

Revenue Based Finance Coalition Comments on Proposed Rulemaking Under the California Consumer Financial Protection Law: Commercial Financing to Small Businesses, NonProfits, and Family Farms (PRO 02-21)

The Revenue Based Finance Coalition (“RBFC”) is comprised of responsible finance companies that provide needed capital to small businesses through innovative methods. RBFC members offer accounts receivable purchase financing to small businesses and some members also engage in lending in the state of California through a California Financing Law license. Our members also include select vendors that provide technology services to the small business finance industry. This letter responds to the Department of Financial Protection and Innovation’s “Comments on Proposed Rulemaking Under the California Consumer Financial Protection Law: Commercial Financing to Small Businesses, NonProfits, and Family Farms (PRO 02-21)” dated August 18, 2021.

Respectfully, we submit the following comments:

I. Definition of “Unfair”

We respectfully request that the DFPI adopt the Consumer Financial Protection Bureau’s definition of unfairness that has been defined, tested, and relied upon in the consumer context first by the Federal Trade Commission and then the CFPB for more than 40 years.¹

Comparison	
CFPB’s definition of unfair²	<p>(1) It causes or is likely to cause substantial injury to consumers;</p> <p>(2) The injury is not reasonably avoidable by consumers; and</p> <p>(3) The injury is not outweighed by countervailing benefits to consumers or to competition.</p>
DFPI’s proposed definition of unfair	<p>(A) The act or practice violates another law.</p> <p>(B) On balance, the harm from the conduct outweighs the utility of the conduct.</p> <p>(C) The act or practice offends an established public policy, or the act or practice is immoral,</p>

¹ 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. See 15 U.S.C. § 45(n).

² *Id.*

	<p>unethical, oppressive, unscrupulous, or substantially injurious to a person.</p> <p>(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.</p>
--	---

The DFPI’s proposed definition of “unfair” is vague, overly broad, and so subjective that a provider of small business financing would be unable to know what conduct violates California law. The definition of “unfair” should recognize the need to provide businesses with clear guidelines to negotiate and compete in the marketplace. California courts have been specifically concerned with similar language, explaining that such language can cause more confusion and harm to the marketplace.

In *Cel-Tech Communications, Inc. v. Los Angeles Cellular Telephone Co.*, 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.³

California courts have recognized that use of amorphous terms such as “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. Accordingly, we respectfully request the following specific changes to the definition of “unfair.”

³ *Cel-Tech Communications, Inc. v. Los Angeles Cellular Telephone Co.*, 20 Cal.4th 163, 186 (1999) (emphasis added).

1. **Strike “The act or practice violates another law.”** This standard is redundant because it prohibits conduct already expressly prohibited under California law. In addition, this standard is unduly burdensome, in that it would presumably compound penalties for conduct that already is penalized separately under California law.
2. **Strike “On balance, the harm from the conduct outweighs the utility of the conduct.”** This standard is duplicative of section (D)(2)’s “the injury is not outweighed by countervailing benefits.” There is also no explanation of how “harm” and “utility” would be calculated.
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.”** This language originated in the FTC’s 1964 statement of basis and purpose related 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

Neither the FTC nor the CFBP use this standard, and we urge the DFPI not to adopt an out-of-date standard that has been abandoned by federal regulators.

II. Definition of “Deceptive”

We respectfully request that the DFPI adopt the CFPB’s definition of “deceptive” that has been defined, tested and relied upon in the consumer context first by the FTC and then the CFPB for more than 40 years.⁶

Comparison	
CFPB’s definition of deceptive⁷	(1) There must be a representation, omission or practice that is likely to mislead the consumer.

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>.

⁶ See 15 U.S.C. § 45(n).

⁷ https://www.ftc.gov/system/files/documents/public_statements/410531/831014deceptionstmt.pdf.

	<p>(2) Is the representation, omission or practice likely to mislead reasonable consumers under the circumstances.</p> <p>(3) Is the representation, omission, or practice a “material” one.</p>
DFPI’s proposed definition of deceptive	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.

The DFPI’s proposed definition of “deceptive” lacks two key elements:

1. Whether a **reasonable** small business, nonprofit, or family farm is likely to be misled. The DFPI’s proposed standard would subject a provider of small business finance to a deception claim if any small business alleges that they were misled, without considering the reasonableness of the small business.
2. Whether the representation, omission, or practice is **material**. Without the element of materiality, providers of small business finance would be subject to unreasonable and potentially ruinous litigation costs.

Accordingly, we respectfully request that the DFPI either adopt the CFPB’s definition of “deceptive” or revise the definition of “deceptive” 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 the act or practice results in a material representation, omission, or practice and a reasonable small business, nonprofit, or family farm is likely to be deceived by the act or practice.

III. Definition of “Abusive”

The “abusive” standard was created in 2010 as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act. We respectfully request that the DFPI adopt the CFPB’s definition of abusive, which includes a “materiality” element. We also request that the DFPI add a “reasonableness” element to the lack of understanding on the part of the small business, nonprofit, or family farm and the inability of the small business, nonprofit, or family farm to protect its interests. We believe that a reasonableness element is appropriate in the context of a business enterprise, whether for-profit or not-for-profit.

Comparison	
CFPB's definition of abusive ⁸	<p>(1) Materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service; or</p> <p>(2) Takes unreasonable advantage of:</p> <ul style="list-style-type: none"> • A lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service; • The inability of the consumer to protect its interests in selecting or using a consumer financial product or service; or • The reasonable reliance by the consumer on a covered person to act in the interests of the consumer.
DFPI's proposed definition of abusive	<p>(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.</p> <p>(B) Takes unreasonable advantage regarding any of the following:</p> <ol style="list-style-type: none"> 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. 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.

⁸ 12 U.S.C. 5531(d).

We respectfully request that the DFPI revise the definition of “abusive” as follows:

- (A) **Materially** 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 **reasonable** 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 **reasonable** 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.
 - 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.

Note that the CFPB has not released a policy statement on the meaning of “abusive.” We respectfully ask the DFPI to consider whether even the CFPB’s definition of abusive is overbroad and duplicative, in the way the FTC did with its 1980 policy statement on “unfairness.”

IV. Requiring providers of small business finance to annually report the “total dollar cost of the financing”

The proposed regulations include the following reporting requirement:

Section X.90009.2. Commercial Financing Data

(b) Each person engaged in the business of offering or providing commercial financing or other financial products or services to a small business, nonprofit, or family farm shall report the following information regarding activity within this state for the calendar year preceding the due date of the report.

(1) The person’s contact and organization identification information.

(2) By type of commercial financing or other financial products or services, the person’s total number and total dollar amount of transactions in this state for the prior calendar year with small businesses, nonprofits, and family farms.

(3) By type of commercial financing or other financial products or services, the person’s total number transactions in this state for the prior calendar year with small businesses, nonprofits, and family farms for financing over \$100,000, over \$50,000 but under \$100,000, over \$25,000 but under \$50,000, over \$10,000 but under \$25,000, and at or less than \$10,000.

(4) On or after the operative date for the regulations under Financial Code section 22804, for the commercial financing data reported under paragraph (3) of this subdivision, the minimum, maximum, average, and median total dollar cost of the financing at each interval set forth in paragraph (3).

We respectfully question the DFPI's basis for requiring a provider of commercial financing to annually report the total dollar cost of financing to the DFPI. Although the legislature granted the DFPI expansive authority through the California Consumer Financial Protection Law ("CCFPL"), the legislature did not grant the DFPI authority to regulate the cost of commercial financing. The relevant section of the CCFPL provides as follows:

(e) 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.

While the DFPI has authority to collect "data", the DFPI's authority over commercial financing under the CCFPL is confined to unfair, deceptive, and abusive acts and practices ("UDAAP"). We believe there should be some nexus between the data collected by the DFPI under the authority granted by the CCFPL and the DFPI's UDAAP authority granted by the CCFPL. If the DFPI intends to take the position that commercial financing can be unfair, deceptive or abusive simply because of the cost of financing, the DFPI will be going beyond its authority under the CCPL or any California law.

In addition, California law does not define the "total dollar cost of the financing." Neither Financial Code section 22804, requiring commercial finance disclosures, nor the DFPI's proposed regulations implementing commercial financing disclosures define the "total dollar cost of the financing."

We respectfully request that the DFPI strike the requirement that providers of commercial financing annually report the cost of commercial financing.

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