THIS MEANS EVERYTHING ELSE IS PUT ASIDE....CLOSE THE SALE!!!! (See Exhibit ED-14) In XXXXX's deposition on page 309), he was asked what XXXXX was trying to communicate when it wrote "Close the sale". His response was "Enrolling the client on the program." (see Exhibit 16).

The employee would contact the consumer to acknowledge receipt of the fax and to discuss the any or all benefits that the client would receive (reduce rates, lower payments, waive over the limit fee, etc). The consumer was told that "Once XXXXX receives your first payment we will submit a formal contract proposal to all of the creditors you have listed with. This allows your creditors to give you the benefits we discussed. If you are delinquent, some creditors will report you current to the credit bureaus when they receive the proposal." The employee would then discuss the payment amount and where and how to make the first payment. See Exhibit ED-14.

Once the payment amount has been set, the "XXXXX FOLLOW UP PROCEDURES" script instructs the employee to contact the consumer every seven days from the date the payment was set to remind the consumer about the payment due date. The script emphasized the following "REMEMBER, FOLLOW UP IS THE KEY TO SUCCESS!!!!!!!!!!!! IF YOU DO NOT FOLLOW UP EVERY SEVEN DAYS AFTER YOU SET THE PAYMENT, THE PAYMENT WILL PROBABLY NOT COME IN."

Once the first payment is received, employees used the "FIRST PAYMENT PROCEDURE" script to continue with the enrollment process. The employee first acknowledged receipt of the first payment and then informed the consumer that they would be receiving an Introduction Package a/k/a Welcome Package with information to explain the details of the program. Consumers were instructed to mail future payments to the payment processing center (XXXXX,) and were told that if they have any

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questions while on the program to contact the customer service department at the number provided.

Once the application process was complete and the initial "contribution" received, the completed package was forwarded to XXXXX.

At the time of employment, employees were informed in writing of XXXXX's policy of monitoring any phone conversations. Employees were required to sign the notice acknowledging that they have read and understood the policy and would abide by such policy. See Exhibit ED-30 for copy of telephone Monitoring Waiver in personnel file of XXXXX, employees' phone calls were randomly monitored by their supervisors and a Counselor Critique - Telephone Monitoring form (critique form) was completed for each call monitored. The critique form listed seven items which XXXXX felt was important and employees were rated on these elements. Such elements included the following:

- a) "Script adherence"
- b) "Overcoming Objectives"
- c) "Voice Tone"
- d) "Enthusiasm"
- e) "Aggressiveness"
- f) "Explanation of Benefits"
- g) "Professionalism"

A rating of either excellent, good, fair, and poor appeared beside each item listed above and the supervisor circled the appropriate rating for each call monitored. Information such as whether consumer was indigent, or was unable to pay the fees was not included on the form.

From the personnel folder of XXXXX (see attached Exhibit ED-25) the following information was noted:

Critique Form dated 6/27 & 6/28 - In the manager notes for specific areas needing improvement the manger note the following "keep calls as short as needed."

From the personnel file of XXXXX (see attached Exhibit ED-26):

June 25 & 26 - " XXXXX more Vigor" "Moderate # of calls. Can make more" Received a fair for "Enthusiasm"

From the personnel file of XXXXX (see attached Exhibit ED-19):

Critique Form dated June 19, 2001 - Listed under areas needing improvement (manager's notes) were the following: 1) "Too personal with client" 2) " Off script/tries to shortcut; needs to be more informative" 3) "Explanation of

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benefits needs improvement” Employee received a rating of fair and poor for Script adherence.

Critique Form June – “Must be more thorough with sale. Tendency to “rush sale”

For examination years XXXXX and part of XXXXX, employees' performance reviews seem to be based solely on sales figures for most of the periods under examination. As discussed earlier, the employee's production was taken into consideration during performance review. However, review of various personnel files showed that for most of the periods under examination, this was the main and sometimes the only factor which was used. Several personnel file were reviewed and the following performance reviews were noted.

From the personnel file of XXXXX (see Exhibit ED-19), the following comments were noted on the “employee Review” dated June 5, 2001:

“Employee has demonstrated good sales skills in the past. However, sales have dropped \$5,000 from the previous month. Employee has been warned about deviating from the scripts and reporting inaccurate daily totals.” Included in the “Action” paragraph was the following statement “Needs to increase sales so as to maintain high levels of performance as demonstrated in previous months.”

From the personnel file of XXXXX (see Exhibit ED-27):

Employee Review dated XXXXX – “XXXXX concluded the month of August with \$. While employee has now shown improvement, he must focus on remaining consistent with his sales. Sales should never fall below 15K. Employee individual goal should be between 17.5 and 20K.”

From Personnel file of XXXXX (see Exhibit ED-28):

Employee Review for XXXXX dated XXXXX – indicated that one of the following corrections were required immediately: “ Follow our scripts “verbatim” each time she is on the phone, regardless of any circumstances. Must stop from incorporating too much of her own language into the XXXXX scripts.”

From Personnel file of XXXXX (see Exhibit ED-20):

Employee Review dated XXXXX – “Employee has demonstrated excellent sales skills for the months of February, March, and April, however sales decreased for the month of May. XXXXX needs to remain more focused in his work and follow the scripts more closely. Also must watch out for too much time on the phone and make more telephone calls.”

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From Personnel file for XXXXX (see Exhibit ED-29):

Salary and Performance Review memo showed the following information for one employee: B.B. " concluded the month of June at 40 accounts, but for only \$. XXXXX unfortunately has seemed to lose her way here at XXXXX. What was once a promising salesperson reaching consistent high sales totals is now lackluster. XXXXX should work closely with her manager to bring sales totals back up to where they once were. Salary will be adjusted downwards to 28K. Employee is cautioned that if she does not reach at least 13K in sales for June 2002 she will be dismissed." Her Salary was also adjusted on April 29, 2002 for the following reasons "2 out of last 3 months XXXXX has fallen below 13K in sales. Number of accts are O.K. but is falling short in the dollar category. Must increase sales to 14K to increase salary back to 34K."

Personnel file for XXXXX (see Exhibit ED-25):

An employee review memo dated September 9, 2001 noted the following information "XXXXX concluded the month of August at \$. 3 month avg. is 15,868. As a senior credit-counselor, XXXXX's sales should average no less than 17K based on her annual salary. Will be required to work extra time if needed. Sales totaling less than 17K will be considered unsatisfactory."

Personnel file for XXXXX (see Exhibit ED-30):

Salary and Performance review dated August 7, 2000 showed the following: "XXXXX's sales have now significantly suffered over the past 2 months reaching approximately only 7K in sales. XXXXX is required to determine what the problem is and take corrective measures immediately. XXXXX is required to put in additional time to increase her sales back to satisfactory level. Salary will be adjusted downwards in accordance with the XXXXX sales Performance Agreement. Must average no less than 14K for two months consecutively to reinstate salary to \$29,000." XXXXX's salary was decreased from \$33K to \$29K.

Personnel file for XXXXX (see Exhibit ED-31):

In personnel file folder for XXXXX, Salary and Performance Review dated August 2002 showed a salary increase from \$31,000 to \$34,000. The increase was based on the following information: Current month \$15,639; Three Month Average: \$14,287.78; and Six Month Average: \$13,899.08.

At some point in XXXXX, XXXXX began to use a performance appraisal which had several evaluative areas: quality, productivity, job knowledge, reliability, attendance, independence, creativity, and initiative, adherence to policy, interpersonal relationships and judgment. However, based on manager's

performance appraisal comments in personnel file for XXXXX, the primary focus remained on enrollment and dollar amounts. See Exhibit ED-47 for performance appraisal.

Referrals of Customers by XXXXX Employees. In response to IDR DEB-24, (see attached Exhibits *ED-6* and *ED-32*), XXXXX stated that it made referrals to XXXXX. The response further states that XXXXX referred to XXXXX clients who made seven consecutive, on-time, monthly payments to the debt management program. Employees were provided information relative to referring consumers to other companies. Informing consumers about the availability of a consolidation loan was included in the Sales Presentation script as one of the additional benefits of participating in XXXXX debt management program. As indicated in the script "This is what makes our program so unique and gives us an advantage over any other debt consolidation company."

According to pages 210 - 212 of XXXXX's deposition (see Exhibit 16), XXXXX had links on its website that would say "homeowners click here." The links pointed to XXXXX or XXXXX. XXXXX is a mortgage company owned by XXXXX, who served as a director and vice president for XXXXX from XXXXX to XXXXX (see XXXXX testimony in Exhibit 25). According to XXXXX, both companies were basically given free advertisement. See Exhibit 16 in XXXXX's deposition. A review of XXXXX website also showed a homeowner link to XXXXX which according to XXXXX response to IDR DEB- 51, item 3, its "counselors" received informal approval to refer clients to XXXXX Group who were interested in refinancing their property (See Exhibit *ED-33*). XXXXX website also had a homeowners' link 2001 to a website "XXXXX" The note on the site stated the following "XXXXX a marketing agent of XXXXX Services, a subsidiary of XXXXX" See Exhibit ED-34 for copies of website links.

Documents Provided by XXXXX's Employees to the Consumer. To enroll in XXXXX's debt management program, consumers were provided the following forms and information via facsimile to be completed and returned to XXXXX:

- a) A one-page document which touted all the "benefits" of XXXXX's debt management program. Such listed "benefits" included one lower monthly payment, reduction in interest, improved credit, late and over the limit fees stopped, and end of creditor harassment.
- a) The "Agreement" provided the terms of the DMP.
- b) An "AUTHORIZATION TO RELEASE INFORMATION" form – allowed XXXXX to negotiate with the consumer's creditors.
- b) Creditor Information Sheet – requested a list of all unsecured creditors
- c) An "XXXXX Budget Worksheet" was included in the IDR response but as discussed earlier, it does not appear that this form was sent or used.

See attached Exhibit ED-22 for these documents.

Once the consumer was enrolled in the program and the initial payment was received a **Welcome Package** (See Exhibit ED-35) was sent to the new enrollee. The package contained all or some of the following information.

- a) Letter of Congratulations and welcome; the letter, the following - indicated that file has been forwarded to XXXXX to whom all future contacts should be directed; reminder of the benefits of the program, and the necessity for payments to be made on time.
 - b) One page instructions – telephone number of client services provided and instructions to call client services with future questions; the address to which all future payments should be made and payment form (cashier's check, money order, etc.).
 - a) A one page list of Do's and Don'ts and What If which included information such as – a) do mail your payment promptly, b) do not miss payments c) Do not use the accounts on the program d) what if my payment is late e) what if I withdraw from the program f) what if I lose my job
 - c) The Welcome Package also included a Two-page handout titled "IMPORTANT: PLEASE REMEMBER..." which consisted of things the consumer needed to remember. The reminder items were as follows: a) If creditors called, ask them to call Client Services Center; b) How to make monthly payments – cashier's check, certified bank check, money order or Western Union with name, social security number and address on the check. Mailing address of where check needs to be mailed; c) call Client Services Center if full payment cannot be made; d) information on the negotiation period; e) possible slight increases might be proposed by creditors; f) what do if client's financial situation changes; g) how to request review of one's account for loan referral after 7 on-time payments; h) reminder to continue to make timely payments to XXXXX during the loan evaluation period since late payments may result in ineligibility for the loan program.
 - b) List of creditors that the enrollee must call to change their payment due date
 - c) A Cease and Desist Notification form and a form titled Collection Agencies Report which provides instruction on the usage of the form.
 - d) Payment envelopes and payment coupons.
- See Exhibit ED-35 for contents of a sample Welcome Package.

XXXXX claimed that a book titled XXXXX was also sent to individuals who enrolled in the DMP. According to XXXXX's response to IDR DEB-DEB-001, question 7 (see Exhibit ED-16) and DEB-44 (see attached Exhibit ED-2), the book was distributed to consumers who enrolled in the debt management program. According to IDR response DEB-59 (see Exhibit ED-48), XXXXX itself did not distribute the books. The books were distributed by an outside vendor. Although, XXXXX paid several invoices relative for the purchase of the books, it had no mechanism in place to ensure that the companies responsible for mailing the books actually did mail the books to the consumers. The book was not made available to the general public but only to individuals who enrolled in the debt management program.

Customer Service Operations as Provided by XXXXX

In XXXXX, XXXXX contracted with a for-profit company, XXXXX, to provide "customer service" to XXXXX's clients. Per the agreement, XXXXX was retained to perform fulfillment, back-office and customer relations services to XXXXX budget plan clients. Once the completed application and all related documents including the initial contribution had been secured from the consumer, a package was prepared and forwarded to XXXXX. Basically, XXXXX was the processing center for XXXXX during the years under examination and provided services such as, submission of proposal to the creditors, payment processing, data entry, and customer service to the clients. XXXXX also handled the fair share payment received from the creditors for distribution to XXXXX. Page 3 of the agreement excludes intake and counseling services from XXXXX obligations (see the Fulfillment Agreements in Exhibit ED-36). The agreement also stated that XXXXX "will have no further direct contact with the client other than telephone or face-to-face contact initiated by the client for the purpose of receiving additional counseling."

In IDR DEB-45, (see Exhibit ED-2) XXXXX was asked to describe fully any activities that were conducted by XXXXX to educate XXXXX's clients. In response, XXXXX stated that "XXXXX did not provide educational services to XXXXX's clients."

Question 29 on the interview questionnaire mailed to an employee SMG asked if he generally called the consumer after they enrolled in the DMP to provide additional counseling. His response was as follows: "This was not encouraged." If a consumer called back for further information "-in that case some further counseling might be done. Mainly consisting of advising the client to monitor statements from creditors, call XXXXX if needing to make changes or report problems." See Exhibit ED-37 for copy of questionnaire response for S.M.G.

B.B Interview Questionnaire response indicated that once enrolled in the DMP she generally did not call consumers back to provide additional counseling. See Exhibit ED-38 for copy of questionnaire response for B.B.

XXXXX paid XXXXX a total of \$ in XXXX, \$ in XXXXX, and \$ in XXXXX for services associated with the debt management program. Such amounts represent approximately 36%, 44%, and 42% of XXXXX's total expenses for the years XXXXX, and XXXXX, respectively. See Exhibit ED-39 for this analysis of Forms 990 disclosures.

Website Operations

XXXXX, in response to IDR DEB-001, question 28, (see Exhibit ED-16) indicated that the website at the time the organization was named XXXXX was online as of XXXXX. Undated copies of pages allegedly from this website was provided in response to the IDR. According to IDR response DEB-34, in 2001 a new website was

being developed under the name of XXXXX to replace the XXXXX site. XXXXX personnel believe that the XXXXX site went online in XXXXX.

XXXXX also stated that the only portion of its website to which was restricted was the portion that allowed enrollees to obtain information about their DMP plan since it contains nonpublic personal information.

Using the internet site for "Internet Archive Wayback Machine" "Waybackmachine.com" website copies of XXXXX's website were retrieved from archive for several dates for XXXXX and XXXXX. Based on the review of the websites included as Exhibit ED-40, an overview of the information on the website is discussed below. The following categories of information as listed in XXXXX's sitemap is as follows. Each page from the website has the following statement "A non-profit organization helping people and families become debt free."

- Who are we - This portion of the website offered information about XXXXX and its purpose. The information provided stated that XXXXX is a non-profit organization dedicated to assist consumers who are having personal financial difficulties. The site also contained a paragraph which outlined the benefits of XXXXX's program. "XXXXX offers the most beneficial programs in the industry! We offer many unique solutions, which include debt consolidation loan programs and/or debt management programs." There was link on the page for consumers to apply for the program.
- How we help - List of the benefits that creditors offered for DMP participants i.e. reduction in minimum payments, consolidation of multiple payments into one monthly payment, reduce or eliminate interest rate, elimination of late charges and over the limit fees, and re-aging of past due accounts to improve credit rating. Site also contained the "Program Steps" which include the following 1) a review of "credit and budget information" with "counselor" to arrive at a repayment plan; 2) Decision on when to begin making first payment; 3) XXXXX contact with creditors to negotiate lowered monthly payment and reduce interest rates; 4) Client to keep making monthly payment on time. The remaining portion of this section dealt with "Results". The section listed the results that can be expected from participating in the program which include paying off the debt in much less time than paying on their own due to the interest reduction. The page has a link for consumers to apply.
- The site also has an application which asked for name, phone number, address, email address, amount of unsecured debt, best time to reach consumer, whether or not the person rents or owns their home, if their mortgage was past due or current and if past due how long; and a section to check the types of debt i.e. credit cards, personal loans, medical bills, etc. However, immediately before the application the benefits of the

program were highlighted with the phone number to call and a link for access to an online application. On the page was a link which states "Homeowners CLICK HERE! Clicking on the link takes the consumer to XXXXX Group website to a page which state the following: "Your house is your greatest asset, use it!

- o consolidate debt
- o lower monthly payments
- o home improvement
- o cash advance
- o or combine all into one loan ...with or without equity"

Consumers were provided an opportunity to apply online or to call a number to speak with a representative.

In 2001, the homeowners link took the consumer to a website titled "XXXXX" the note on the site stated the following "XXXXX a marketing agent of XXXXX Services, a subsidiary of XXXXX"

- Typical Client: Site consist of a calculator depicting a consumer with a balance of \$20,500 and a comparison of using the DMP or self pay. Comparison information includes interest rate, monthly payment, length of time to pay off debt, and total interest paid to creditor. The comparison is followed by the following paragraph "**XXXXX is ready to offer you a FREE consultation, to show you how our program can benefit you! Whether you are current or past due, find out how much our program can save you, and how many years of payments you can invest in yourself and your family instead of sending to a creditor. You owe it to yourself to find out! It costs nothing, and could save you thousands! Apply online now or Call us toll free at XXXXX**"
- Debt Statistics – Has an average of three pages and contained a short paragraph on pre-approved credit card offers, average family credit card debt, personal bankruptcy, national consumer debt, and a section titled other facts. The facts provided include information such as a) the average balance on a credit card b) the average interest rate c) average late fee, d) average household has 10 credit cards e) length of time to pay off a credit card with average balance of \$8,000 with an interest rate of about 18% when making the minimum payment is 25 years, 7 months f) Total interest paid out by Americans was \$65 billion g) number of bankruptcy filings for 1999 h) Average American is solicited 7 times per year for credit cards i) how to calculate debt to income ratio j) typical minimum monthly payment is 90% interest and 10% principal. This section of the site also has the phone number for consumers to call for a "FREE evaluation in 15 minutes or less" or to apply online. The homeowners' link was also on the page.

Form 886-A, Examination Report of XXXXX (attached to 30-day Letter)

- Testimonials – Titled “What our clients are telling us:” - showed a list of several comments from clients. This section of the site also has the phone number for consumers to call for a “FREE evaluation in 15 minutes or less” or to apply online. The homeowners’ link was also on the page.
- Call us/Contact us – A page with instructions for consumers to fill out an application on line or call the toll free number which was provided in order to speak with a “credit counselor” to find out more about how the program could benefit them.
- Apply Now – to allow individuals to apply for DMP
- Frequently Asked Questions – includes questions such as “why can’t I just negotiate with creditors on my own?”; “why can’t I just keep paying off my creditors on my own?”; “how much will it cost me to be on the debt management program?”; “how will joining XXXXX’s program affect my credit rating?”; “Can I send in more money once I have better cash flow?”; “Will I receive harassing phone calls?” The page also contained a number for consumers to call for a “FREE evaluation in 15 minutes or less or to apply online. The homeowner’s link was also on the page.
- Home - A page titled “Welcome to XXXXX” may be representative of the home site. The page provided a list of benefits that the DMP program provides.
- Existing Clients Home Page – allowed existing clients to access account information.

Copies of websites representing time frames in XXXXX for XXXXX were also retrieved from the wayback machine website. The site showed information similar to that discussed above under XXXXX.org. Information included 1) opportunity on each page to apply online 2) list of benefits of DMP 3) an overview of how the DMP program works 4) reasons why consumers should choose XXXXX – experience, confidentiality, and compassion 5) questions and answers – such as Will XXXXX work with all types of debt; what interest rate do you charge; how much does XXXXX charge to enroll?; why can’t negotiate with my creditors?; how do I know if these programs are for me?, etc. In response to the question which asked “How do the XXXXX debt management and credit counseling programs work?”, XXXXX statement was as follows: “The XXXXX programs allow you to pay off your existing unsecured debt under new terms. These new terms may include lower interest rates, lower monthly payments, and waived late and over-limit fees. The XXXXX programs do not require you to declare bankruptcy or take out a new loan. Take two minutes and apply today.”

See Exhibit *ED-40* for a copy of the website.

Educational Outreach Activities:

In IDR DEB-40, (see Exhibit *ED-2*) XXXXX was asked to provide a list of all workshops and seminars conducted in which members of the general public were in attendance and all related expenses. In response, XXXXX alleged that a seminar was held at a shelter for battered women possibly in XXXXX. However, it had no records relative to material used in the seminar or expenses incurred including expenses reimbursed to the employee who supposedly conducted the training. XXXXX indicated in response to IDR DEB-001, question 7, that it provided "free educational services" via topics on its website. A review of the website primarily shows information directly or indirectly related to the debt management program such as the benefits of the programs, and frequently asked questions regarding the debt management program. XXXXX also stated that it provided a free copy of the book, XXXXX, to DMP participants (see Exhibit *ED-41* for a copy of the book). However, the book was not distributed to individuals who were in financial crisis but chose not to participate in the program. It was only distributed to individuals enrolled in the debt management program. In addition, the book was not referenced in the script and the employees did not inform the consumers about the availability of the book.

XXXXX, XXXXX, XXXXX and XXXXX

As stated previously, XXXXX founded XXXXX, and eventually spun-off the customer service department (also referred to as back office services) to his for-profit company, XXXXX, on XXXXX. As of XXXXX, XXXXX serviced all of XXXXX's back office functions as well as all of the XXXXX spin-off CCAs including XXXXX. Upon formulation of a spin-off CCA, a Fulfillment Agreement is executed by XXXXX and the CCA (see XXXXX-XXXXX Agreement in Exhibit *ED-11*). Substantial fees are then remunerated to XXXXX by the CCA for customer service.

XXXXX was a former employee of XXXXX (see XXXXX testimony in Exhibit *16*). XXXXX left XXXXX in XXXXX to form XXXXX/XXXXX. XXXXX was one of 11 spin-offs that utilized former employees of XXXXX or close friends or family of XXXXX (see the XXXXX Bankruptcy examiner's report detailing the start-up individuals of XXXXX spin-offs and their relationships to XXXXX and XXXXX in Exhibit *27*). XXXXX was able to start XXXXX with co-opted elements from XXXXX and assistance, financial and marketing, from XXXXX. XXXXX gave XXXXX a \$90,000 loan to start XXXXX (see XXXXX testimony in Exhibit *22*). XXXXX also received leads from XXXXX as its primary marketing source to find potential DMP clients (again, see XXXXX Testimony in Exhibit *22* and XXXXX testimony and invoices in Exhibit *10* and Exhibit *42*). The start up funds and leads were critical to the formation and going concern of XXXXX. Also critical were co-opted items from XXXXX: forms, agreements, legal, accounting, and business model practices (see

XXXXX testimony of 7/8/2004, Page 51-58, in Exhibit 19, for co-opted items from XXXXX business practices, and XXXXX deposition and testimony in Exhibit 16). XXXXX agreed to allow XXXXX to start "his own CCA" in return for using XXXXX as its servicing agency (see XXXXX testimony on 7/8/2004, page 58, Exhibit 19). Hence, excess XXXXX leads could be timely serviced by XXXXX and XXXXX would be able to receive exuberant fees the resulting servicing of these DMPs clients.

As stated, XXXXX advertised heavily and received many leads for potential DMP clients. XXXXX would utilize XXXXXs and XXXXX to reconcile the distribution of these leads to various CCAs, including XXXXX (see XXXXX testimony in Exhibit 10 and Exhibit 42). XXXXX started as a vehicle to service the excess leads that XXXXX could not service and solicit for DMPs.

XXXXX also utilized a former XXXXX Director and XXXXX COO, XXXXX, and his company, XXXXX, for purchases of leads. Because of the relationship between XXXXX, XXXXX, XXXXX and XXXXX, leads purchases were purchased by XXXXX and directed to XXXXX totaling more than \$ in 20 (see Exhibit 37 for the XXXXX disclosure to the FTC for leads sold to XXXXX directly in 20 and for copies of XXXXX's invoices)

XXXXX has paid numerous amounts to XXXXX for back office processing. These amounts, from XXXXX billing, are as follows (see attached Invoice Analysis in Exhibit 28):

XXXXX:	None paid, but Accounts Payable to XXXXX for \$
XXXXX:	\$ paid and \$ in Accounts Payable to XXXXX
XXXXX:	\$ paid and \$ in Accounts Payable to XXXXX
XXXXX:	\$ paid and \$ due in Accounts Payable to XXXXX

In XXXXX and XXXXX, millions more were paid under the similar fee structure to XXXXX (and the resulting company, The XXXXX Group) based on the Fulfillment Agreements signed and leads purchases.

Non-compete Agreement for XXXXX and XXXXX

According to XXXXX deposition (see Exhibit 49), it was XXXXX's employment policy to have all its employees sign a Non-Compete Agreement at the time of employment. XXXXX was a former employee of XXXXX, entering into competition with XXXXX by starting XXXXX.

In his deposition, XXXXX was asked whether or not he had signed a non-compete agreement. The following is an excerpt from XXXXX's deposition taken from page 101. (See Exhibit 16 for XXXXX's deposition).

Q Okay. Did you sign any type of agreements that restricted your ability to compete with XXXXX when you were an XXXXX employee?

- A I don't remember. I do remember the issue coming up why I would not sign a non-compete.
- Q Right.
- A And this goes back seven, eight years. Whether or not ultimately I signed that non-compete -- and I don't want to give you inaccurate information. So at first, I said yes, then I said no. Now I'm telling you I'm not sure if I signed a non-compete agreement.

XXXXX in his deposition on page 101 – 102 indicated that he never discussed the issue of non-compete with XXXXX or XXXXX.

XXXXX in her deposition on April 15, 2004 (page 65) provided the following information on XXXXX's policy relative to the non-compete agreement.

- Q The next page, page 7, is the non-compete agreement; do you see that?
- A Yes, sir.
- Q Did you sign a similar agreement?
- A Yes, sir.
- Q Did all employees -- were all employees asked to sign this non-compete agreement?
- A Yes, sir.
- Q Were you asked to sign a similar agreement when you were an employee of XXXXX?
- A Yes, sir.
- Q Were all XXXXX employees asked to sign non-compete agreements?
- A Yes, sir.

Based on the above from XXXXX, it appears that XXXXX as well as other former XXXXX employees employed in any capacity at XXXXX including former employees named on XXXXX's board would have signed a non-compete agreement at the time of their employment with XXXXX.

Section 4 of the agreement (Exhibit 35 for template copy of agreement used by XXXXX) reads as follows:

“NON-COMPETITION. The below signed employee agrees that during the term of its commercial relationship with XXXXX, and for a period of two (2) years thereafter, it will not, without prior written consent of XXXXX, do any of the following:

- (a) Render services to any person, firm or corporation directly or indirectly in competition with the business, which is now or hereafter performed by XXXXX.
- (b) Hire or offer to hire any employee or agent of XXXXX;
- (c) Directly or indirectly engage in or become interested, as an owner, stockholder, partner, director, officer, employee or agent, in any business or any enterprise which competes with XXXXX in the business which is now or hereafter performed by XXXXX; or

- (d) Solicit any person or entity, who was a customer of XXXXX at anytime during its commercial relationship with XXXXX, or divert, take away or attempt to divert away such customer.”

Contrary to item (a) above, in XXXX, XXXXX formed a corporation that performed the exact business activity conducted by XXXXX. XXXXX and XXXXX are both XXXXX corporations operating in the same markets and therefore XXXXX was in direct competition with XXXXX. Contrary to item (b) above, XXXXX hired XXXXX's employees such as XXXXX (See Exhibit ED-51), XXXXX, as well as XXXXX who was named on XXXXX's board. Contrary to item (c) above XXXXX became the director, employee, and agent of XXXXX which competed with XXXXX. Contrary to item (d) above XXXXX received XXXXX potential customer leads.

XXXXX, known as the founder and controller of XXXXX's operations, did not initiate or seek any type of injunction against XXXXX directly or through XXXXX. Instead, he assisted with the development of XXXXX. As indicated in XXXXX's deposition on March 3, 2004 (pages 278 – 282 in Exhibit 49), she acknowledged that XXXXX was involved in the early stage development of other CCAs in the following manner:

- c) XXXXX shared counseling and education best practices with other CCAs during their initial state of development.
- d) XXXXX and XXXXX advised CCAs on other business practices
- e) XXXXX provided training to other CCAs.

On page 155 of XXXXX's deposition (in Exhibit 19), XXXXX acknowledged that XXXXX paid part of XXXXX fees for leads that were supplied to its CCA clients.

XXXXX's operation was a mirror image of what XXXXX had implemented at XXXXX. XXXXX through XXXXX had control and power through the non-compete agreement on whether or not XXXXX could create or otherwise be involved in another company that was in competition with XXXXX. The creation of XXXXX was not challenged by XXXXX/XXXXX because XXXXX was going to be treated by XXXXX as a subsidiary company evidenced by XXXXX and XXXXX involvement in its formation. The absence of any discussions between XXXXX with XXXXX on the matter of the non-compete agreement signifies that XXXXX and XXXXX did not perceive XXXXX was in direct competition with XXXXX. XXXXX, was not perceived by XXXXX/XXXXX as a direct competitor to XXXXX because XXXXX functioned as an extension of XXXXX providing similar services in a different location. XXXXX was not a threat to XXXXX/XXXXX but was an extension of XXXXX's control of the credit counseling market. The absence of any legal action against XXXXX or any of XXXXX's former employees then employed by XXXXX for violating the non-compete agreement demonstrates that XXXXX/XXXXX had the ability to control the operations of XXXXX, since it had the mechanism in place to legally challenge its existence and operations. The involvement of XXXXX/XXXXX in the establishment of XXXXX, the business practices that XXXXX shared with XXXXX through its own staff or through XXXXX staff, and the execution of a fulfillment agreement, a document created solely

for XXXXX's purposes, resulted in XXXXX having significant influence over the operations of XXXXX.

XXXXX's Revenue Sources

In response to IDR DEB-001, question 7 and 8 XXXXX indicated that it enrolled 19,261 new consumers in its debt management program for the year XXXXX (see Exhibit ED-16). In response to IDR DEB-57, XXXXX indicated that it enrolled 9,191 and 20,888 new enrollees in XXXXX and XXXXX, respectively. In response to IDR DEB-009, XXXXX indicated that in XXXXX, three clients did not pay any portion of the requested enrollment fee (see Exhibit ED-12).

According to its Form 990 returns (see Exhibit ED-42), XXXXX generated total revenue of \$; \$; and \$ for the years XXXXX, and XXXXX2, respectively. Revenue was generated from three main sources:

1. The initial enrollment fee or "first pay" requested from each individual who enrolled in the debt management plan. Consumers were asked to give 3% of their debt load as an initial "contribution."
2. The monthly fee of \$6.00 per account or \$25 minimum requested from each participant who enrolled in a debt management plan.
3. Amounts received from creditors which were classified as fairshare revenue.

Revenue Type	Amount (TY XXXX)	% of total Revenue (TY XXXX)	Amount (TY XXXX)	% of Total Revenue (TY XXXX)
First Payment	\$	69%	\$	56%
Monthly Fee	\$	18%	\$	29%
Fair Share	\$	12%	\$	8%
	Amount (TY XXXX)	% of total Revenue (TY XXXX)		
First Payment	\$	45%		
Monthly Fee	\$	34%		
Fair Share	\$	17%		

For XXXXX, and XXXXX overall amounts paid by consumers to XXXXX for services constitute approximately 98%, 91% and 96% of total revenue, respectively. See Exhibit ED-43, IDR response to DEB-52.

Expenses Paid to/or on behalf of XXXXX

XXXXX controlled XXXXX until XXXXX. Through this control he was able to select his lead generation company, XXXXX (see the corporate record of XXXXX in

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Exhibit 29), to sell leads to XXXXX (see the only invoice XXXXX sent XXXXX in XXXXX that was paid in Exhibit 30). These leads were either fictitious or bogus, but were paid by XXXXX because XXXXX was in control (see the lawsuit complaint by XXXXX v. XXXXX in Exhibit 23). XXXXX company, XXXXX, received an advance payment for leads in XXXXX, for \$ (see the XXXXX Financial Statement disclosure in Exhibit 31, Footnote 12).

XXXXX also put three individuals on XXXXX payroll in the years under examination who did not perform any services for XXXXX: XXXXX, XXXXX, and XXXXX. These individuals were the girlfriends of XXXXX (see XXXXX testimony in Exhibit 22 and XXXXX testimony in Exhibit 21). These individuals were "hired" by XXXXX in XXXXX and put on the payroll by him. They were never seen in an employment capacity at XXXXX (see XXXXX testimony in Exhibit 22, the testimony of XXXXX, Human Resources Director in Exhibit 32, and the XXXXX litigation v. XXXXX in Exhibit 23). The total amounts paid as wages or compensation to these three girlfriends of XXXXX totaled \$ in 20 (see Exhibit 33 for an analysis of these payments and Exhibit 23 for the XXXXX complaint).

XXXXX and his wife XXXXX had XXXXX corporate credit cards in XXXXX which they used for personal expenses. XXXXX also had XXXXX pay for apartments and other personal expenses from XXXXX funds in XXXXX and XXXXX. The total disputed business charges for XXXXX amount to \$ (expenses include lavish trips, entertainment and other personal expenses) in XXXX and XXXX American Express charges (this does not include charges made on his wife, XXXXX's, card). See Exhibit 23 for the complaint and the spread sheet of the Analysis of XXXXX AMEX account at XXXXX in Exhibit 34. XXXXX also paid for an apartment and moving expenses for himself (see the Complaint in Exhibit 23) totaling \$. XXXXX approximates its total loss from the XXXXX embezzlement of \$ from XXXXX.

The Fulfillment Agreements with XXXXX and Due Diligence by XXXXX

In the accountant's August 1, 2000 summary of the FA provisions for XXXXX (see the Exhibit from the Accountants- XXXXX as Exhibit 48), the provisions of all the FAs (note that all of the initial FA that are signed between XXXXX and CCAs are identical) are discussed:

- CCA must submit to XXXXX all the documentation for each budget plan client within 5 business days following the first remittance
- CCAs must maintain and give full access to such bank accounts (the "trust accounts") to allow for the deposits of money and the payment of funds on behalf of the CCA's budget plan clients. CCAs can remove monies from the accounts; the balances can not fall below the amounts necessary to operate the client's budget plans
- XXXXX shall deposit client budget payments into the creditor accounts no later than the fifth day of receipt. XXXXX shall deposit fairshare monies solicited from creditors no later than the next business day of receipt

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- Compensation for the services provided is \$100 as a one time fee for the initial set up of a new client payment plan. A fee of \$25 per client plan per month for each client on which XXXXX received payments on behalf of during that month is imposed. The invoicing should include total receipts from the clients, a listing of the portion of the client receipts that represent client contributions, a listing of the fair share portion of the payment received from creditors, and total distribution to creditors.
- The term of the agreement is five years, which automatically renews for an additional five years unless one of the parties has given notice to the other no less than one year prior to the end of the lease agreement

The accountant's summary is indicative of the XXXXX agreements with XXXXX. XXXXX original Fulfillment Agreement with XXXXX was signed by XXXXX (wife of XXXXX) for XXXXX (XXXXX) and XXXXX for XXXXX, as President of XXXXX. XXXXX also signed for XXXXX (XXXXX). The signees did not date the agreement but the reference, similar to the XXXXX Fulfillment Agreement with XXXXX, is effective XXXXX (per the first paragraph of the XXXXX Fulfillment Agreement in Exhibit 11).

XXXXX and XXXXX signed several FA addendums and changes to the original FA. On XXXXX, XXXXX, through the signature of XXXXX (through signature stamp), and XXXXX, through the signature of XXXXX, executed a new FA (see Exhibit ED-36). The new FA was entered into without any due diligence on behalf of XXXXX (see the Minutes in Exhibit 17). The major changes were as follows:

- XXXXX obtained full and exclusive access to the trust accounts and XXXXX would be penalized substantially for breaching this agreement
- XXXXX can use XXXXX's fair share monies to pay outstanding balances due for services
- On Jan. 1st of each year the fees will increase 2% annually automatically and other increases can be implemented with a 60-day notice by XXXXX
- Upon termination of the FA if XXXXX is in default of any of its obligations under the FA, XXXXX can reassign the DMPs to another CCA
- XXXXX is limited forever from being involved in anyway with any other back office processing business unless it benefits XXXXX (removed the two year non-compete limitation)
- added a five-year term to the Agreement

This Agreement did not call for any reduction in fees as a result of XXXXX agreeing to a long-term agreement with XXXXX, agreeing not to compete with XXXXX, and agreeing to allow XXXXX to have exclusive use of XXXXX's trust account. Moreover, XXXXX's agreeing to give XXXXX the ability to reassign clients based on any default in the agreement was given without any consideration to XXXXX.

On February 7, 2003, (also referred to as the 3/25/2003 Agreement Amendment in the September 23, 2003 Memorandum of Understanding from XXXXX to XXXXX)

XXXXX and XXXXX (now XXXXX Group) amended the FA. The agreement was signed by XXXXX for XXXXX and XXXXX for the XXXXX Group (see attached as Exhibit 11). This addendum calls for XXXXX to agree to hold XXXXX harmless for losses and comply with the Gramm-Leach-Bliley Act.

In an updated Memorandum of Understanding dated September 23, 2003, from XXXXX (signed by XXXXX) to XXXXX, Executive Director for XXXXX, a number of major changes are set forth:

- The initial set up fee was reduced to \$25 per DMP client per month, with incentive for XXXXX to have its clients sign up for electronic funds transfer. Also, if state laws limit the amount of fees to be charged by up-front contributions then XXXXX provided a formula to calculate the fee, if under \$25. It also provided minimum fees of \$20 up-front and \$10 monthly.
- XXXXX will use XXXXX's "XXXXX" information system; agree to a transition period if the Agreement is not extended.
- The agreement is good for another 2 years and extended to July 18, 2008.

It appears that this agreement was predicated on several state laws or governmental regulations that limited the amount of fees that could be charged to DMP clients.

Also, not mentioned in the Agreements, XXXXX has the exclusive right to the "XXXXX" software package that allows for automating the back office processing of DMP clients. XXXXX and other XXXXX CCA clients were precluded from purchasing and using this software prior to August, 2004 (see Exhibit 22 for the testimony of XXXXX, former Executive Director of XXXXX).

XXXXX has to pay for all added costs as mentioned above (i.e. VANCO fees for processing EFT payments, postage, etc.). These amounts are in addition to the amounts for fees that were previously included in the FA. Hence, this is an added cost to XXXXX that does not appear to be negotiated by XXXXX and discussed in any due diligence or Board minutes. The decision appears to be unilaterally made by XXXXX and/or XXXXX Group.

Lack of Superficial Due Diligence

As stated, XXXXX performed limited due diligence in selecting, determining, pricing, and vetting XXXXX as a vendor. In fact, XXXXX solicited the exact same bids for services that XXXXX solicited (see the XXXXX Bankruptcy Examiner's Report that discusses the documents and analysis performed by XXXXX in selecting XXXXX in Exhibit 27). Both XXXXX and XXXXX received a pricing bid from XXXXXMS (owned by former XXXXX business associate, XXXXX); a VISA study that is referenced in the April 24, 2000, Minutes as a industry trend to outsource customer service (although this is never discussed or mentioned in the study); a cost analysis from XXXXX, and an in-house cost analysis (which is actually the in-house cost analysis from

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XXXXX)- see the response to IDR DEB-005 and the Due Diligence documents in Exhibit 54).

The minutes that discuss the selection of XXXXX are 9 months after the Agreement was in effect (see the Minutes in Exhibit 17 and the Fulfillment Agreement in Exhibit 11). No explanation has been given for the lack of contemporaneous study and execution of the Agreement.

Payments to XXXXX Under the Fulfillment Agreements and Fair Market Value

Under the Fulfillment Agreements, the following amounts were paid by XXXXX to XXXXX for back office services only:

<i>Expense</i>	<i>XXXX Expenses</i>	<i>%of Total Expenses</i>	<i>XXXX Expenses</i>	<i>% of total Expenses</i>
<i>XXXXX-Backoffice</i>	<i>\$</i>	<i>36%</i>	<i>\$</i>	<i>44%</i>
	<i>XXXX Expenses</i>	<i>%of Total Expenses</i>		
<i>XXXXX-Backoffice</i>	<i>\$</i>	<i>42%</i>		

The IRS Engineering Report and overpayments to XXXXX

The IRS valued the Fulfillment Agreements and fair market value of the customer service functions performed by XXXXX.

The IRS Engineering Report concludes that XXXXX is "super-profitable" by industry standards. In fact, XXXXX, by industry standards, over-charged XXXXX in processing fees under the Fulfillment Agreement in XXXXX, and XXXXX in the amounts of \$ \$ and \$ respectively, or a total three-year over-charge of \$ (see IRS Engineer's report in Exhibit 38 and analysis of overcharges paid by XXXXX in Exhibit 39)

LAW

Section 501(a) of the Internal Revenue Code provides that an organization described in section 501(c) (3) is exempt from income tax. Section 501(c)(3) of the Code exempts from federal income tax corporations organized and operated exclusively for charitable, educational, and other purposes, provided that no part of the net earnings inure to the benefit of any private shareholder or individual. The term charitable includes relief of the poor and distressed. Section 1.501(c) (3)-1(d) (2), Income Tax Regulations.

The term educational includes (a) instruction or training of the individual for the purpose of improving or developing his capabilities and (b) instruction of the public on subjects useful to the individual and beneficial to the community. Treas. Reg. §

1.501(c)(3)-1(d)(3). In other words, the two components of education are public education and individual training.

Section 1.501(c)(3)-1(a)(1) of the regulations provides that, in order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. The existence of a substantial nonexempt purpose, regardless of the number or importance of exempt purposes, will cause failure of the operational test. Better Business Bureau of Washington, D.C. v. U.S., 326 U.S. 279 (1945).

Educational purposes include instruction or training of the individual for the purpose of improving or developing his capabilities and instruction of the public on useful and beneficial subjects. Treas. Reg. § 1.501(c)(3)-1(d)(3). In Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 (1945), the Supreme Court held that the presence of a single non-exempt purposes, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. The Court found that the trade association had an "underlying commercial motive" that distinguished its educational program from that carried out by a university.

Similarly, in American Institute for Economic Research v. United States, 302 F.2d 934 (Ct. Cl. 1962), the Court considered the status of an organization that provided analyses of securities and industries and of the economic climate in general. The organization sold subscriptions to various periodicals and services providing advice for purchases of individual securities. Although the court noted that education is a broad concept, and assumed for the sake of argument that the organization had an educational purpose, it held that the organization had a significant non-exempt commercial purposes that was not incidental to the educational purpose and was not entitled to be regarded as exempt.

Rev. Rul. 69-441, 1969-2 C.B. 115, granted exempt status under section 501(c)(3) to an organization with two functions: it educated the public on personal money management, using films, speakers, and publications, and provided individual counseling to "low-income individuals and families." As part of its counseling, it established budget plans, *i.e.*, debt management plans, for some of its clients. The debt management services were provided without charge. The organization was supported by contributions primarily from creditors. By virtue of aiding low income people, without charge, as well as providing education to the public, the organization qualified for section 501(c)(3) status.

In the case of Consumer Credit Counseling Service of Alabama, Inc. v. U.S., 44 A.F.T.R.2d 78-5052 (D.D.C. 1978), the District Court for the District of Columbia held that a credit counseling organization qualified as charitable and educational under section 501(c)(3). It fulfilled charitable purposes by educating the public on subjects useful to the individual and beneficial to the community. Treas. Reg. § 1.501(c)(3)-1(d)(3)(i)(b). For this, it charged no fee. The court found that the counseling programs were also educational and charitable; the debt management and creditor intercession activities were "an integral part" of the agencies' counseling function and thus were charitable and educational. Even if this were not the case, the court viewed the debt management and creditor intercession activities as incidental to the agencies' principal functions, as only approximately 12 percent of the counselors' time was applied to debt management programs and the charge for the service was "nominal." The court also considered the facts that the agency was publicly supported and that it had a board dominated by members of the general public as factors indicating a charitable operation. See also, Credit Counseling Centers of Oklahoma, Inc. v. United States, 79-2 U.S.T.C. 9468 (D.D.C. 1979), in which the facts and legal analysis were virtually identical to those in Consumer Credit Counseling Centers of Alabama, Inc. v. United States, discussed immediately above.

The organizations included in the above decision waived the monthly fees when the payments would work a financial hardship. The professional counselors employed by the organizations spent about 88 percent of their time in activities such as information dissemination and counseling assistance rather than those connected with the debt management programs. The primary sources of revenue for these organizations were provided by government and private foundation grants, contributions, and assistance from labor agencies and United Way.

Outside the context of credit counseling, individual counseling has, in a number of instances, been held to be a tax-exempt charitable activity. Rev. Rul. 78-99, 1978-1 C.B. 152 (free individual and group counseling of widows); Rev. Rul. 76-205, 1976-1 C.B. 154 (free counseling and English instruction for immigrants); Rev. Rul. 73-569, 1973-2 C.B. 179 (free counseling to pregnant women); Rev. Rul. 70-590, 1970-2 C.B. 116 (clinic to help users of mind-altering drugs); Rev. Rul. 70-640, 1970-2 C.B. 117 (free marriage counseling); Rev. Rul. 68-71, 1968-1 C.B.249 (career planning education through free vocational counseling and publications sold at a nominal charge). Overwhelmingly, the counseling activities described in these rulings were provided free, and the organizations were supported by contributions from the public.

Internal Revenue Code section 501(c)(3) specifies that an exempt organization described therein is one in which "no part of the net of earnings inures to the benefit of any private shareholder or individual." The words "private shareholder or individual" in section 501 refer to persons having a personal and private interest in the activities of the organization. Treas. Reg. § 1.501(a)-1(c). The inurement prohibition provision "is designed to prevent the siphoning of charitable receipts to insiders of the charity" United Cancer Council v. Commissioner, 165 F.3d 1173 (7th Cir. 1999). Reasonable

compensation does not constitute inurement. Birmingham Business College v. Commissioner, 276 F.2d 476, 480 (5th Cir. 1960).

An organization must establish that it serves a public rather than a private interest and "that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests." Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii). Prohibited private interests include those of unrelated third parties as well as insiders. Christian Stewardship Assistance, Inc. v. Commissioner, 70 T.C. 1037 (1978); American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989). Private benefits include an "advantage; profit; fruit; privilege; gain; [or] interest." Retired Teachers Legal Fund v. Commissioner, 78 T.C. 280, 286 (1982).

An organization formed to educate people in Hawaii in the theory and practice of "est" was determined by the Tax Court to a part of a "franchise system which is operated for private benefit," and, therefore, should not be recognized as exempt under section 501(c)(3) of the Code. est of Hawaii v. Commissioner, 71 T.C. 1067, 1080 (1979). Although the organization was not formally controlled by the same individuals who controlled the for-profit entity that owned the license to the "est" body of knowledge, publications, and methods, the for-profit entity exerted considerable control over the applicant's activities by setting pricing, the number and frequency of different kinds of seminars and training, and providing the trainers and management personnel who are responsible to it in addition to setting price for the training. The court stated that the fact that the organization's rights were dependent upon its tax-exempt status showed the likelihood that the for-profit entities were trading on that status. The question for the court was not whether the payments made to the for-profit were excessive, but whether the for-profit entity benefited substantially from the operation of the organization. The court determined that there was a substantial private benefit because the organization "was simply the instrument to subsidize the for-profit corporations and not vice versa and had no life independent of those corporations."

In International Postgraduate Medical Foundation, T.C. Memo. 1989-36, one individual controlled both a nonprofit that ran tours aimed at doctors and their families and a for-profit travel agency that handled all the nonprofit's tour arrangements. The nonprofit spent 90 percent of its revenue on travel brochures prepared to solicit customers for tours arranged by the travel agency. The tours were standard sightseeing trips, with little of the alleged medical education that was the basis for exemption. The Tax Court held the petitioner was not tax exempt, finding that it was operated for the benefit of private interests, namely the founder's travel agency. The court found that a substantial purpose of the nonprofit was to increase the income of the travel agency. (In this case there was both inurement and private benefit.) Also, its activities were directed at providing opportunities for recreation, not education.

The Credit Repair Organizations Act (CROA), Pub. L. No. 104-208, § 2451, 110 Stat. 3009-455 (Sept. 30, 1996), 15 U.S.C. § 1679 et seq., effective April 1, 1997 imposes restrictions on credit repair organizations, including forbidding the making of untrue or

misleading statements and forbidding advance payment, before services are fully performed. 15 U.S.C. § 1679b. Significantly, section 501(c)(3) organizations are excluded from regulation under the CROA.

The CROA defines a credit repair organization as:

(A) any person who uses any instrumentality of interstate commerce or the mails to sell, provide, or perform (or represent that such person can or will sell, provide, or perform) any service, in return for the payment of money or other valuable consideration, for the express or implied purpose of—

(i) improving any consumer's credit record, credit history, or credit rating,
or

(ii) providing advice or assistance to any consumer with regard to any activity or service described in clause (i).

15 U.S.C. § 1679a(3). The courts have interpreted this definition broadly to apply to credit counseling agencies. The Federal Trade Commission's policy is that if an entity communicates with consumers in any way about the consumers' credit situation, it is providing a service covered by the CROA. In Re National Credit Management Group, LLC, 21 F. Supp. 2d 424, 458 (N.D.N.J. 1998).

Businesses are prohibited from cold-calling consumers who have put their phone numbers on the National Do-Not-Call Registry, which is maintained by the Federal Trade Commission. 16 C.F.R. § 310.4(b)(1)(iii)(B); 47 C.F.R. § 64.1200(c)(2). Section 501(c)(3) organizations are not subject to this rule against cold-calling. Because 501(c)(3) organizations are exempt from regulation under the CROA and the cold-calling restrictions, organizations that are involved in credit repair have added incentives to be recognized as section 501(c)(3) organizations even if they do not intend to operate primarily for exempt purposes.

XXXXX'S POSITION

I. In the Years under Examination, XXXXX Was Organized and Operated for Charitable and Educational Purposes, Not for the Benefit of Any Private Entity.

XXXXX, Inc. (hereinafter "XXXXX") takes issue with the conclusions of the draft report of the Internal Revenue Service (hereinafter the "Service") detailing its proposed findings resulting from its examination of XXXXX's activities during the years XXXX to XXXX conducted for the purpose of determining whether XXXXX is an organization exempt from income tax under section 501(c)(3) of the Internal Revenue Code of 1986 (hereinafter the "Code").

Contrary to the Service's proposed conclusions, XXXXX operated exclusively for exempt purposes within the meaning of section 501(c)(3) of the Code in that it engaged primarily in educational and charitable activities. The extensive education provided by XXXXX about budgeting, credit, and debt generally and the availability and operation of debt management plans specifically served to instruct the public on a useful and beneficial subject. Further, XXXXX's services were charitable in that they benefited almost exclusively a low and moderate income clientele. Moreover, in general, individuals who need a debt management plan are, by definition, in financial distress and therefore represent their own charitable class.

XXXXX also operated charitably in that it received substantial financial support for its services from entities other than its clients. This subsidy enabled XXXXX to perform its services for a cost significantly below what the cost of the services would have been in the absence of such subsidy.

XXXXX did not operate for a substantial non-exempt purpose. The creation and implementation of debt management plans furthered XXXXX's exempt purposes. Moreover, contrary to the Service's contentions, XXXXX did not operate for the benefit of any third party or for the purpose of avoiding federal regulation under the Credit Repair Organizations Act, 15 U.S.C. § 1679 *et seq.* (hereinafter "CROA").

XXXXX's earnings did not inure to the wrongful benefit of any private individual or company. The organization's service provider and other agreements reflected market conditions at the time they were entered into, and XXXXX did not otherwise operate primarily for the benefit of one or more private entities.

II. In Recent Years, XXXXX Overhauled Its Leadership, Split from the XXXXX Group, and Has Increased Its Focus on Charitable and Educational Activities.

Since XXXXX, XXXXX has been under brand new management, led by President & Chief Executive Officer XXXXX. The new management immediately took on two key and onerous tasks – forcing the resignation of the entire board of directors

(under threats to XXXXX's life and that of his family), and moving to terminate the outsourced payment processing agreement with the XXXXX Group (under the threat of litigation). The board was replaced with a community-based board that provided invigorated leadership to the overhauled organization, and, almost immediately upon XXXXX taking charge of the organization, the fees paid to XXXXX were cut by approximately 75%. Within a year or so, the contract with the XXXXX Group was ultimately terminated – following an extremely tortuous, difficult battle with XXXXX – and XXXXX took in-house all functions (including payment processing) for its clients. In addition, since XXXXX, XXXXX has provided more comprehensive and effective educational opportunities to the general public and to individual clients than it had done in prior years. Set forth below are a number of the notable examples of XXXXX's recent operations and activities:

- XXXXX, through the work of its Community Outreach Department, has made hundreds of presentations on budgeting issues to community groups alone and as a member of coalitions dedicated to improving financial literacy. In XXXXX alone, XXXXX prepared and delivered more than 200 free workshops and seminars at a variety of locations inside and outside of XXXXX, including local schools, public libraries, shopping malls, community centers, the Boys & Girls Clubs of America, rehabilitation centers, and a veteran's group.
- Since XXXXX, attendees have received, without charge, a financial literacy workbook written by XXXXX, entitled XXXXX. XXXXX has spent more than \$ preparing and presenting these seminars and workshops and has given away more than 2,300 copies of the workbook and other educational materials.
- In addition, from XXXXX through XXXXX, XXXXX broadcasted a weekly radio program, "XXXXX" on a XXXXX, XXXXX radio station, XXXXX. XXXXX estimates that the broadcasts reached more than 1,200,000 listeners, and the organization spent more than \$ preparing, conducting, and producing the broadcasts.
- In early XXXXX, XXXXX initiated a program referred to as "XXXXX." "XXXXX" is produced by XXXXX, , and is licensed to XXXXX through an agreement with the company. The program provides an interactive educational program dedicated to enhancing an individual's literacy in sound money management practices. Individuals take an exam at the end of each chapter to receive certification, which is awarded upon achieving a grade of 80 percent or above on each test. Certification tests can be taken online or manually with a pencil and paper.
- Each successful "XXXXX" test-taker receives report cards from XXXXX that certify to his or her successful completion of the course. The individual can then mail the report card to a credit-reporting agency, and a notation will be

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added to the individual's credit file that indicates that he or she has successfully completed a financial literacy program. As a further incentive to its clients, in early XXXX, XXXXX initiated a program to award debt management plan participants a \$25 refund on their initial contribution upon passing the exam.

- Between XXXXX and XXXXX, XXXXX prepared, produced, and distributed four separate educational information packets. The principal recipients of the educational packets were individuals who contacted XXXXX for assistance with their financial problems, but who, after discussing their issues with XXXXX's counselors, were determined not likely to benefit from enrollment in a debt management plan. The topics covered by each education packet included how to change one's spending habits, understanding credit, taking a proactive approach to managing finances with budgeting techniques, and how to provide for basic necessities.
- Since XXXXX, XXXXX has replaced the educational packets. XXXXX contains much of the same information addressed in the educational packets, but provides additional details on those topics, and is consolidated into one publication. XXXXX also contains new information that was not in the educational packets about spending behaviors, identity theft, and handling debt according to three different account statuses: current, behind, and in collections.
- In early XXXX, XXXXX created a series of 55 topical information sheets ("XXXXX") to submit to consumers who contact XXXXX (not just DMP clients) upon their request for information related to a specific issue. Each Topic Mailer is provided free of charge to consumers through the mail upon request and is available on XXXXX's website.
- In XXXXX, XXXXX sent out 15,000 calendars (at a significant cost to XXXXX) to consumers containing monthly information and suggestions about personal financial management.
- XXXXX's website contains a variety of educational materials that are accessible to the general public 24 hours a day, seven days a week. In addition to providing access to "XXXXX," the XXXXX, and XXXXX discussed above, the website also provides access to additional educational information. For example, XXXXX posts a budget worksheet and an interactive loan calculator so that an individual can develop a personal budget and an understanding of his or her finances.
- XXXXX's website also hosts a range of audio and video files that viewers can listen to and watch. For example, recordings of the radio programs and full-length DVDS from community outreach presentations are available on the website.

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- XXXXX estimates that, since XXXXX, its employees have spent more than 200 hours making educational materials available on the organization's website. XXXXX's current website does not track the number of visitors to it. XXXXX, however, is in the process of designing a newer version of the website, which will have that capability and will provide enhanced capacity to offer educational information to the general public.
- As for personal counseling to individuals and families who have financial problems, regardless of income level, the principal contact with XXXXX remains the counseling sessions over the telephone. Since XXXXX, however, counselors have received enhanced training and additional encouragement to listen to each caller's concerns, ask a series of questions related to the consumer's income, assets, expenses, debts, and past experiences, identify the scope of the caller's finance-related problems, and offer, if appropriate, alternatives to a debt management plan.
- Beginning in XXXXX, XXXXX established an enhanced in-house training program to support the additional counseling offered to clients. Training time for beginning counselors was expanded from one to two weeks. During the first week, trainees thoroughly review XXXXX's training manual, including its scripts, are instructed on the use of XXXXX's computer-based client database system, learn about the history of credit counseling and XXXXX, and enhance their understanding of money, debt, credit, and ethical issues. During the second week, the trainees are allowed to listen as more experienced counselors provide educational information to clients and study for their certification exam.
- Since XXXXX, XXXXX has required that each counselor pass the National Association of Certified Credit Counselors (NACCC) exam before being permitted to communicate with a consumer. The certification exam consists of 100 multiple-choice questions that relate directly to the content presented in the NACCC study manual, which each employee receives upon being hired. Ninety XXXXX credit counselors have obtained NACCC certification.
- XXXXX requires experienced credit counselors with at least one year of counseling experience to become certified by NACCC as a "Certified Senior Credit Counselor." To achieve that status, XXXXX's counselors prepare by reviewing study materials received one month prior to the seminar and then participate in a one-day long certification course. The program focuses on enhancing listening skills, problem solving, and client motivation. Since XXXXX, 14 of XXXXX's team leaders and managers have become NACCC Senior Credit Counselors.
- In XXXXX, fifteen of XXXXX's managers attended and passed a one-day-long NACCC certification course to become Quality Team Leaders. Each

manager was required to prepare by reviewing study materials received one month prior to the seminar and then participating in the seminar's activities to demonstrate the ability to tolerate a rapidly changing work environment, develop trust, use the conflict management processes to bring differing perceptions and expectations into harmony, and create an understanding of effective performance management through accountability and feedback.

- XXXXX requires that *all* staff (not only its counselors) become certified as credit counselors through the NACCC. XXXXX also mandates that all counselors take a minimum of 16 continuing education units every two years in order to maintain their certifications. XXXXX has taken the certification of its counselors yet a step further by enrolling over half of its counseling staff in a Department of Housing and Urban Development certification program. Moreover, XXXXX continues to maintain its ISO 2000:9001 registration through BSI.

XXXXX has at all times operated in a manner that is wholly consistent with its own tax-exempt purposes and all applicable requirements of section 501(c)(3) of the Code, and, as such, its exempt status should not be revoked for any period of time.

In the event that the Service disagrees with this position, it should consider the more recent, significant changes made to XXXXX's activities, operations and organizational structure that clearly demonstrate the organization is organized and operated solely to further a robust program of charitable and educational activities.

Thus, if the Service should conclude that XXXXX's activities for the years under examination were not sufficiently consistent with section 501(c)(3) of the Code, the Service should recognize the recent beneficial changes made by the organization and exercise its discretion either not to revoke XXXXX's exemption at all or to reinstate XXXXX's exemption effective XXXXX.

Alternatively, the Service should recognize that if XXXXX is not found to have operated exclusively for educational or charitable purposes within the meaning of section 501(c)(3) of the Code, it did operate exclusively for the promotion of social welfare under section 501(c)(4) of the Code. Accordingly, XXXXX requests that, if the Service finally determines that XXXXX's exemption under the former section should be revoked, it recognize XXXXX's exemption from the date of revocation under the latter section.

GOVERNMENT POSITION

Discussion – Form 1023 Application

In XXXXX, XXXXX presented a Form 1023 Application outlining several proposed educational activities which purportedly would constitute approximately 80%

of its operations. Based on representations made in XXXXX's Application, the IRS granted exemption under section 501(c)(3) of the Code. However, based on the Service's review of the evidence gathered through its examination, it has been determined that a significant portion of the activities outlined in the application did not correctly represent how the organization did, in fact, actually operate. Moreover, XXXXX did not conduct any of the activities it proposed in its Application.

Specifically, in the Form 1023 Application, XXXXX indicated that it would conduct financial and budgeting workshops offered free of charge to religious organizations civic groups, businesses, labor unions. XXXXX application also discussed the use of videos, pamphlets and other education materials on budgeting and buying practice, and sound use of consumer credit to be provided free of charge to the groups listed above. XXXXX did not conduct financial and budgeting workshops. XXXXX did not distribute materials or make available materials discussed in its Application to the local groups. There were no indications that it ever attempted to include any of the local groups in any aspect of its operations

Discussion – Actual Activities

Based on information obtained during the examination, it was determined that the primary activity of XXXXX was not educational in the manner described in the Form 1023 Application and was not "educational" or "charitable" as defined under the Internal Revenue Code, its Regulations, or legal precedence. The primary activity was the sale of debt management plans. This determination was made based on the types of activities that XXXXX conducted and the manner in which they were conducted. These factors together demonstrate that XXXXX's operations were not consistent with section 501(c)(3) of the Code.

Advertising. XXXXX engaged in extensive advertising activities in order to generate leads and made significant expenditures to purchase leads from lead generation companies. The procurement of leads was essential to XXXXX's objective to market its debt management plan (DMP). The magnitude of its advertising and lead generation activity is reflected in the percent that advertising/lead expenses represent to the overall expenditures of the organization. Specifically, 27%, 26% and 22% of XXXXX's overall expenditures were spent on advertising, marketing, and lead generation during XXXXX and XXXXX, respectively.

Based on the review of XXXXX advertisement on its website and its advertisement materials, XXXXX had several general points that it wanted to communicate in its advertisements .

Reduce or Eliminate Interest Rates; Reduce Monthly Creditor Payments;
Consolidate Numerous Bills Into One Easy Payment; Eliminate Late Charges and
Over-the-limit Fees; Free Consultation

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The duration of the commercials was either 30 or 60 seconds in length. The presentation and content of XXXXX's commercials were substantially similar to those used by commercial enterprises to market their products.

Leads generated by lead companies were procured mainly through banners strategically placed on various websites to advertise debt consolidation services. Although XXXXX's name may or may not have been associated with advertisements on the banners, such vendors were commercial companies whose sole purpose was to generate leads for sale, not to educate consumers.

In addition to its radio commercials, and purchasing leads from vendors, XXXXX also extended its advertising efforts through the use of internet campaign. The formats of the internet campaigns banners were
XXXXX Click Here.

The time frames for radio commercials and the line spacing used in the internet campaigns did not allow XXXXX to present extensive amount of information to the general public. However, within the constraints of time or space, XXXXX consistently informed consumers of the availability of its debt management plan, giving quick highlights of the alleged benefits of the program. Thus, the advertising language used within the time frame served to market the debt management plan.

Every form of advertising or marketing technique used by XXXXX exclusively promoted the availability of its DMP product and the alleged benefits of the program. XXXXX advertisements advocated the sale or availability of the DMP product and did not provide "education" or any "charity" within the meaning of section 501(c)(3) of the Code. The term "educational" includes "The instruction of the public on subjects useful to the individual and beneficial to the community." In XXXXX's case, however, its advertisements lack instructional information the nature of which could assist a financially distressed individual to cultivate credit practices that would eliminate or minimize future financial disasters. The advertisements did not provide information such as budgeting techniques, buying practices, or sound use of consumer credit which is generally a part of the provision of credit counseling and which XXXXX presented as a part of its proposed activities in the Form 1023 Application. The advertisements did not fall within the parameters of individual counseling. Rather the advertisements served a commercial purpose and were being used as a marketing tool to sell debt management plans.

The advertising and marketing campaigns generated a significant amount of leads which were used by employees to market the debt management program. XXXXX operations were statistically driven and were reflected in the goals that were established. Monthly goals for total initial contributions and number of enrollees relating to sales of DMPs were communicated to managers and employees.

Employee Qualification, Training and Compensation. To achieve its monthly goals, XXXXX designed a compensation package for its employees based on production.

Employees were required to sign a performance agreement at the time they were employed to acknowledge that salary ranges are "commensurate with account achievements" (see Exhibit ED-17). Each employee's base salary and bonus/commission was based on the number of enrolled consumers and the amount of contribution that the employee acquired (see Exhibit ED-16 & ED-18). If the figures were in line with management's expectations, the form showed an increase in salary for that employee. Employee personnel files also showed decreases in salaries when production was not in line with management's expectations (see Exhibits ED-21). Due to the personal financial gain, the incentive was present for employees to quickly push consumers into a DMP. There was no incentive for employees to provide meaningful education or counseling since consumer enrollment in the DMP was their top priority.

Failure to produce at minimum acceptable levels resulted in the employee being counseled and/or terminated. Review of various personnel file folders showed the upward or downward adjustment of the employees' base salary based on their production. Personnel folders reviewed also showed employees being counseled for inadequate production. Employees' personnel files showed individuals being issued warnings for production below certain amounts. In the personnel file for XXXXX, the State of XXXXX - Department of Labor indicated the following in a letter "**The claimant was discharged by XXXXX on 5-30-02 because she could not make her sales quotas.**" See Exhibit ED-46.

According to the Managers Weekly Meeting dated September 9, 2002 the following was noted "Managers need to evaluate everyone in their group. If an employee hasn't broken at least \$12,000 after their first full 3 months, they need to be terminated". In one weekly meeting managers were told that "Once an employee is placed in a group, it is the manager's responsibility to turn their employees into good sales representative by effectively managing. They should be collecting payments immediately Can you turn every employee into a good sales representative? Probably not Make or break them" See Exhibit ED-15 for minutes of weekly meetings. XXXXX created a "telemarketing" sales environment which resulted in consumers being pressured into enrolling in XXXXX's DMP. The environment was not conducive to provide meaningful education or counseling sessions.

Even though "Credit Counselors" formed the pool of employees responsible for the provision of "counseling" services to financially distressed individuals, XXXXX did not require applicants to have prior credit counseling experience or any counseling experience. It did not require candidates to have a certain level of education or knowledge in the field of credit counseling. Also, XXXXX did not require candidates to have any special license or certificates in the area of counseling. XXXXX's "Credit Counselor" position was similar to telemarketing positions and its advertisement in the local papers to fill such positions was similar to the classified ads used for sales/telemarketing positions (see Exhibit ED-10).

XXXXX provided approximately seven days of in-house training to its employees (see Exhibit 16 Page 182 of XXXXX Deposition). However, the training materials

primarily focused on how to sell the debt management plan and aspects associated with the plan through the use of various scripts (see the Exhibit *ED-13*). Use of the script was emphasized during the training and employees were required to read and follow the script verbatim. No significant training was provided on counseling methods, counseling techniques or on topics such as proper budgeting techniques, sound use of consumer credit, etc. The overall goal and purpose of the training can be summarized in the first line of "How to be a successful Telephone Sales Representative" "As new employees we have all accepted this position with one common goal. To make money". (See Exhibit *ED-14*) How to sell the DMP was the primary purpose of the training. No training was provided to equip the employees with skills necessary to counsel in the areas of money management skills, or sound use of consumer credit.

As a result of XXXXX recruitment practices and the type of training that was provided, the employees neither had the experience, knowledge, or training, that would allow them to effectively counsel a financially distressed person. Neither did the employees' compensation package provide an incentive for them to educate the consumers in the area of credit counseling. The scripts used in XXXXX, and XXXXX had little or no educational content. Minimal educational material was covered in the training such as credit bureaus and reports; information that would be useful to consumers was not included in the script. Thus, substantially all of the training that was provided to the employees served to equip them to sell the debt management plans.

Scripted DMP Enrollment Sessions. To determine the type, level and quality of credit counseling that was allegedly provided to consumers, the examination team looked to the scripts since those were primarily the only tools that were used to impart information to the consumers. The training materials, including the scripts, also provide detailed information on the techniques that were used by the employees.

As stated previously, dialogue with consumers was controlled via the mandatory use of the script. Telephone calls were monitored to make sure that employees were following the scripts. Deviations from script lead to employee counseling or termination.

The overall basic purpose of the script was to determine if an individual meets the requirements for a debt management program and to convince consumers to enroll in the debt management program by outlining all the benefits associated with the program. Information provided to consumers to persuade them to enroll in the program included the following: a) detailed description of the benefits of a debt management program which includes low interest rates, reduce payments, one monthly payment, accounts are brought current, and balance are paid off faster, etc.. The intent was to "get them excited about the interest rates reductions and additional benefits." Consumers were also told about an "advantage" that XXXXX had over any other debt consolidation company, which was the opportunity to for a consolidation loan. Consumers were told that they were successful in making seven, on-time payments, they would be referred to one of their lenders to be reviewed for a debt consolidation loan.

Once the consumer became excited about the lower payment, the employee read the portion of the script that asked for a "contribution" and informed the consumer of the monthly fee associated with the program. If the employee encountered any resistance in this area with regards to payments of the fees, other scripts were used to convince the consumer to pay the "contribution".

The training materials has a page titled "DETERMINING THE CUSTOMER NEEDS" in which the employees were trained how manipulate the needs of the consumer in order to "close the sale". "The hot button will tell you exactly which approach or sales presentation you will use with the customer." According to the information given, employees were to determine the customer needs by finding out why the consumer submitted the application. The training material said "It is the Credit Counselors job to determine what those needs are and adjust their sales presentation accordingly. "By determining the customers needs you will ultimately find their "HOT BUTTON". If a consumer's hot button was dissatisfaction with the reduction of their principal balance after each payment, the employee was trained to tell the consumer about the lower interest rate which would result in faster reduction in their balance; if the consumer's motivation was to restore their credit then employees would tell the consumer about the benefit of the program that would allow them to restore their credit; and if their hot button was debt consolidation loan then the employee would tell them about the feature of the program that provides them an opportunity for a debt consolidation loan. The purpose for determining the consumer need was summarized in the last sentence on the page "The more hot buttons you find, the easier it will be to close the sale!" Thus, determining the customer needs was not geared towards soliciting information that would allow the employee to understand the consumer's background or habits that are behind the problem of their indebtedness in order to provide meaningful counseling to address the problem. Instead, the employee focus was to find out the consumer main point of disappointment or motivation that led them to contact XXXXX and to use that information to pressure the consumer into thinking that a DMP is the solution for their crises. See Exhibits ED-13 and ED-14 for training materials.

Included in the tips of "How to be a successful Telephone Sales Representative" was the following advice to employees "Keep it simple! Avoid over explaining the program. This will often confuse the client and bring up objections which would otherwise been avoided." The telephone system has a display that showed the actual time spent during a conversation. If "11 minutes have lapsed you need to ask yourself if the conversation is going anywhere. If not, end the call as quickly as possible and call someone else. Do not let uninterested customers waste your valuable time." The ultimate goal of each phone call is the enrollment of the consumer in the DMP. Employees are therefore trained that if consumer is not interested in the DMP then the call should be terminated. If an employee after going through the script saw that a sale was not imminent, the consumer's plight was totally disregarded since at that point the call was not extended to discuss and address situations affecting the consumer's predicament. Thus, XXXXX did not provide consumer education or counseling to its callers outside the commercial realm of the debt management program. Any limitation on talk time served to keep the entire focus of the conversation on the sale of the DMP

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product since it was not feasible for employees to sell the DMP product and educate consumers on personal money management during the amount of time allotted.

Employees were given a handout with a series of questions and answers to use to overcome objections that the consumer may have. Most if not all of the answers to the questions used strategic sales language which served to push the consumer into the debt management program. The handout itself titled "Overcoming Objections" stated that "Building a rapport with your client and establishing a mutual trust is a crucial because the individual can not see you. Once you have gained the clients trust you will ultimately enroll the client." The overall purpose for this handout was not to develop a trust that would facilitate educating the consumers but to ultimately enroll them in the debt management program. None of these materials or strategies was geared towards educating consumers about how to exercise good judgment in the use of credit, or how to develop practices that could prevent future occurrence of financial crisis.

Employees' calls were consistently monitored, not to make sure that valuable educational information is being shared with the consumer but to make sure that employees were following the script, overcoming any objection regarding enrollment in a DMP that they may have encounter, being enthusiasm, and aggressive.

The scripts allowed management to control the length of the conversation and the type and quality of information that was provided to consumers. The criteria used to critique employees, as well as their compensation arrangements encouraged employees to make quick sales in order to quickly move on to the next consumer.

During the years under examination, the XXXXX Sales Presentation Script did not contain a section that allowed employees to discuss options with the consumer. On pages 256 to 262 in XXXXX's Deposition, he was asked where in the training materials was it explained to the counselor how to make the assessment to determine what option (self pay, DMP, bankruptcy, or debt consolidation loan) to recommend to the consumer. He indicated that "nothing that would reflect in the training manual" and neither did the slide presentation provided written training or written guidelines to the employees on how to make that type of determination. On page 271 of XXXXX's deposition, XXXXX was asked if "counselors" were provided a script to be used if the consumer did not qualify. XXXXX stated that "we were very reluctant to refer people to file for bankruptcy. You know, we frowned upon it," He acknowledged that XXXXX did not have a script that would instruct a "counselor" what to tell a consumer who did not qualify for a debt management plan. XXXXX did not consider it a priority or necessity to educate the consumer about the various options via the script or during the telephone session. Neither did XXXXX attempt to provide any educational literature or information that would assist this particular consumer in exercising sound money management.

Overall the script was a tool to effectively and efficiently sell debt management plans. The information that was provided relates to how the DMP program operated and the benefits of the programs. It provided no information that would assist the financially

distressed to see why and how they came to be in a financial crisis. XXXXX, as a consistent part of its telephone session, did not address the consumer spending habits or budgetary matters in a personalized manner that would assist the consumer to prevent or minimize similar financial crisis. It provided no educational information or counseling in areas similar to those represented in its Form 1023 Application such as counseling on matters such as proper budgeting, buying practices and the sound use of consumer credit. It provided no information that was of an educational nature that would assist a financially distressed person to ultimately exercise sound judgment in the use of consumer credit or address the factors that originally created the financial distress.

XXXXX in his deposition on page 278 stated the following regarding the industry "credit counseling as a whole, the industry as a whole, maybe not today, but certainly at this particular time, all credit counseling companies were **sales oriented.**" [emphasis added]. He was also asked on page 279 to identify in any of the scripts where there was actual counseling being conducted as opposed to selling. XXXXX indicated the following "I don't think you can find actual counseling written in the form of a script or at least you will not here in XXXXX's materials."

After consumers were enrolled in the program, XXXXX had no further contact with the consumer unless the consumer initiated a call for "additional counseling.," As a practical matter, consumers were given the telephone number for XXXXX for all future contact. Consumers were not told in the package that they could or should contact XXXXX for "counseling." Due to sales goals and compensation based on amount of sales, employees did not want and neither were they encouraged by management to spend their time talking to a consumer who no longer had the potential boost their compensation.

Based on the content of the script, testimonies provided by employees, the method by which XXXXX compensated its employees, and management's policy regarding the mandatory use of the script and the elements used to critique the employees, were placed in an environment which was not conducive to provide education but instead created a sales environment geared towards the sale of debt management plans.

Fees/Contributions. In the Form 1023 Application, XXXXX indicated that "Clients will be requested to pay periodic fees to XXXXX to receive the budget plan service. The fees will consist of \$3.00 per creditor per month up to a maximum monthly fee of \$30.00 per client. **These fees will be reduced or waived for any client who is financially unable to pay the full amounts.**" [emphasis added]. Part ii, line 2 of the 1023 application states the following "XXXXX also anticipates receiving revenues in the form of fees to be charged to financially able clients who participated in the budget planning program. These fees will consist of a monthly fee of \$3 per month per creditor per client up to a maximum fee per client of \$30 per month. **Fees will be charged to non-indigent clients (those with incomes above government poverty thresholds) for the budget plan service.**" [emphasis added]. XXXXX expected that approximately 25% of its revenue would come from the fees. A copy of the template copy of the consumer agreement submitted with the Form 1023 application package stated the

following "I understand that XXXXX does not charge any "advance fees" for any of their programs, but I understand that I will be requested to make a monthly contribution to XXXXX of \$3.00 per account". The template agreement did not discuss a one-time "contribution". In practice, XXXXX was consistent in charging all consumers a monthly fee of \$6.00 per account or a total sum of \$25.00 monthly whichever was greater. XXXXX also consistently charged a "one time non-refundable "counseling contribution" equivalent to approximately 3% of the consumer's total debt.

In practice, XXXXX did not attempt to identify those persons who could be classified as indigent. The debt management program was made available to anyone who was interested in the program. The criteria used to determine eligibility were as follows (see Exhibit ED-44):

1. the State in which the consumer lives, and
2. at least \$2,000 in unsecured debt

The following standard language was used in the XXXXX Debt Management Agreement: "I have also been requested and agree to make a voluntary monthly contribution of six-dollars \$6.00 per account that XXXXX is handling for me, or a total sum of \$25.00 monthly, which is greater. These amounts are included in my regular monthly payment. These funds will be used for covering the costs involved in handling my creditors on a monthly basis. XXXXX will never bill or invoice me for any of these costs. XXXXX does not require any advanced fees for their services. However, I have been requested and agree to make a one time non-refundable "counseling" contribution to XXXXX equivalent to approximately 3% of the total debt they are handling for me. The contribution will assist XXXXX's operating costs including, but not limited to, enrollment of my accounts and time and resources used in negotiating a repayment plan with creditors. I understand that this amount will be procured from my initial payment to XXXXX. " This section of the agreement has been revised several times for the period under examination. See Exhibit ED-45 for template copies of XXXXX Debt Management Agreement.

In XXXXX's deposition page 177 (See Exhibit 16), he was asked if XXXXX had a written policy regarding collecting fees from only non-indigent individuals. XXXXX indicated that it was not written anywhere. XXXXX's policy was to ask all individuals for a monthly fee and a "contribution" and to attempt to convince them to pay it if they are reluctant to pay. Therefore, no distinction was made between those individuals who were considered above the poverty lines and those who could be classified as indigents.

Employee personnel and the Managers Weekly Meeting Minutes showed that employees were under great pressure to bring in the first payment. They were reprimanded or terminated if they were unable to secure the first payment. Even though consumers were initially told that the first payment was voluntary, if a consumer indicated that they could not afford the first payment, employees would use persuasive language to convince the consumers to give the first payment. Per response to Interview

Questionnaire items 21 and 22, B.B. provided the following statement "I was supposed to try to persuade them to make the contribution. I was told to tell them it was tax deductible. I would have to refer them to my supervisor if they still refused to make the voluntary contribution." The questionnaire response indicated that it was a requirement to obtain the supervisor's signature to waive or reduced the voluntary contribution (See Exhibit ED-37 for response to interview questionnaire). According to response to IDR DEB-001, question 24, XXXXX indicated that if a client declined to pay the recommended fee, the consumer would receive an explanation as to how the payments financed the services and that XXXXX informed them about the amount of money that they would save over time by participating in the program. Based on the manner in which XXXXX solicited the "contribution", it cannot be called a contribution but an administrative fee charged for participation in the debt management program. The success of the strategy used by XXXXX to solicit the contribution was reflected in the percent that revenue collected from consumers represented to XXXXX's total revenue, as well as the number of individuals who enrolled in the program without giving a first payment. In 2001, XXXXX stated in IDR DEB-009, that only three individuals did not pay the monthly fees. For 20 , 20 , and 20 , overall amounts paid by consumers to XXXXX for services constitute approximately 98%, 91%, and 96% 78% and 87% of total revenue, respectively.

The first payment charged by XXXXX to its clients was based on that particular client's total amount of debt. Therefore, an individual with one credit card who had an extremely large amount of debt would pay a higher first payment than an individual with multiple accounts with a smaller amount of debt. Thus, the first payment amount charged by XXXXX bears no correlation to the actual cost to establish the customer on the debt management program.

XXXXX did not limit its debt management program to a charitable class. It had no established procedure or policy in place that would allow for a waiver or reduction of the first payment or monthly fee. XXXXX had no policy or guideline in place to waive the fee for individuals or families to whom the payment would cause financial hardship. XXXXX's debt management program was not designed to distinguish between the indigents, non-indigents or low-income individuals or families. The organization erected obstacles to prevent or minimize any reduction or waiver of first payment or monthly fees. Such policy includes the requirement that reduction of contributions be approved by the manager, and using a compensation package based on the number of enrollees and total contribution. Based on the manner in which the program was administered, the debt management plan did not serve a charitable purpose.

Website/Welcome Package/Referrals/XXXXX. The organization's website during XXXX thru XXXX had information regarding its debt management program with little or no educational items. It was not a practice of XXXXX employees to refer consumers to its website to read educational materials because such materials did not exist.

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The Welcome Package had items that purported to be educational, however; such items related directly or indirectly to the debt management program. A detailed review of the Welcome Package showed that most if not all of the information was follow-up information for those who enrolled in the debt management program. Such information includes a two page document of reminders for consumers enrolled in DMP; list of creditors for consumers to call to change payment due dates; payment envelopes; and Cease and Desist Notification forms. (Exhibit ED-35 contains the Welcome Package documents).

XXXXX claimed that it distributed a book, XXXXX, to individuals who enrolled in the DMP. XXXXX itself did not distribute the books and the examination did not reveal any procedures in place used by XXXXX to ensure that the books were being mailed to the consumers. The organization indicated that the book was distributed only to enrolled consumers. Thus, financially distressed individuals who contacted XXXXX but did not enroll in the program were not sent copies of information that XXXXX itself classified as educational.

The scripts used in the initial phone contact made no reference to the book XXXXX. Thus, the employees during their contact with consumers, made no reference to the availability of this items as an educational benefit provided to clients. XXXXX has claimed that these items were educational but it did not place any great emphasis on sharing any of this information during the initial telephone session with the consumer.

The inclusion of a blank XXXXX worksheet in the package did not appear to serve any educational purpose since it consumers where only required to complete it if they have accounts with certain lenders and neither was the form accompanied by any information to educate the consumer on how to use the form or the importance of the form.

Overall, substantially all information in the Welcome Package relates to DMP matters. Payment envelopes, important reminders about the DMP plan, and cease and desist notification forms do not serve to educate consumers on sound money management. Thus, the Welcome Package was not used primarily as an educational tool.

XXXXX's referral process was not an educational credit counseling service. XXXXX merely pointed the consumer to another company which could provide some other form of financial assistance for a fee. The primary purpose for most of the referrals was to allow consumers to obtain loans to pay off their debt using companies owned by individuals who were former directors, employees, or friends of XXXXX such as XXXXX.

The back office services provided by XXXXX served as the customer service unit to respond to clients inquiries regarding matters relating to the debt management plan. Clients would contact XXXXX if they felt their statement was incorrect or if creditors continued to contact them after they have been enrolled in a debt management plan. The XXXXX contract specifically excludes intake and counseling service. XXXXX

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involvement with the clients after enrollment in the program was an extension of the debt management service and did not serve an educational purpose.

Use of Resources

The majority of XXXXX's staff was employees whose responsibility was to enroll consumers in the debt management program. Approximately 89% of its staff consists of "counselors" including those employees' immediate supervisors and managers. Approximately 6% of the staff consisted of individuals who participated in the DMP process by providing assistance in processing the DMP package and others who were responsible for lead distribution. Together these individuals represent approximately 95% of the overall staff of XXXXX that were directly involved in distributing leads, taking phone calls and processing the applications and other forms (see Exhibit ED- 8)

According to the Form 990, XXXXX's total expenditures for XXXXX and XXXXX were \$, \$, and \$, respectively. At a minimum, looking at two expense categories that were clearly identifiable as expenses associated with the DMP process - 1) leads/advertising, and 2) XXXXX-back-office - the following was noted.

Expense	XXXX Expenses	%of Total Expenses	XXXX Expenses	% of total Expenses
Leads/Advertising	\$	27%	\$	26%
XXXXX-Backoffice	\$	36%	\$	44%
	Overall %	63%		70%
	XXXX Expenses			
Leads/Advertising	\$	22%		

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XXXXX-Backoffice	\$	42%		
	Overall %	64%		

Excluding any payroll expenses, the annual average amount of XXXXX's overall expenditures on the DMP process represent 65% of its total expenses. Since approximately 96% of the staff is directly involved in the DMP process, payroll expenses when included would cause this figure to be even higher. See Exhibit ED-50 for leads/advertising amounts for XXXX and XXXX identified on exhibit as Public Relations, Public Awareness, or advertising. See Exhibit ED-6 for leads/ Advertising amounts for XXXX.

XXXXX's debt management program is the primary activity of the organization since a substantial amount of its resources were devoted to the program and represent a significant percent of its overall operating cost. XXXXX does not further any charitable or educational purpose when it mass markets a DMP.

Although the representations contained in XXXXX's Form 1023 Application package portrayed XXXXX as an organization substantially similar to the organization described in Revenue Ruling 69-441 and the Consumer Credit Counseling Service of Alabama, Inc. case ("CCC of Alabama"), its actual operations/activities were not consistent with the activities described in the revenue ruling or in the CCC of Alabama case. XXXXX did not provide community education or counseling assistance similar to that described in the revenue ruling or the CCC of Alabama case. Based on the daily duties of the employees, substantially all of the XXXXX employees' time was spent on the debt management program, as contrasted with the CCC of Alabama case where the DMP activity was a relatively small part of that organization's activities. Moreover, in that case, the organization charged "nominal" fees, received some public support and had a board dominated by members of the general public, factors indicating a charitable operation.

In addition to the lack of educational or charitable activities, XXXXX has a substantial non-exempt purpose of selling a product, the DMP, and providing business to XXXXX and its successor entities.

Discussion: Control of XXXXX by XXXXX and XXXXX

Exemption from tax under section 501(c)(3) is necessary in order for fair share monies to be paid by creditors to credit counseling organizations, as well as to avoid Federal Trade Commission scrutiny under the Credit Repair Organizations Act, which was enacted September 30, 1996, and became effective on April 1, 1997. This Act specifically excludes any nonprofit organization that is exempt from taxation under section 501(c)(3) of the Internal Revenue Code (see a summary of the CROA law in Exhibit 40). Hence, securing tax-exempt status under section 501(c)(3) was critical to all organizations' economic viability as a credit counseling organization and assisted in ensuring that it could operate in a more unfettered manner.

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Once XXXXX could no longer handle all its leads and his wholly-owned back office company XXXXX was operating as a separate entity, XXXXX ordered individuals within XXXXX to assist in start up operations of other credit counseling agencies (CCAs), all of which entered into fulfillment agreements with XXXXX. Memos and e-mails from XXXXX of XXXXXs, the former XXXXX employee who assisted in distribution of leads to XXXXX and XXXXX client CCAs, clearly indicate that XXXXX was controlling the operations of the CCAs (see Exhibit 42 for memos received from XXXXX). The memo to XXXXX, XXXXX, and XXXXX clearly discusses TV commercials that were sent to XXXXX (XXXXX) of XXXXX and requests feedback from all. The TV commercials were physically sent to XXXXX by Federal Express. The memos clearly state that XXXXX is "going over the numbers" (i.e. the leads) with XXXXX and that XXXXX agreed to absorb excess leads during busy times. As stated previously, XXXXX had the "agreement" to purchase all excess leads. These excess leads, according to the testimony and documents of XXXXX and XXXXXs (see Exhibit 10), were distributed to the XXXXX contracted CCAs such as XXXXX.⁶ Those CCAs, including XXXXX, all contracted with XXXXX, XXXXX's wholly-owned company, to process the client payments resulting from individuals entering into a debt management plan.

The fees paid by XXXXX to XXXXX in XXXXX under the Fulfillment Agreement are not reasonable in relation to the industry. The analysis of XXXXX's financial statements and tax returns show that it was "super-profitable" compared to industry norms. This was due exclusively to the lack of arms-length negotiations between XXXXX and XXXXX resulting from XXXXX controlling both entities either directly or through nominees.

The overcharges in XXXXX by XXXXX pursuant to the Fulfillment Agreement alone equate to \$. XXXXX was a spin off of XXXXX that was orchestrated by XXXXX. XXXXX of XXXXX testified that XXXXX asked him to start a CCA and that XXXXX provided him with assistance from XXXXX and his other companies to achieve the start-up (see XXXXX's testimony in Exhibit 16).

Further evidence of the overcharging is found in XXXXX testimony (see Exhibit 9) where he states that he can process the clients with more quality at a much cheaper cost. Also, the US Bankruptcy Court Examiner concluded that he found a vendor who can currently service the XXXXX's DMPs at a cost much cheaper than the current arrangement with XXXXX (see Exhibit 27). XXXXX's memo on XXXXX Processing (see Exhibit 43 for the XXXXX Memo taken from the FTC files) even states that the 2003 cost (with substantial portions of the cost attributable to corporate "overhead") is \$6.36 per DMP per month, far less than the initial \$25 a month that XXXXX, XXXXX and other XXXXX contracted CCAs were charged by XXXXX and the cost of \$ 50 per

⁶ There are no written contracts with XXXXX, the friends of XXXXX and the former employees of XXXXX or XXXXX for lead purchases.

DMP per month that XXXXX stated in its minutes was computed in its "due diligence" (Exhibit 17) in 2000, 8 months after entering into Fulfillment Agreement with XXXXX.

Due to a 1996 criminal conviction in XXXXX on money laundering, XXXXX used nominees in order not to draw scrutiny on his companies (see the Court documents in Exhibit 44). XXXXX installed XXXXX into XXXXX to control its operations and immediately enter into a Fulfillment Agreement with XXXXX for substantial fees for back office services (see XXXXX testimony in Exhibit 16).

XXXXX also controlled the leads through the coordination of advertising and lead inventories. XXXXX put a former XXXXX employee, XXXXX, into her business, XXXXXs, in order to consolidate and distribute leads generated from XXXXX advertising to XXXXX clients (and subsequently advertising for other spin-off CCAs). Ms. Gardner contracted with advertising media for XXXXX and sold the resulting leads to XXXXX, XXXXX, XXXXX, and other XXXXX spin-offs that were XXXXX clients. Also, see Exhibit 42 on memos and e-mails to _____ for direction of lead inventory and advertising approval by XXXXX.

A further exhibit proving that XXXXX and XXXXX controlled XXXXX and other XXXXX client CCAs is found in the data that XXXXX collected on the CCAs. XXXXX had substantial lead cost information as well as profitability analysis (see the XXXXX/XXXXX memo in Exhibit 43, the XXXXX accounts receivable and revenue analyses in Exhibit 28 which contains information on all XXXXX controlled CCAs and the Bear Stearns XXXXX Sale Due Diligence in Exhibit 45). XXXXX responded to the FTC (see Exhibit 46) showing all of the relationships to the XXXXX client CCAs. The See the Senate Report (XXXXX comments in the Senate Report in Exhibit 6) which contends that the "XXXXX-XXXXX" conglomerate is controlled by the XXXXX business practices and XXXXX.

XXXXX was able to direct the resources and personnel of XXXXX to start XXXXX. XXXXX directed XXXXX to provide forms, agreements, management assistance, training, and personnel to XXXXX who he started with a trusted, former employees of XXXXX, XXXXX. Virtually all of these XXXXX spin off companies were represented during the exemption application process by XXXXX who also represented XXXXX. XXXXX also assisted them with loans and leads to start the companies in exchange for them signing Fulfillment Agreements with his company, XXXXX. The Bear Stearns memo discusses this business model that was employed by XXXXX (see Exhibit 45). Also, the XXXXX financial statements for XXXX and XXXX state that the business model is to assist CCAs who are clients with advertising and marketing (i.e. leaXXXXX) (see Exhibit 46).

XXXXX's operation was a mirror image of what XXXXX had implemented at XXXXX. XXXXX through XXXXX had control and power through the non-compete agreement on whether or not XXXXX could create or otherwise be involved in another company that was in competition with XXXXX. The creation of XXXXX was not challenged by XXXXX/XXXXX because XXXXX was going to be treated by XXXXX

as a subsidiary company evidenced by XXXXX and XXXXX involvement in its formation. The absence of any discussions between XXXXX with XXXXX on the matter of the non-compete agreement signifies that XXXXX and XXXXX did not perceive XXXXX has in direct competition with XXXXX. XXXXX, was not perceived by XXXXX/XXXXX as a direct competitor to XXXXX because XXXXX functioned as an extension of XXXXX providing similar services in a different location. XXXXX was not a threat to XXXXX/XXXXX but was an extension of XXXXX control of the credit counseling market. The absence of any legal action against XXXXX or any of XXXXX's former employees then employed by XXXXX for violating the non-compete agreement demonstrates that XXXXX/XXXXX had the ability to control the operations of XXXXX, since it has the mechanism in place to legally challenge its existence and operations. The involvement of XXXXX/XXXXX in the establishment of XXXXX, the business practices that XXXXX shared with XXXXX through its own staff or through XXXXX staff, and the execution of a fulfillment agreement, a document created solely for XXXXX purposes, resulted in XXXXX having significant influence over the operations of XXXXX.

All of these transactions were able to occur because XXXXX controlled XXXXX and XXXXX. The FA fees were not negotiated at arms-length and as a result, substantial monies inured to the benefit of XXXXX.

Discussion: Inurement and Private Benefit to XXXXX and XXXXX

As stated previously, XXXXX signed a Fulfillment Agreement with XXXXX, a company wholly owned by XXXXX, upon formulation of XXXXX. The Board did not conduct any contemporaneous due diligence with regards to this Agreement and all subsequent agreements as evidenced in the Minutes provided (see Exhibit 17 for the Minutes with the only reference to due diligence and review by the Board being almost 9 months after XXXXX began servicing XXXXX clients- i.e. the Minutes and discussion of the Board on XXXXX, long after the start-up of XXXXX and XXXXX on September 1, 1999).

XXXXX was able to exert significant control over the business operations of XXXXX, through his former employee at XXXXX, XXXXX, to overcharge for back office services. According to an IRS Engineering Report on the value of the back-office services, XXXXX substantially overcharged XXXXX for the services provided (see IRS Engineering Report in Exhibit 38).

The IRS Engineering Report concludes that XXXXX is "super-profitable" by industry standards. In fact, XXXXX, by industry standards, over-charged XXXXX in processing fees under the Fulfillment Agreement in XXXXX, and XXXXX in the amounts of \$, \$, and \$, respectively, or a total three-year over-charge of \$ (see analysis in Exhibit 39). Like the situations in the cases of est of Hawaii and International Postgraduate Medical Foundation, supra, XXXXX's for-profit entity, XXXXX, benefited substantially from the operation of XXXXX and

other CCAs. The evidence in this case establishes that the substantial purpose of XXXXX was to increase the income of XXXXX.

Discussion- Inurement to XXXXX and XXXXX

XXXXX was able to utilize XXXXX for his personal and private gain. XXXXX sold leads in XXXX for \$ for which he never provided or were of no value to XXXXX (see the XXXXX v. XXXXX/XXXXX Complaint in Exhibit 23). XXXXX was able to control XXXXX procurement and payment to embezzle funds to XXXXX. XXXXX was also able to utilize corporate credit cards and XXXXX funds to pay for fictitious employees that were in reality his girlfriends that provided no services to XXXXX (see testimony of XXXXX in Exhibit 22, Complaint in Exhibit 23).

XXXXX also embezzled funds to pay for the personal expenses of himself and his wife, XXXXX, the purported founder of XXXXX. XXXXX and XXXXX used XXXXX American Express cards for three years to purchase lavish trips and pay personal expenses that benefited themselves and XXXXX's girlfriends.

Discussion: Inurement/Private Benefit to XXXXX, XXXXX Board Member

As stated, XXXXX provided leads from its counselors to XXXXX, a company owned by XXXXX, a Board member from XXXXX. Neither XXXXX or XXXXX can quantify the amount of leads but neither deny that XXXXX and his company received them without paying XXXXX for their value (see XXXXX testimony in Exhibit 25, XXXXX testimony in Exhibit 16, and XXXXX testimony in Exhibit 22). Because XXXXX was a Board member and allegedly in a fiduciary position to direct the operations of XXXXX, these referrals constitute inurement to the benefit of XXXXX.

Discussion: Substantial Private Benefit Conferred on Others

Former XXXXX employees and XXXXX friends, XXXXX and XXXXX, also arranged to sell the book, XXXXX, to all XXXXX DMP clients in the Welcome Package. This arrangement was made by XXXXX (see the testimony of XXXXX in Exhibit 9). XXXXX derived \$ in income from the book and XXXXX (and his company XXXXX) derived over \$1.27 million in revenue from the book (see Exhibit 19).

CONCLUSION

XXXXX is not operated exclusively for educational or for any other exempt purposes within the meaning of section 501(c)(3) of the Code since its primary activity is the sale of debt management plans. XXXXX conducted no educational activities within the community, provided no educational training or counseling to individuals on credit or debt management issues, and did not provide education in the context of sales of its debt management plans. The debt management program was not limited to a charitable class

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and XXXXX did not have an established policy or procedure to waive or reduce the fees for the indigents or to waive the fees for those to whom such fees would create financial hardship. Consequently, the debt management program did not serve a charitable purpose. Since XXXXX's primary activity was the sale of debt management plans which lacked substantial educational or charitable aspects, its exemption under section 501(c)(3) of the Code should be revoked effective January 1, 2000.

In addition, XXXXX had a substantial non exempt purpose in selling a product, the DMP, and providing business to XXXXX under a contract that was extremely lucrative to XXXXX. XXXXX did not further any charitable or educational purpose when it marketed its DMPs. Moreover, because XXXXX as a section 501(c)(3) organization was exempted from the CROA, it was able to engage in deceptive business practices that Congress intended to prohibit when it passed the CROA law. As such, XXXXX is operated for a substantial non-exempt purpose that of carrying on a business while avoiding federal regulation.

XXXXX's earnings also inured to the benefit of XXXXX and its founder (and the founder of XXXXX), XXXXX. XXXXX paid fees to XXXXX's company XXXXX, in XXXXX, that were \$ in excess of reasonable, fair market value. Since XXXXX's earnings inured to the benefit of XXXXX and his company XXXXX, its exemption under section 501(c)(3) of the Code should be revoked effective January 1, 2000. Furthermore, even without considering inurement, XXXXX was operated primarily for the benefit of XXXXX.

XXXXX's earnings also inured to the benefit of the individual who ran its day to day operations from its inception in XXXX until XXXXX, XXXXX. In the years XXXXX, XXXXX received substantial payments for which goods and services were not provided. He embezzled funds from XXXXX to pay for lavish trips, care of his girlfriends, and for the personal benefit of himself and his wife, the purported founder of XXXXX, XXXXX.

In addition to conferring private benefit on XXXXX's for-profit business, XXXXX and XXXXX, XXXXX also substantially served the private interests of individuals associated with XXXXX. These include former employees of XXXXX, the company that was founded by XXXXX, and friends of XXXXX as well as family members who derived benefit, without question from XXXXX, for sales of services and products diverted to their companies. These individuals personally benefited from transactions that were composed solely to benefit them. Since XXXXX substantially served the private interests of individuals associated with XXXXX, XXXXX, or conferred substantial private benefits on a number of individuals and companies in contravention of section 501(c)(3) of the Code, its exemption under section 501(c)(3) of the Code should be revoked effective January 1, 2000.

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