

Insights

California Commercial Lenders Beware: UDAAP Doesn't Only Apply to Consumer Lending Anymore

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The California Department of Financial Protection and Innovation ("DFPI") recently adopted a new unfair, deceptive, and abusive acts and practices regulation (the "UDAAP Regulation") applicable to commercial lenders extending credit to small businesses (defined as a business with annual gross receipts of no more than \$16 million), not for profit corporations, and family farms. Covered commercial lenders will be required to comply with this UDAAP Regulation beginning on October 1st of this year. This UDAAP Regulation creates an almost identical definition of "unfair" and "abusive" acts as applied to consumer lending by the Consumer Financial Protection Bureau (the "CFPB") pursuant to the Consumer Financial Protection Act of 2010 (the "CFPA"). Commercial lenders and financial services providers unfamiliar with the concept of regulatory oversight and enforcement associated with alleged unfair, deceptive, and abusive acts and practices ("UDAAP") need only review the wide variety of enforcement actions by the CFPB against consumer financial services providers to gain an appreciation for the scope of this new regulatory requirement, and the importance of compliance with its requirements.

The UDAAP Regulation provides that it is unlawful for a "covered provider" to engage or have engaged in any unfair, deceptive, or abusive act or practice in connection with the offering or provision of commercial financing or another financial product or service (including the purchase of accounts receivable) to a covered entity. The regulation provides that an act is "unfair" if either:

- The act or practice causes or is likely to cause substantial injury to covered entities, the injury is not reasonably avoidable by covered entities, and the injury is not outweighed by countervailing benefits to covered entities or to competition; or
- The act or practice is unfair in accordance with Business and Professions Code section 17200 and the case law thereunder.

The UDAAP Regulation provides that an act or practice is "deceptive" if either:

- The act or practice misleads or is likely to mislead the covered entity, the covered entity's interpretation of the act or practice is reasonable under the circumstances, and the act or practice is material; or
- The act or practice is deceptive in accordance with Business and Professions Code section 17200 and the case law thereunder.

The UDAAP Regulation provides that an act is "abusive" if either:

- The act or practice interferes with the ability of the covered entity to understand a term or condition of commercial financing or another financial product or service; or

- The act or practice takes unreasonable advantage of a lack of understanding on the part of the covered entity of the material risks, costs, or conditions of the commercial financing or other financial product or service, or the inability of the covered entity to protect its interests in selecting or using commercial financing or another financial product or service, or the reasonable reliance by the covered entity on a covered provider to act in the interests of the covered entity.

The UDAAP Regulation also creates a new annual reporting requirement for covered providers, beginning in 2025, whereby on or before March 15th of each year, commercial lender and other entities providing commercial financing must file an electronic report detailing the type, number, and dollar amount of all commercial financing transactions with covered entities.

Lenders and other commercial financing institutions should immediately update their existing Unfair, Deceptive, Acts and Practices policies and procedures to account for the California specific requirements of this UDAAP Regulation. UDAAP liability is often in the eye of the beholder – i.e. – the regulator knows it when they see it – which makes compliance challenging. Penalties for violating a UDAAP can be significant, ranging from rescission or reformation of the loan or financing contract and disgorgement of all profits to civil money penalties of up to \$2,500 per violation (or even higher if the violation is considered reckless).

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