



August 28, 2023

CALIFORNIA ISSUES UDAAP RULE FOR BUSINESS FINANCE

Consumer-like protections continue to invade business finance. The latest example is a new rule expanding the California Department of Financial Protection and Innovation's authority to regulate unfair, deceptive *and abusive* acts and practices ("UDAAP") in "commercial financing transactions", defined to mean consummated commercial financing transactions for which California disclosures are required. See Cal. Code Regs. tit. 10, §§ 1060 *et seq.* (UDAAP rule); § 920(a) (commercial disclosures requirement). California was the first state to pass new commercial disclosure requirements and other states may be expected to adopt similarly expansive UDAAP authority. This simply continues a long-term trend for certain kinds of business lending and commercial finance.

In a 2016 white paper, the U.S. Treasury recommended subjecting small business lenders to increased oversight similar to that imposed on depository institutions to foster greater transparency and better outcomes for borrowers. At the time, small business loans under \$100,000 (which the Treasury believed share similar characteristics with consumer loans) became subject to the same protections extended to consumers under the federal Truth-in-Lending Act. See, e.g., our ALERT of May 11, 2016; [https://home.treasury.gov/system/files/231/Opportunities and Challenges in Online Marketplace Lending white paper.pdf](https://home.treasury.gov/system/files/231/Opportunities_and_Challenges_in_Online_Marketplace_Lending_white_paper.pdf).

The Treasury specifically referenced the Responsible Business Lending Coalition's ("RBLC") Small Business Borrower's Bill of Rights as evidence that future legislation could be enacted without imposing undue burden or cost on industry. See our ALERT of Sept. 16, 2015 (for more information on the Small Business Borrower's Bill of Rights). The RBLC's effort was followed by the Innovative Lending Platform Association's (ILPA) effort to develop a model small business pricing disclosure called "SMART" (Straightforward Metrics Around Rates and Total Cost) Box (SMARTBox™) for different types of commercial financing, designed to help small businesses better assess and compare different kinds of financing options in a more systematic way. See our ALERT OF MAY 13, 2016. California's commercial disclosure requirements followed. Other states, including New York, Utah and Virginia, have since passed their own (non-uniform) commercial financing disclosure requirements. See our ALERTS of [Mar. 28, 2023](#); [Sept. 29, 2022](#); [June 15, 2022](#); and

[May 6, 2022](#). (New Hampshire has had a simpler commercial disclosure requirement for decades.)

Recently, the Consumer Financial Protection Bureau ("CFPB") determined that the federal Truth-in-Lending Act does not preempt state commercial financing disclosure statutes and declared that "merchant cash advances" ("MCA"), a form of financing not traditionally considered "credit", are governed by the federal Equal Credit Opportunity Act ("ECOA") for purposes of the new small business data collection requirements that implemented Section 1071 of the Dodd-Frank Act.

In 2019, the Federal Trade Commission's ("FTC") Strictly Business Forum brought together various stakeholders to discuss trends and potential consumer protection risks in the small business financing market. Among other things, forum participants addressed (i) online loans and alternative financing products for small businesses, (ii) the financial sophistication of small business owners, (iii) disclosure challenges given the variety of small business financing products available on the market, (iv) regulatory concerns with lead generators, brokers and other intermediaries in the small business financing ecosystem and (v) the use of confessions of judgments in small business financing. Scrutiny of small business financing has only continued to increase since then. The FTC itself has initiated public enforcement actions involving UDAP allegations and small business financing. See, e.g., Complaint, *FTC v. Seed Consulting, LLC et al.*, No. 21-cv-0154 (D. Nev. Jan. 29, 2021); Complaint, *FTC v. Yellowstone Capital LLC*, No. 20-06023 (S.D.N.Y. Aug. 3, 2020); Complaint, *FTC v. RCG Advances LLC*, No. 20-04421 (S.D.N.Y. June 10, 2020); Complaint, *FTC v. Ponte Investments LLC*, 20-cv-00177 (D. Nev. April 17, 2020). In light of this steady advance, California's action is unsurprising.

The new California UDAAP rule applies to commercial financing offered or provided to certain covered entities as defined in the regulation, including small businesses, nonprofits and family farms. The rule requires annual reporting for covered providers (defined broadly to mean any person engaged in the business of offering or providing commercial financing or another financial product or service to a covered entity), but expressly exempts banks, credit unions, federal savings and loan associations and others, including certain current licensees under California law when acting within the scope of their licenses. Penalties run from \$2,500 for each act or omission to up to \$1 million per day or 1% of the violator's net worth,

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whichever is less, for certain “knowing” violations. The regulation takes effect October 1, 2023.

We have long advised clients engaging in various business loans and other commercial financing programs (like MCAs) to take reasonable steps to avoid recognized regulatory risks in lending to sole proprietorships and other small and medium businesses (“SMB”). A variety of existing state and federal laws already can be applied to SMB financing either directly or by analogy. Because we routinely advise clients regarding 50-state consumer programs, we can advise on various state laws and drafting and compliance strategies to remain ahead of the next wave of commercial financing regulation. Let us know how we can assist you! ☐

✧ *Mike Tomkies and Mercedes Ramsey*