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## ONLINE POINT-OF-SALE FINANCING PROVIDER DENIED CALIFORNIA LENDER LICENSE

On December 30th, the California Department of Business Oversight (“DBO”) issued an administrative decision denying a point-of-sale financing provider’s application for a lender license under the California Financing Law (“CFL”) because the DBO found that the financing provider had engaged in unlicensed lending in California. In the press release accompanying the decision, the DBO mentioned that it recently issued a legal opinion to a second, unnamed lender that its point-of-sale product is a loan under California law and requires a CFL license.

The point-of-sale financing product at issue in the administrative decision enabled consumers to pay for a purchase over time in four installments. The product has a 0% interest rate, but a consumer could incur fees by missing or rescheduling payments. Consumers could use the financing to make a purchase at over 6,800 participating merchants, who pay an undisclosed fee to the financing provider. The financing provider had not pursued a CFL license because the provider considered the financing a credit sale made by merchants and purchased by the provider. Because of the structure of the purported credit sale transaction, the federal Truth-in-Lending Act and the California Unruh Act did not apply, leaving the transaction mainly unregulated.

The DBO disagreed with the provider’s characterization of the point-of-sale financing product. Analyzing the substance of the transaction over its form, the DBO found that the financing did not constitute a bona fide credit sale, but rather a loan. According to the California cases cited by the DBO, extensive third-party involvement in underlying credit sales may cause transactions to be deemed loans. Although California courts have not considered transactions structured and marketed like the provider’s transaction, the DBO summarized the following three principles from California common law in evaluating a third party’s participation in purported credit sales:

1. A transaction may be considered a loan if a third party’s involvement with the merchant goes beyond that which is necessary to effectuate the purchase of credit sales.
2. A transaction may be considered a loan if the role of the third party and the terms of the transaction are not fully disclosed to the consumer.

3. A transaction may be considered a loan if the third party does not bear the full risk of consumer performance under the credit sale.

To support its finding that the transaction is a loan under California law, the DBO noted the following: (i) the provider markets its financing product directly to consumers before consumers have decided to shop at a particular merchant, (ii) the consumers and merchants do not enter into contracts with each other, (iii) there is no existing contract under which the provider purchases credit sales from merchants, (iv) the provider describes itself as a creditor to consumers, (v) the provider performs various services for merchants that are not related to the purchase of credit sales from merchants, (vi) the provider reserves the right to unilaterally impose new fees on consumers at any time so that consumers are not fully informed of the all financing terms and (vii) the provider may refuse to provide financing for certain purchases after a merchant has processed the sale. The DBO made these findings from reviewing the provider’s licensing application, website, user agreements with consumers and merchant agreements. The financing provider has 15 days to appeal the DBO’s denial decision.

The risk that a credit sale could be re-characterized as a loan subject to state lending laws is not new. The definition of “loan” in each state can vary. Few products are truly new or innovative, but rather variations of existing or old products. Seeking the input of counsel with a deep understanding of consumer finance can pay dividends before launching a new product. This decision demonstrates the challenges that can arise when applying for a license after launching a product or engaging in licensable activities.



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