September 17, 2021

Emailed to: regulations@dfpi.ca.gov and copy to Colleen Monahan at [redacted]@dfpi.ca.gov.

Subject line: PRO 02-21

Dear [Commissioner Gonzales]:

The Online Lenders Alliance (OLA) represents the online lending industry and companies that provide services to those online lenders. We appreciate the invitation to provide comments on rulemaking under the California Consumer Financial Protection Law ("CCFPL"): Commercial Financing to Small Businesses, Nonprofits, and Family Farms ("PRO 02-21").

While the primary focus of OLA is to serve the online consumer finance marketplace, many of its members also offer small business financing. In addition, OLA recognizes that PRO 02-21 may have an impact on other proposed rulemaking relating to consumer finance. Research has shown time and time again the importance of ensuring that credit is available to consumers as well as small businesses. Promulgating overreaching and ambiguous rules creates uncertainty, making it more difficult for creditors to understand what products, disclosures, and conduct may be allowed, lessening competition, innovation, and product diversity while also reducing marketplace protections and making it more difficult for small business to obtain needed financing.

The DFPI invitation issued on August 18, 2021 seeks input from interested parties on draft language implementing section 90009, subdivision (e) of the CCFPL (the "Statute"). The Statute provides:

> The department, by regulation, may define unfair, deceptive, and abusive acts and practices in connection with the offering or provision of commercial financing, as defined in subdivision (d) of Section 22800, or other offering or provision of financial products and services to small business recipients, nonprofits, and family farms. The rulemaking may also include data collection and reporting on the provision of commercial financing or other financial products and services.

In inviting interested parties to comment on the PRO 02-21 language, the DFI requests (among other things) that the parties:

1. Provide an explanation of the costs and benefits of the recommended rule, and
2. Explain whether other businesses are subject to the same rule and why the rule is appropriate under the CCFPL.

The DFPI requests that interested parties provide these explanations but has not provided its own similar explanations for the language in PRO 02-21. We are not aware of the DFPI providing cost/benefit analysis data on the impact of PRO 02-21 on businesses providing commercial financing and the small businesses in need of such financing. Furthermore, we are not aware of any other specific type of

California businesses singled out for its own standards of unfairness, deceptiveness, and abusiveness in dealing with other businesses. There are no reasons why the businesses subject to PRO 02-21 should be subject to any higher general standard in conducting commercial transactions than other California businesses.

In addition, the DFPI seeks comments from interested parties on the potential economic impact on businesses that would be affected by the draft language. The DFPI requests comment on things such as:

1. Whether the draft language impacts California competitiveness;
2. Whether the draft language will affect the ability of California businesses to compete with other states by making it more costly to provide services here;
3. Whether the draft language will result in the creation or elimination of businesses in this state, and the numbers of each;
4. Whether the draft language will result in the creation or elimination of jobs in this state, and the numbers of each;
5. Whether any alternative to the draft language would lessen any adverse impact on small business; and
6. The consequences of the draft language on those impacted.

These DFPI requests are seeking comments on three general areas: (1) impact on competitiveness, (2) impact on business and job loss, and (3) general adverse impact. Again, we are not aware of the DFPI performing any investigation or conducting any data analysis in these areas before proposing PRO 02-21. It is unlikely that anyone has had sufficient time in the month provided to respond to conduct such an impact analysis. That said, it is clear PRO 02-21 will negatively impact competitiveness, result in the loss of small business financing companies, and, as such related jobs, as well as have an overall general negative impact on small business financing (including availability, costs, etc.).

In addition to the overall concerns, OLA has several comments about the proposed language in PRO 02-21 relating to the meaning of unfairness, deceptive and abusive.

I. Unfairness

The DFPI proposes to define "unfairness" to mean:

> (A) The act or practice violates another law.
>
> (B) On balance, the harm from the conduct outweighs the utility of the conduct.
>
> (C) The act or practice offends an established public policy, or the act or practice is immoral, unethical, oppressive, unscrupulous, or substantially injurious to a person.
>
> (D) (1) The injury is substantial, (2) the injury is not outweighed by countervailing benefits, and (3) the injury could not reasonably have been avoided.

The DFPI's definition of unfairness is overly broad and so subjective that a provider of small business financing will be unable to know what conduct is allowed under California law. California courts have been specifically concerned with similar language understanding that such language can cause more confusion and harm to the marketplace.

In the Cel-Tech case, the California Supreme Court criticized similar language contained in the California Unfair Practices Act and unfair competition law:

> **We believe these definitions are too amorphous and provide too little guidance to courts and businesses. Vague references to "public policy," for example, provide little real guidance.**
>
> . . .
>
> L.A. Cellular and supporting amici curiae emphasize the need for California businesses to know, to a reasonable certainty, what conduct California law prohibits and what it permits. We sympathize with this concern. An undefined standard of what is "unfair" fails to give businesses adequate guidelines as to what conduct may be challenged and thus enjoined and may sanction arbitrary or unpredictable decisions about what is fair or unfair. **In some cases, it may even lead to the enjoining of procompetitive conduct and thereby undermine consumer protection**, the primary purpose of the antitrust laws. "Because ours is a culture firmly wedded to the social rewards of commercial contests, **the law usually takes care to draw lines of legal liability in a way that maximizes areas of competition free of legal penalties**." (Della Penna v. Toyota Motor Sales, U.S.A., Inc. (1995) 11 Cal. 4th 376, 392 [45 Cal. Rptr. 2d 436, 902 P.2d 740].) Courts must be careful not to make economic decisions or prevent rigorous, but fair, competitive strategies that all companies are free to meet or counter with their own strategies. Companies that cannot compete with others that are more capable or efficient may lawfully fail.[1] (Emphasis Added).

The California courts have recognized that use of nebulous and indefinite terms like "public policy" and "immoral, unethical, oppressive [and] unscrupulous" not only provide businesses (and the courts) little guidance but also impede competition in the marketplace and thus undermine consumer protection. Not only is such language unhelpful, confusing, and counter-productive but it is also redundant as the Cel-Tech case shows. The California Unfair Practices Act and Unfair Competition Law already apply to commercial financing businesses in its transactions with small businesses.

In comparison, the Federal Trade Commission's ("FTC") and the Consumer Financial Protection Bureau's ("CFPB") definition of "unfairness" is as follows:

> (1) It causes or is likely to cause substantial injury to consumers;
>
> (2) The injury is not reasonably avoidable by consumers; and
>
> (3) The injury is not outweighed by countervailing benefits to consumers or to competition.

[1] 20 Cal. 4th 163 (1999)

The DFPI should adopt the FTC's definition of unfairness that has been defined, tested, and relied upon by the FTC (and later by the CFPB) for more than 40 years.[2] California courts support applying the FTC definition.[3] The definition of "unfair" as it applies to business-to-business transaction should recognize the need to provide businesses with clear and adequate guidelines and allow for competition in the marketplace.

OLA would recommend the following specific changes to the Pro 02-21 definition of "unfairness":

1. Strike "The act or practice violates another law."

This standard is not consistent with the CFPB and FTC definition of "unfairness" and appears only intended to add penalties for conduct that is already prohibited by California law.

2. Strike "On balance, the harm from the conduct outweighs the utility of the conduct."

This language is duplicative of the definitional language stating, "The injury is not outweighed by countervailing benefits." There appears to be no substantive distinction between "harm" and "injury" as well as between "utility" and "benefits." There is also no explanation as to how "harm" and "utility" may be determined. The language allows for changing political and other bias in the interpretation of what is helpful or harmful to the small business obtaining financing.

3. Strike "The act or practice offends an established public policy, or the act or practice is immoral, unethical, oppressive, unscrupulous, or substantially injurious to a person."

As discussed above, the California courts criticize the use of such language. Furthermore, this language comes from the FTC's 1964 statement of purposes relating to smoking advertisements, sometimes called the "cigarette rule."[4] In 1980, the FTC expressly abandoned this standard as duplicitous, stating as follows:

> Finally, the third . . . standard asks whether the conduct was immoral, unethical, oppressive, or unscrupulous. This test was presumably included in order to be sure of reaching all the purposes of the underlying statute, which forbids "unfair" acts or practices. It would therefore allow the Commission to reach conduct that violates generally recognized standards of business ethics. The test has proven, however, to be largely duplicative. Conduct that is truly unethical or unscrupulous will almost always injure consumers or violate public policy as well. The Commission has therefore never relied on the third element . . . as an independent basis for a finding of unfairness, and it will act in the future only on the basis of the first two.[5]

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[2] The standard for unfairness in the Dodd-Frank Act has the same three-part test as the FTC Act. This standard was first stated in the FTC Policy Statement on Unfairness (Dec. 17, 1980), available at: https://www.ftc.gov/public-statements/1980/12/ftc-policy-statement-unfairness. Congress later amended the FTC Act to include this specific standard in the Act itself. 15 U.S.C. § 45(n). See also page 1, https://files.consumerfinance.gov/f/documents/102012_cfpb_unfair-deceptive-abusive-acts-practices-udaaps_procedures.pdf.

[3] See Drum v. San Fernando Valley Bar Assn., 182 Cal. App. 4th 247, 256, 106 Cal. Rptr. 3d 46 (2010).

[4] https://www.ftc.gov/public-statements/2003/05/ftcs-use-unfairness-authority-its-rise-fall-and-resurrection.

[5] https://www.ftc.gov/public-statements/1980/12/ftc-policy-statement-unfairness.

II. Deceptive

The DFPI's proposed definition of "deceptive" is as follows:

> An act or practice is deceptive and may not be engaged in by a person offering or providing commercial financing or other financial products or services if a small business, nonprofit, or family farm is likely to be deceived by the act or practice.

OLA would suggest that the DFPI use language more like that used by the FTC and CFPB. Those federal agencies define deceptive as follows:

> (1) There must be a representation, omission or practice that is likely to mislead the consumer;
>
> (2) Is the representation, omission or practice must be likely to mislead **reasonable** consumers under the circumstances.
>
> (3) Is the representation, omission, or practice **"material"**.[6]

The FTC definition appropriately inserts the general "reasonableness" standard. Without such a standard in the DFPI's definition of "deceptive," commercial financing companies would be faced with the impossible task of trying to determine whether every representation, omission or practice might deceive each small business. This would require the commercial financing company to make a separate assessment of each small business and its likelihood of likely being deceived. This is not even a standard used in the consumer context and would place unnecessary and unavoidable risk on those companies covered by PRO 02-21.

III. Abusive

The DFPI's proposed definition of "abusive" is as follows:

> (A) Interferes with the ability of a small business, nonprofit, or family farm to understand a term or condition of a financial product or service.
>
> (B) Takes unreasonable advantage regarding any of the following:
>
> > 1. A lack of understanding on the part of the small business, nonprofit, or family farm of the material risks, costs, or conditions of the commercial financing or other product or service.
> >
> > 2. The inability of the small business, nonprofit, or family farm to protect its interests in selecting or using the commercial financing or other financial product or service.

[6] https://www.ftc.gov/system/files/documents/public_statements/410531/831014deceptionstmt.pdf. See also page 5, https://files.consumerfinance.gov/f/documents/102012_cfpb_unfair-deceptive-abusive-acts-practices-udaaps_procedures.pdf.

3. The reasonable reliance by the small business, nonprofit, or family farm on a person offering or providing commercial financing or other financial product or service to act in the interests of the small business, nonprofit, or family farm.

The Consumer Financial Protection Act ("CFPA") defines abusive as follows:

> (1) Materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service; or
>
> (2) Takes unreasonable advantage of:
>
> (a) A lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service;
>
> (b) The inability of the consumer to protect its interests in selecting or using a consumer financial product or service; or
>
> (c) The reasonable reliance by the consumer on a covered person to act in the interests of the consumer.[7]

The DFPI's proposed definition of "abusive" importantly lacks the materiality element in (2)(a) of the CFPA's definition. It is also important to note that the CFPB rescinded its policy statement on the meaning of "abusive" and has not issued a new policy statement – which means the term remains unclear and frustrates effective operations and competition in the marketplace.[8] The DFPI should consider whether the CFPB's definition of abusive is overbroad and duplicative, in the way the FTC did with its 1980 policy statement on "unfairness." OLA recommends that the DFPI deem the term "abusive" duplicative and rely on the definition of "unfairness" for enforcement of the Statute.

We look forward to further engaging and working with the DFPI to promulgate reasonable and cautious rules that are consistent with the CCFPL, other applicable laws, as well a competitive marketplace.

Thank you very much for your consideration,

[redacted]

Andrew Duke
Executive Director
Online Lenders Alliance

[7] See page 9, https://files.consumerfinance.gov/f/documents/102012_cfpb_unfair-deceptive-abusive-acts-practices-udaaps_procedures.pdf

[8] https://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-rescinds-abusiveness-policy-statement-to-better-protect-consumers/.