

Date of Hearing: July 1, 2024

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Timothy Grayson, Chair

SB 1286 (Min) – As Amended April 25, 2024

SENATE VOTE: 28-9

SUBJECT: Rosenthal Fair Debt Collection Practices Act: covered debt: commercial debts

SUMMARY: Expands the Rosenthal Fair Debt Collection Practices Act (Rosenthal Act) to cover commercial debts owed by specified types of debtors.

Specifically, **this bill:**

- 1) Adds “covered commercial debt” to the Rosenthal Act, subjecting persons that engage in debt collection related to a covered commercial debt to that act.
- 2) Defines the following terms:
 - a) “Covered debt” means a consumer debt or a covered commercial debt.
 - b) “Covered credit” means consumer credit or covered commercial credit.
 - c) “Covered commercial debt” and “covered commercial credit” mean money, property, or their equivalent, due or owing or alleged to be due or owing from a natural person to a lender, a commercial financing provider, or a debt buyer, as specified, by reason of a covered commercial credit transaction. “Covered commercial credit transaction” means a transaction between a person and another person in which property, services, or money, of a total value of no more than \$500,000, is acquired on credit by that person from the other person primarily for other than personal, family, or household purposes.
- 3) Provides that a debtor includes a natural person who guarantees an obligation related to a covered commercial credit transaction and does not include a corporation or limited liability company.
- 4) Replaces “consumer debt” with “covered debt” throughout the Rosenthal Act, except in provisions related to communications with a debtor’s employer, consumer debt originated by a hospital, and an incorporation by reference of provisions of specified federal law related to consumer debt collection.

EXISTING LAW:

- 1) Regulates the collection of consumer debt under the Rosenthal Act, which generally prohibits deceptive, dishonest, unfair, and unreasonable debt collection practices by debt collectors and regulates the form and content of communications by debt collectors to debtors and others. (Title 1.6C of Part 4 of Division 3 of the Civil Code, Section 1788 et seq.) The Rosenthal Act:
 - a) Defines the following terms:

- i) “Consumer debt” and “consumer credit” means money, property, or their equivalent, due or owing or alleged to be due or owing from a natural person by reason of a consumer credit transaction. The term “consumer debt” includes a mortgage debt.
 - ii) “Consumer credit transaction” means a transaction between a natural person and another person in which property, services, or money is acquired on credit by that natural person from the other person primarily for personal, family, or household purposes.
 - iii) “Debt collector” means any person who, in the ordinary course of business, regularly, on behalf of that person or others, engages in debt collection.
 - iv) “Debt collection” means any act or practice in connection with the collection of consumer debts. (Civil Code Section 1788.2)
- b) Prohibits a debt collector from the following conducts or practices, among others, when collecting or attempting to collect a consumer debt:
- i) The use or threat of physical force or violence. (Civil Code Section 1788.10)
 - ii) Threats and communications that rely on false representations. (Civil Code Section 1788.10 and 1788.13)
 - iii) Using obscene or profane language. (Civil Code Section 1788.11)
 - iv) Communicating with the debtor with such frequency as to be unreasonable, and to constitute harassment of the debtor under the circumstances. (Civil Code Section 1788.11)
 - v) Communicating unnecessarily about the debtor’s debt with the debtor’s employer or extended family. (Civil Code Section 1788.12)
- c) Requires a debt collector to provide its California debt collector license number to a consumer in specified circumstances. (Civil Code Section 1788.11)
- d) Incorporates by reference specified provisions of the federal Fair Debt Collection Practices Act into state law. (Civil Code Section 1788.17)
- e) Provides remedies to a harmed debtor in an amount equal to any actual damages sustained by the debtor as a result of violation, plus an amount of \$100 - \$1,000 if the violation was conducted willfully and knowingly by the debt collector. (Civil Code Section 1788.30)
- f) Provides a release from liability to a debt collector who cures a violation, as specified, or who shows by a preponderance of evidence that the violation was not intentional and resulted notwithstanding the maintenance of procedures reasonably adapted to avoid any such violation. (Civil Code Section 1788.30)
- 2) Provides the Debt Collection Licensing Act (DCLA) that prohibits a person from engaging in the business of the collection of consumer debt without a license and requires the Department

of Financial Protection and Innovation to administer the licensing program. (Division 25 of the Financial Code, Section 100000 et seq.)

FISCAL EFFECT: Unknown. This bill is keyed Fiscal by Legislative Counsel.

COMMENTS:

1) Purpose

According to the author:

Small businesses face many barriers in accessing capital, especially minority-owned businesses. Since the economic crash and Great Recession in 2008, many lenders have moved to require small business owners to personally guarantee their business debt. While lenders are within their right to require co-signatories, this goes against the purpose of entity formation. Although the individual is borrowing for their business, the personal guarantee exposes the individual to abusive, deceptive, or unfair debt collection practices. SB 1286 will extend the debt collection protections provided under the Rosenthal Act to individuals who have a personal guarantee on their business debt.

2) Background: Protections related to the collection of consumer debt

An assortment of federal and state laws establish consumer protections related to debt collection and debt purchasing. These laws generally do not cover commercial debt. These consumer-centered statutes include:

- The federal Fair Debt Collection Practices Act (FDCPA). In 1977, the federal government established the FDCPA to prohibit debt collectors from engaging in abusive, unfair or deceptive practices to collect debts. Violations of the FDCPA are enforceable through a private right of action or a class action, or through administrative action. Under the FDCPA, a debt collector must send a debtor written validation letters containing information such as the amount of debt and the name of the creditor to whom the debt is owed.
- The Rosenthal Act. This bill amends the Rosenthal Act, which was passed in 1977 to place reasonable limits on the kinds of activities that creditors and debt collectors can employ when collecting payments from consumers. The Rosenthal Act, like the FDCPA, prohibits deceptive, dishonest, unfair and unreasonable debt collection practices, and many of the law's provisions govern how debt collectors can interact and communicate with consumers. The law also provides a private right of action for harmed consumers.
- The Fair Debt Buying Practices Act. The Legislature passed the Fair Debt Buying Practices Act in 2013 to provide protections to consumers whose debts were sold to a debt buyer. It requires a person who buys delinquent or charged-off consumer debt to maintain certain documentation and require a debt buyer to provide disclosures to consumers when the buyer attempts to collect debts that are beyond the applicable statute of limitations. While the Fair Debt Buying Practices Act applies only to instances when the transfer of collection is structured as a sale, it also contains stronger validation requirements than the Rosenthal Act and the federal Fair Debt Collections Practices Act.

- Debt Collection Licensing Act (DCLA). SB 908 (Wieckowski), Chapter 163, Statutes of 2020, establishes a program within the Department of Financial Protection and Innovation (DFPI) to license and oversee debt collectors and debt buyers in California. While this licensing program does not add significant new requirements for these entities, the new licensing program adds a layer of regulatory oversight over them. Under the DCLA, a debt collector and debt buyer must obtain a license and must comply with both the Rosenthal Act and Fair Debt Buying Practices Act. A licensee must pay an annual fee and requires DFPI to examine a licensee for compliance.

3) Background: Commercial debt collectors

The myriad of federal and state statutes aimed at protecting consumers from debt collection harms do not apply to business debt. Generally, it is assumed that unlike a consumer, a business is more sophisticated and has greater means to evaluate commercial credit options and their associated risks. However, this assumption has started to weaken as policymakers and advocates scrutinize commercial debt collection practices.

In 2022, CFPB flagged small business debt collection issues stemming from the COVID-19 pandemic. The agency notes:

Of the estimated 31.7 million business enterprises in the country, small businesses constituted about 99.9% of all firms. Nearly 81% of those small businesses do not have paid employees. Of the business establishments with employees, the Census Bureau has identified 72.5% with 9 or fewer employees and more than half (54.4%) with fewer than 5. That suggests a level of resources and expertise for most small businesses on par with consumer borrowers rather than what may be the general perception of commercial enterprises with readily available financial resources and expertise. The result is the potential for exploitation comparative to what is encountered by consumers, without any of the protections granted to consumers by the FDCPA.¹

Congress has also explored this issue. In 2022, Rep. Lawson introduced H.R. 6814, titled the Small Business Fair Debt Collection Act, to extend FDCPA protections to small businesses with loans or obligations less than \$2.5 million. Writing in support of the measure, Small Business Majority argued that “While consumer borrowers are covered by FDCPA, small business borrowers are not. This is particularly concerning because many small business owners often use their personal finances to start and expand their businesses and will apply for credit using their personal credit, but they don’t receive the same protections as individual consumers.”

For its part, commercial debt collection industry actors make a case that responsible collectors do not engage in many of the activities barred by the FDCPA or the Rosenthal Act. For example, the Commercial Collection Agencies of America and the International Association of Commercial Collectors each publish a “Code of Ethics” with conduct rules

¹ <https://www.consumerfinance.gov/about-us/blog/protecting-families-and-honest-businesses-from-debt-collection-abuses/>

that members must follow. Examples of prohibited behavior include making false statements, threatening debtors or their vendors, and making harassing phone calls.²

4) What does this bill do?

SB 1286 extends Rosenthal Act protections to certain types of commercial debt. Specifically, Rosenthal Act would apply to money or property due or owing or alleged to be due by reason of a “covered commercial transaction,” which is a transaction that is \$500,000 or more and acquired for a reason other than personal, family, or household purposes. Moreover, a debtor as it applies to a commercial debt must be a natural person and includes a natural person who guarantees an obligation related to a commercial credit transaction.

According to the sponsors, the above parameters mean that SB 1286 will extend Rosenthal Act to two situations: (1) When a person takes out a personal loan in their own name for the business; and (2) When a person co-signs a loan taken out in the business’s name. The author’s office contends that since the Great Recession, “many lenders started requiring business owners to personally sign for their business debt. While this practice is antithetical to the purpose of entity formation, lenders are within their right to require co-signatories. However, small businesses do not have the same protections as consumers in the collection of debt.”

5) Summary of recent discussions

SB 1286 was amended in Senate Banking and Financial Institutions Committee following discussions between supporters, committee staff, and industry stakeholders. While those amendments addressed many of the earlier concerns about the bill’s scope, stakeholders have continued to debate whether certain provisions in the Rosenthal Act simply cannot work for business debt.

As an illustrative example, collection industry representatives argue that the prohibition against a collector contacting a debtor’s family member is incompatible with commercial debt because it is common for family members to work in the business. In this example, if the collector sends a payment request to the accounting department where a debtor’s family member also happens to work, have they violated SB 1286? (This issue would be addressed in amendments described in Comment #6)

As another example, the Rosenthal Act prohibits communicating to any person any list of debtors that discloses the nature or existence of a consumer debt, also referred to as “deadbeat lists,” except for reports to a consumer reporting agency. Opponents argue that these limitations, if applied to commercial debt, calls into question the ways that commercial lenders help determine the creditworthiness of business borrowers. Commercial lenders use databases or “business bureaus” run by private firms, and the Rosenthal Act’s allowance for reporting consumer credit agencies does not apply to these types of companies.

Opponents describe a scenario where John’s Pizza, LLC is provided a loan that is personally guaranteed by John. The business defaults on the loan, and John cannot be located because he has left the country. A year later, John returns and applies for a loan for John’s Tacos,

² <https://www.commercialcollector.com/wp-content/uploads/2021/10/code-of-ethics.pdf>

LLC. Opponents argue that under SB 1286, a creditor would be barred from reporting to anyone their experience with John and John's Pizza, LLC because the expansion of the Rosenthal Act to business debt bars this activity, even for an individual.

Supporters of the bill contend that in this scenario, the Rosenthal Act already allows for John's actions to be reported to a consumer reporting agency, even for a business debt, which will serve as a signal to future creditors. Generally, a person's credit score is used to determine their creditworthiness for a personal loan that is used for business purposes or for when the person co-signs the loan. SB 1286 does not change that.

As a third example, opponents also argue that the prohibition against written communication with the debtor that displays or conveys information about a commercial debt could prohibit sending invoices to the accounts receivables department. The author's response that SB 1286 allows for such invoices to be sent to a business for the business debt, but not to an individual. Moreover, this prohibition applies only when the intent of the communication is to embarrass the debtor, and it is unclear why an invoice would meet that standard.

The above disagreements reflect, in large part, a different risk analysis from the supporters and opponents. Opponents, who must comply with the Rosenthal Act, see new traps that would produce litigation or confusion. They are correct to worry about the details and the associated risks associated with expanding the Rosenthal Act to some business debts.

6) Amendments and a procedural note

The author has committed to taking the following amendments. If it is to move forward, this bill will next need to be heard in Assembly Judiciary Committee the following business day (July 2, 2024). Therefore, for process reasons, amendments will need to be taken either in Assembly Judiciary or upon returning from the Summer Recess. These amendments are meant to clarify the scope of SB 1286, make technical fixes, and respond to specific requests from creditor or collection industry representatives. Specifically:

- Clarify that SB 1286 is not intended to create an additional licensing requirement by adding (c) to Section 1788.1 as follows:

(c) Nothing in this title is intended to create or impose an additional licensing requirement under Division 25 (commencing with Section 100000) of the Financial Code on a debt collector with respect to the collection of covered commercial debt or covered commercial credit.

- Modify the definition of "debtor" in response to stakeholder feedback. Delete reference to LLCs and corporations given that "debtor" is a natural person. Specifically, modify Civ. Code Section 1788.2 (h) (2) as follows:

(2) In relation to a covered commercial ~~debt~~, debt or covered commercial credit, a "debtor" ~~includes~~ shall mean a natural person who guarantees an obligation related to a covered commercial credit transaction.

(3) A "debtor" ~~does not include a corporation or limited liability company.~~

- Narrow prohibition on communicating information regarding a covered debt to a member of debtor's family member to consumer debt. Specifically, amend Civil Code Sec 1788.12(b) as follows:

(b) Communicating information regarding a ~~covered~~ consumer debt to any member of the debtor's family, other than the debtor's spouse or the parents or guardians of the debtor who is either a minor or who resides in the same household with that parent or guardian, prior to obtaining a judgment against the debtor, except where the purpose of the communication is to locate the debtor, or where the debtor or their attorney has consented in writing to that communication.
- Make clarifying change to reflect that commercial debt collectors do not need a license. Specially, amend Section 1788.13(l) as follows:

(l) Any communication by a ~~licensed~~ collection agency to a debtor demanding money unless the claim is actually assigned to the collection agency.
- Fix an outdated reference to the California Private Protection Agency: Amend Civil Code Section 1788.18(b)(1) as follows:

(2) The debtor's written statement that the debtor claims to be the victim of identity theft with respect to the specific debt being collected by the debt collector.

(b) The written statement described in paragraph (2) of subdivision (a) shall consist of either of the following:

(1) A written statement that contains the content of the Identity Theft Victim's Fraudulent Account Information Request offered to the public by the California ~~Privacy Protection Agency~~ Office of Privacy Protection.
- Updating venue provision. Specifically, add to Civil Code Section 1788.15 the following:

(c) Notwithstanding subdivision (b), when the obligation of the debtor arises from a guaranty by the debtor of a covered commercial debt, a debt collector may collect or attempt to collect covered commercial debt by means of a judicial proceeding in the county in which the non-natural person for whose purpose the commercial debt was incurred is located.

(d) This section shall apply to all delinquent covered commercial debt sold or assigned on or after July 1, 2025.
- Make the following technical change to Civil Code Section 1788.22(a)(1):

(1) No such person shall attempt to consummate any ~~consumer~~ covered credit transaction ~~or small business credit transaction~~ thereunder knowing that credit privileges under the account have been terminated or suspended.

- Clarify that the Debt Collector Licensing Act does not apply to commercial debt or covered commercial credit, as defined by this bill. Specifically, amend Financial Code Section 100001 (c) as follows:

(c) This division shall not apply to debt collection regulated pursuant to Division 12.5 (commencing with Section 28100) or to the collection of covered commercial debt or covered commercial credit, as those terms are defined in Title 1.6C (commencing with Section 1788) of Part 4 of Division 3 of the Civil Code.

7) Prior and related legislation.

SB 1482 (Glazer) of this legislative session expands the scope of the California Licensing Law to cover specified commercial financing transactions offered to small businesses and establishes requirements and prohibitions on commercial financing providers and brokers engaged in such transactions. SB 1482 is scheduled to be heard by this committee during the same hearing as this bill.

SB 1324 (Durazo) of the 2021-22 session would have added rental debt as a consumer debt covered by the Rosenthal Act, thus requiring a landlord or third party collecting rental debt on behalf of a landlord to comply with the Rosenthal Act. The bill passed this committee, but subsequently was held by the Senate Appropriations Committee.

SB 187 (Wieckowski, Chapter 545, Statutes of 2019) provides that a mortgage debt is a consumer debt for the purposes of the Rosenthal Act and removes an exemption in the Rosenthal Act for attorneys who regularly, in the ordinary course of business, collect debts on behalf of themselves or others.

8) Support

A coalition of organizations representing consumers and small businesses, including the East Bay Community Law Center, Small Business Majority, California Low-income Consumer Coalition, and the Consumer Federation of California, argue in support of this bill. Their coalition letter states:

Since the 2008 Great Recession, many lenders started requiring business owners to personally sign for their business debt. Lenders are within their right to require co-signatories, however a personal guarantee defeats the purpose of an LLC, and it is antithetical to the purpose of entity formation.... Given the lack of access to traditional business funding and the current trend of requiring personal guarantees, the need for dignified debt collection practices for individuals who incur debt for their business is necessary as small businesses do not have the same protections as consumers in the collection of a business debt.

9) Opposition

The California Association of Collectors, California Creditor Bar Association, Electronic Transactions Association, and Receivables Management Association International, and the Small Business Finance Association are opposed to SB 1286, unless amended. Some of these submitted amendments have been agreed to by the author, as described in Comment #6. The coalition writes:

The provisions of the Rosenthal Act are ill-suited for commercial debt collection. For instance, while individual consumers have the right to demand that creditors cease contact, it is unclear under SB 1286 whom a creditor or collector may contact concerning the covered commercial debts. This ambiguity raises concerns about potential violations of privacy and confidentiality, particularly regarding the disclosure of debt details to employees handling accounts payable.

Commercial debt collection requires a tailored approach that accounts for the unique dynamics of business transactions, rather than applying regulations intended for individual consumers to commercial transactions

Additionally, a coalition that includes the California Bankers Association, the California Mortgage Bankers Association, the California Credit Union League, and the American Financial Services Association opposes this bill. Among their concerns, the coalition argues this bill should apply to smaller commercial credit transactions:

Critically, the \$500,000 threshold in Section 1788.2(o) of covered commercial loans established in SB 1286 would cover even very sophisticated and complex loans; and the measure should be tailored to protect small businesses as the proponents claim it does. Loan relationships with commercial loan customers can be complex and contain several lines of credit that would be technically covered under the Act. For example, a borrower may have \$10 million in loans with credit lines of varying amounts, including a line of credit for \$200,000 – it would cause complications for both creditors and debts alike if different rules apply for some lines within that loan and not others. It is our understanding that this type of sophisticated borrower is not the intended recipient of these protections. As such, SB 1286 should establish a \$100,000 maximum that can be owed to any one lender for these provisions to apply. In this context it is also worth noting that 1788.2(o) uses the term “value,” which is subjective and may be up for debate. To avoid uncertainty or conflict, the \$100,000 threshold needs to be tied to the time of origination of the loan, which is clear and agreed upon by both parties

Cox Automotive, on behalf of its subsidiary NextGear Capital (NGC), opposes SB 1286 and argues that the Rosenthal Act is not necessary for floorplan lending. Cox Automotive writes:

As amended, SB 1286 extends existing law prohibiting debt collectors from engaging in unfair or deceptive acts or practices in the collection of consumer debt to California small business borrowers, including motor-vehicle dealers who are sophisticated commercial borrowers. In the case of default, NGC is already obligated to act fairly pursuant to state and federal UDAAP rules and regulations (including existing California state code), making SB 1286 redundant for our operations.

REGISTERED SUPPORT / OPPOSITION:

Support

Berkeley Law & Organizing Collective
California Coalition for Community Investment
California Low-income Consumer Coalition
Cameo - California Association for Micro Enterprise Opportunity
Consumer Attorneys of California
Consumer Federation of California
Decosimo Law
East Bay Community Law Center
Housing and Economic Rights Advocates (HERA)
Ica
LA Cocina
Microenterprise Collaborative of Inland Southern California
Public Law Center
Renaissance Entrepreneurship Center
San Juan Capistrano Chamber of Commerce
Small Business Majority
Sonya Yruel Photography
The Lisa B Company

Oppose

American Financial Services Association
California Bankers Association
California Chamber of Commerce
California Community Banking Network
California Credit Union League
California Financial Services Association
California Mortgage Bankers Association
Cox Automotive, INC.

Oppose Unless Amended

California Association of Collectors, INC
California Creditors Bar Association
Electronic Transactions Association
Receivables Management Association International
Small Business Finance Association

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