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After All This Time: An Analysis of the Recent Trend to Extend Truth-in-Lending-Style Disclosures to Commercial-Financing Transactions

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ABSTRACT

The Truth in Lending Act of 1968 (TILA) was designed to protect consumers by implementing uniform disclosures for consumer financing transactions and by creating substantive consumer protections. While TILA has been amended over the past fifty years to reflect modern needs, it has always remained a consumer financing law. Over the past few years, however, states have challenged that notion by passing laws which require TILA-inspired disclosures for certain commercial-financing transactions. And at the federal level, a bill was introduced in the United States House of Representatives (House Bill) that would expand TILA to commercial-financing transactions falling below a certain threshold. This Article contends that extending consumer-financing protections to small businesses will likely have unintended negative effects, and that although neither state nor federal expansion is advisable, of the two, a uniform federal approach would be less harmful. After reviewing the commercial-financing disclosure requirements in the House Bill and in the three key states of California, New York, and North Carolina, the Article considers the effects on small businesses and consumers of an expansion of TILA and Regulation Z. The Article concludes by suggesting several revisions to ameliorate the negative impact of importing a consumer-financing disclosure regime into small-business commercial financing.

INTRODUCTION

On January 21, 2010, the Supreme Court held in *Citizens United v. Federal Election Commission* that corporations and other associations possess rights entitled to protection under the First Amendment.[1] In the

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decade that followed *Citizens United*, the notion that "corporations are people" became a catchphrase for the idea that corporate entities have certain constitutional and statutory rights.[2]

If corporate entities share certain rights in common with people, should they receive financing disclosures like those which natural persons have received in the consumer-lending context for over fifty years? States are starting to answer that question in the affirmative by passing commercial-financing disclosure laws which emulate consumer disclosure-requirements within the Truth in Lending Act of 1968 (TILA) and Regulation Z.[3]

Beginning in California, this commercial-financing-disclosure trend is sweeping the nation.[4] New York, Virginia, and Utah have all passed laws on the subject,[5] and Maryland, Missouri, New Jersey, Connecticut, and North Carolina are not far behind.[6] Furthermore, a federal bill (H.R. 6054) to expand TILA to cover small-business loans was introduced in the United States House of Representatives in 2021.[7]

This Article analyzes the laws, regulations, and proposed legislation covering commercial-financing disclosures in three key states[8] and the

1. *See* Citizens United v. FEC, 558 U.S. 310, 343 (2010).

2. *See* Kenneth Chestek, *Of Metaphors and Magic Wands: Are Corporations Really People?*, 89 MISS. L.J. 1, 12 (2019); *see also* Burwell v. Hobby Lobby Stores, Inc., 573 U.S. 682, 709 (2014) (recognizing that closely held, for-profit corporations could be entitled to religious freedom protections).

3. *See* Stephen Ornstein, *California, New York Create Disclosure Requirements for Commercial Financing Transactions*, ALSTON & BIRD (Nov. 3, 2021), https://www.alstonconsumerfinance.com/california-new-york-create-disclosure-requirements-for-commercial-financing-transactions/ [https://perma.cc/9PUR-E24J]; Consumer Credit Protection Act, Pub. L. No. 90-321, 82 Stat. 146 (1968) (codified as amended at 15 U.S.C. § 1601); Truth in Lending, 12 C.F.R. § 1026 (2019) (known as "Regulation Z").

4. *See* Brian H. Montgomery, *New CA Commercial Financing Disclosure Regulations Take Effect*, PILLSBURY (June 21, 2022), https://www.pillsburylaw.com/en/news-and-insights/california-finalizes-commercial-financing-disclosure-requirements.html [https://perma.cc/J25V-U2YX] ("California became the first state to enact legislation to impose consumer-style disclosure requirements for commercial financing transactions.").

5. *See id.*; Polo Rocha, *California Finalizes Long-Awaited Disclosures for Small-Business Loans*, AM. BANKER (June 13, 2022, 6:39 PM), https://www.americanbanker.com/news/california-finalizes-long-awaited-disclosures-for-small-business-loans [https://perma.cc/N6YP-HUNB].

6. *See* Montgomery, *supra* note 4; Rocha, *supra* note 5.

7. *See* H.R. 6054, 117th Cong. (2021). Small businesses are independently owned and operated, not dominant in their field of operations, and under the size limits established by the Small Business Administration. *See* 15 U.S.C.A. § 632(a)(1) (West 2023).

8. The states of California, New York, and North Carolina are highlighted because their commercial-lending-disclosure requirements are at different stages. California has

U.S. House and recommends revisions to better serve the interests of consumers and small businesses.[9] While businesses might be people, they do not have the same needs and interests that natural persons have with respect to financing. Thus, the rationale for regimented financial-disclosure requirements does not hold the same sway in the commercial-financing space. And in any case, an ever-increasing array of state laws is the least ideal way to obtain the desired pro-small-business and pro-consumer results these laws seek to achieve. Instead, a uniform or coordinated approach is advisable.

This Article proceeds in three parts. Part I separately reviews the legislation and regulations that have been enacted and promulgated in California and in New York and the bill proposed in North Carolina. Part II summarizes the current version of TILA and Regulation Z and compares their intended benefits with the commercial-financing disclosure requirements (or proposed requirements, as applicable) in California, New York, North Carolina, and in H.R. 6054. Finally, Part III highlights five recommendations for states and four recommendations for federal legislators and regulators, with particular focus on broadening exceptions and allowable tolerances to make commercial-financing-disclosure requirements more palatable for small businesses.

I. STATE COMMERCIAL-FINANCE DISCLOSURE LAWS, REGULATIONS, AND BILLS

To shed light on the effects of the newly required disclosures, this section considers relevant provisions in the legislation and regulations in California and New York and the proposed bill in North Carolina. Laying the groundwork for the recommendations in Part III, this section shows that the variations in the state disclosure provisions' formatting and verbiage requirements arise in several recurring areas: (1) state-specific carve-outs; (2) methods of numerical calculation and permissible toleranc-

passed a law and finalized regulations. *See* Part I.A, *infra*. New York has passed a law and is developing regulations. *See* Part I.B, *infra*. North Carolina has not passed a law yet. *See* Part I.C, *infra*. Furthermore, California is the leader in the space as the first state to introduce legislation, and all three states are important financial centers.

9. In this Article, "small business" is used in the colloquial sense to mean privately owned businesses without a dominant market share in their field of operations, unless specifically defined pursuant to a relevant statute or regulation. Whether a business is small will depend on its number of employees and revenue, which vary depending on the industry. California, New York, North Carolina, and the U.S. House have tailored their commercial-financing disclosure regulations to small businesses by only requiring disclosures for financings below a certain dollar amount, which would presumably be taken out by smaller businesses instead of larger businesses.

es; and (3) in differences in the form and timing of notice. And while the effectiveness of these disclosures will be discussed in Part II.B.2, *infra*, the nearly identical mechanics of these disclosures to those used in consumer-financing law underscores their wholesale importation by legislatures. It also suggests the shared underlying assumptions on which both regimes are premised.

A. The California Commercial-Financing Disclosure Requirements

On September 30, 2018, Senate Bill No. 1235 was signed into law, ushering in commercial-lending disclosure regulation in California (the California Law). Over four years later, on December 9, 2022, the California Law went into effect.[10] Under the California Law, a "provider" of commercial financing must disclose certain economic terms for a proposed transaction to a "recipient."[11] The recipients of commercial loans must sign the disclosure statement before receiving the funds.[12]

Subject to exceptions, provider is broadly defined as "a person who extends a specific offer of commercial financing to a recipient."[13] Exceptions from classification as a provider are available for (1) certain institutions who are already regulated (such as depositary institutions and lenders regulated under the federal Farm Credit Act of 1971), (2) *de minimis* providers who either (A) make only one commercial loan in California a year or (B) make no more than five commercial loans in California in a year if the loans are "incidental" to such person's business, and (3) technology or support service providers with no interest in the loans being made.[14] A "recipient" is more narrowly defined within the body of the definition, as a "person who is presented a specific commercial financing offer by a provider" not exceeding $500,000.[15] Furthermore, a transaction-specific exemption excludes any commercial-financing transactions secured by real property from the disclosure requirements.[16]

10. *See* CAL. FIN. CODE § 22804(c) (West 2019) (stating that "[a] provider shall not be required to comply with the disclosure requirements of this division until the final regulations are adopted by the commissioner"); CAL. CODE REGS. tit. 10, § 900(a)(24) (2022) (defining "Provider" under California's Financial Code).

11. *See* CAL. FIN. CODE § 22802(a).

12. *See id.*

13. *See id.* § 22800(m).

14. *See* CAL. CODE REGS. tit. 10, § 900(a)(24).

15. *See* CAL. FIN. CODE § 22800(n). A recipient-focused exclusion is available if a recipient is a vehicle dealer, a vehicle-rental company, or an affiliate of either of the foregoing (so long as the financing is for at least $50,000). *Id.* § 22801(d).

16. *See id.* § 22801(c).

Unless an exception or exemption applies, providers must disclose to recipients (1) the total amount of funds provided; (2) the total dollar cost of the financing; (3) the term or estimated term; (4) the method, frequency, and amount of payments; (5) a description of prepayment policies, and (6) the annualized rate of the total cost.[17] Clause (7)—the annualized rate of the total cost—will not be required on or after January 1, 2024.[18] With respect to factoring and asset-based lending, where the advance amounts will vary based on circumstances outside of the provider's control, such as the recipient's accounts receivable, providers can satisfy their disclosure obligations by describing the "general terms and conditions" and listing the specific disclosure items by way of an "example of a transaction that could occur under the general terms and conditions for a given amount of accounts receivable . . . ."[19]

The agency in charge of promulgating and enforcing the disclosure regulations is the California Department of Financial Protection and Innovation (previously the California Department of Business Oversight and hereinafter DFPI).[20] In its fifth iteration of implementing regulations, DFPI adopted final regulations which took effect December 9, 2022.[21] DFPI's final regulations (hereinafter, the California Final Regulations) require specific verbiage and formatting for the disclosures mandated by the California Law,[22] some of which are described below.

The disclosure's formatting and content requirements vary depending on if the proposed financing is a closed-end transaction, open-end credit transaction, factoring arrangement, sales-based financing, lease financing, general asset-based financing, or another type of commercial-financing transaction.[23] The specificity of the formatting even extends to the ratios for columns in disclosure tables (which remain the same for the different transaction types at 3:3:7) and the number of rows and columns in such

17. *See id.* § 22802(b).

18. *See* 2018 Cal. Legis. Serv. Ch. 1011 (S.B. 1235) (West).

19. *See* CAL. FIN. CODE § 22803(a); *see also id.* § 22800(i) (factoring transactions); *id.* § 22800(c); CAL. CODE REGS. tit. 10, § 900(a)(4) (asset-backed lending transactions).

20. CAL. FIN. CODE § 22804; *see also Department of Financial Protection and Innovation History*, CAL. DEP'T OF FIN. PROT. & INNOVATION, https://dfpi.ca.gov/history/ [https://perma.cc/2GTW-FJNG] (last updated Mar. 11, 2022, 12:08 PM).

21. *See* CAL. CODE REGS. tit. 10, §§ 900–956.

22. *See, e.g.*, *id.* §§ 901(a)(1), (3); 910(a)(2); 911(a)(2); 912(a)(2); 913(a)(2); 914(a)(2).

23. *See id.* §§ 910–917; *see also id.* § 900(a)(9) (closed-end transactions); CAL. FIN. CODE § 22800(f) (open-end credit plans); CAL. CODE REGS. tit. 10, § 900(a)(28) (sales-based financing); CAL. FIN. CODE § 22800(j)(1) (lease financing).

disclosure tables (which vary depending on the transaction type).[24] When "short explanation[s]" are permitted or required, the explanation must be no more than sixty words,[25] or slightly longer than the characters permitted in a tweet.[26] Disclosures must be presented "as a separate document from any other contract, agreement, or other disclosure document provided to the recipient . . . ."[27]

Furthermore, the California Final Regulations include guidance regarding the calculation of numerical values in the required disclosures in the California Law, specifically with respect to when the required disclosures vary throughout the term of the financing and the point in time that is used for such calculations.[28] For example, the California Final Regulations specify that when calculating the costs of financing and annualized rates for transactions that have floating interest rates, providers should assume that the applicable interest rate will be the rate in effect at the time of the disclosure for "any period when the interest rate cannot be calculated in advance."[29] Similarly, if payment amounts will vary throughout the course of the term—and such payments are impossible to calculate in advance—the initial payment will be included in the payments section of the disclosure table.[30] Although the California Law specifically excludes the annual percentage rate from required disclosures after January 1, 2024, the California Final Regulations do not acknowledge that distinction.[31] Rather, the California Final Regulations require the inclusion of the annual percentage rate within the disclosure tables indefinitely.[32]

Any deductions by the provider from the loan balance prior to release—such as fees, deductions, or third-party pay-offs—must be specially disclosed by a separate "Itemization of Amount Financed" table.[33] The

24. *See, e.g.*, CAL. CODE REGS. tit. 10, §§ 901, 910–916.

25. *Id.* § 901(a)(9).

26. *See generally Counting Characters*, TWITTER, https://developer.twitter.com/en/docs/counting-characters [https://perma.cc/7JNW-RR8M] ("In most cases, the text content of a Tweet can contain up to 280 characters . . . .").

27. CAL. CODE REGS. tit. 10, § 901(a)(6) (stating the disclosures may be sent or transmitted in "a package that contains other documents").

28. *See id.* §§ 910–916, 943(b).

29. *Id.* § 901(a)(13).

30. *See id.* §§ 910(a)(6), 911(a)(7).

31. *Compare* CAL. FIN. CODE § 22802 (West 2019), *and* 2018 Cal. Legis. Serv. Ch. 1011 (S.B. 1235) (West), *with* CAL. CODE REGS. tit. 10, §§ 910(a)(3), 911(a)(4), 912(a)(3), 914(a)(3), 916(a)(4), 917(a)(3).

32. *See* CAL. CODE REGS. tit. 10, §§ 910(a)(3), 911(a)(4), 912(a)(3), 914(a)(3), 916(a)(4), 917(a)(3).

33. *Id.* § 956(a).

Itemization of Amount Financed table is in addition to the requirement to break out the amount disbursed from the amount financed in the main disclosure table.[34] If the disbursement amount may change, providers must include a "short explanation" highlighting that the funds paid directly to the recipient are subject to change as a result of the amount due to third parties.[35]

When providers are determining if an offer is below the thresholds for classifying a potential borrower as a recipient, previous distributions (that have been repaid) are not included in the calculation of the approved credit limit for open-end or asset-based lending transactions.[36] The California Final Regulations are silent with respect to whether previous tranches of a closed-end financing transactions are included when determining the amount financed.[37]

The disclosure statements can only have inaccuracies with a margin of error referred to as an "allowable tolerance."[38] A provider will be considered to be in compliance if the annual percentage rate disclosed is: (1) no more than 0.125% lower than the actual annual percentage rate; (2) no more than 0.25% lower than the actual percentage rate if such transaction has "multiple advances, irregular payment periods, or irregular payment amounts[,]" or (3) "[t]he percentage difference between" the actual percentage rate and the percentage rate disclosed is 2.5% or less.[39] Additionally, providers will not be penalized for inadvertent inaccuracies that are appropriately adjusted in the terms of the financing, as long as the adjustment occurs within sixty days of discovering the inaccuracy and prior to the initiation of an action regarding the error.[40] In keeping with the theme of erring on the side of disclosing a higher cost of financing, providers will remain in compliance if they disclose costs that exceed what a provider

34. *See id.* §§ 910(a)(2), 911(a)(3), 912(a)(2), 914(a)(2), 916(a)(3), 917(a)(2).

35. *Id.* § 910(a)(2).

36. *See id.* §§ 900 (a)(1)–(3). Recipient exceptions are available if a $50,000 threshold for vehicle dealers is met or a $500,000 threshold for all other borrowers is met. *See* CAL. FIN. CODE §§ 22800(n), 22801(d).

37. *See* CAL. CODE REGS. tit. 10, §§ 900–956.

38. *See id.* § 955.

39. *See id.* §§ 955(a)(1)–(3) (stating that the percentage difference between the actual percentage rate and the percentage rate disclosed shall be calculated as follows: "The percentage difference shall be calculated as follows: The annual percentage rate disclosed pursuant to sections 910 through 917 shall be subtracted from the annual percentage rate determined in accordance with subdivision (a) of section 940, and the resulting difference shall be divided by rate disclosed pursuant to sections 910 through 917 and multiplied by 100.").

40. *Id.* § 955(b).

would be required to disclose under the California Law and California Final Regulations.[41]

With respect to enforcement, the California Law states that after the effective date of the regulations, the DFPI commissioner may examine and enforce the regulations against providers "licensed under the California Financing Law . . . ."[42] A notable exemption from the licensing requirement is available for "commercial bridge loan[s]" made by "venture capital compan[ies.]"[43] Within Division Nine of the California Financial Code, a venture capital company is defined as an entity whose primary business purpose is "promoting economic, business, or industrial development through venture capital investments or the provision of financial or management assistance to operating companies."[44] In addition, venture capital companies must maintain at least 50% of their assets in "venture capital investments" and hold a "material equity interest" in the specific operating company in question.[45] To qualify as a commercial bridge loan, the commercial loan must (1) have a principal amount of at least $5,000, (2) have a maturity date of three years or less, (3) be made in connection with an existing "or in bona fide contemplation of, an equity investment[,]" (4) be secured, if at all, by only business assets (not to include real property), and (5) be "subject to the implied covenant of good faith and fair dealing . . . ."[46] The California Law is silent with respect to enforcement against providers who are not licensed under the California Financing Law.[47]

In sum, the California Law and California Final Regulations create numerous disclosure requirements for commercial lending providers in California. Their strict specificity, structural requirements, and formatting rules are unnecessarily burdensome for providers given that the marginal benefit to borrowers is only the disclosure of information that is limited to a specific point in time.

B. New York Commercial-Financing Disclosure Requirements

On December 23, 2020 (a little over two years after California's commercial-financial disclosure law was approved),[48] New York threw its

41. *Id.* § 955(c).
42. CAL. FIN. CODE § 22805 (West 2019).
43. *Id.* § 22062(a)(1).
44. *Id.* § 22062(b)(1)(A).
45. *Id.* § 22062(b)(1)(B).
46. *Id.* §§ 22062(b)(3)(A)–(D).
47. *See id.* § 22805.
48. *See id.*

hat into the ring of commercial-finance disclosure with the passage of Senate Bill 5470-B.[49] Less than two months after New York initiated its commercial-finance disclosure regime, Senate Bill 898 and Senate Bill 5470-B (together, the New York Law) were approved, amending certain provisions of the commercial-finance disclosure framework.[50] The New York Law officially became effective on January 1, 2022.[51] Notwithstanding the New York Law's effective date, the Superintendent of the Department of Financial Services, the entity responsible for enforcing the New York Law, issued guidance on December 31, 2021, indicating that the obligations of the New York Law would not arise until final regulations are effective.[52] Final regulations (hereinafter, the New York Final Regulations) were published on February 1, 2023, with a compliance date set for August 1, 2023.[53]

As with the California Law, the New York Law will require "provider[s]" of commercial financing to deliver certain disclosure information when an offer is extended to "recipient[s]."[54] The New York Law requires a recipient to sign the disclosure information before proceeding any further with the commercial-financing transaction application; whereas, the California Law only requires a signature "[p]rior to consummating" the transaction.[55] However, in the New York Final Regulations, the signature requirements mirror the California Law and California Final Regulations, only requiring a signature for consummated agreements.[56]

A provider is defined in the New York Law as "a person who extends a specific offer of commercial financing to a recipient."[57] An individual who solicits and presents specific offers on behalf of a third party, such as a broker, will also be considered a provider under the New York Law, unless such individual is otherwise exempt.[58] The New York Law aligns with the California Law with respect to provider exceptions for institutions

49. *See* 2020 N.Y. Sess. Laws Ch. 369 (S. 5470-B) (McKinney).

50. *See* S. 898, 2021–2022 Leg. Sess. (N.Y. 2021).

51. *See id.*

52. N.Y. Dep't of Fin. Serv., Regulatory Impact Statement for the Addition of a New Part 102 to 23 NYCRR, https://www.dfs.ny.gov/system/files/documents/2023/01/rp_23nycrr102_sapa_20230118.pdf [https://perma.cc/8SES-3WU7].

53. *See* N.Y. COMP. CODES R. & REGS. tit. 23, § 600.25 (2023); 2023-5 N.Y. Reg. 1 (Feb. 1, 2023).

54. *See* N.Y. FIN. SERV. §§ 801(h)–(i), 803–807 (McKinney 2022).

55. *See id.* § 809; CAL. CODE REGS. tit. 10, § 920(a) (2022).

56. *See* N.Y. COMP. CODES R. & REGS. tit. 23, § 600.18; CAL. CODE REGS. tit. 10, § 920(a); CAL. FIN. CODE § 22802(a) (West 2019).

57. N.Y. FIN. SERV. § 801(h).

58. *See id.*

that are already regulated (such as depositary institutions and lenders regulated under the Farm Credit Act of 1971) and technology-service providers who will not be purchasing any interest in the commercial financing.[59] As in the California Law, the New York Law offers a *de minimis* provider exception.[60] New York's *de minimis* exception is more generous than California's, exempting persons who make no more than five commercial-financing transactions in New York annually, without any requirement that the loans be incidental to such person's business.[61]

A "recipient" is defined under the New York Law as "a person who applies for commercial financing and is made a specific offer of commercial financing by a provider."[62] The New York definition of recipient also includes the authorized representatives (other than brokers) of potential commercial borrowers.[63] While the California Law exempts commercial-financing offers exceeding $500,000, the New York Law applies to commercial-financing transactions in amounts equal to or less than $2,500,000.[64] With respect to transaction-specific exemptions, the New York Law mirrors the California Law in exempting commercial-financing transactions which are secured by real property.[65] Additionally, the New York Law has a transaction-specific exemption for financing arrangements which would be considered leases under section 2A-103 of the Uniform Commercial Code (UCC).[66]

Unless the provider, recipient, or transaction qualifies for an exemption, providers must disclose to recipients (1) the total or maximum amount of the financing and the amount disbursed after any fees are deducted or withheld; (2) the finance charge (which is the cost of financing, expressed as a dollar amount); (3) the annual percentage rate; (4) the total repayment amount; (5) the term (or estimated term); (6) the payment

59. *See id.* §§ 802(a)–(c); CAL. FIN. CODE §§ 22801(a)–(b); CAL. CODE REGS. tit. 10, § 900(a)(24).

60. *See* N.Y. FIN. SERV. § 802(f); CAL. FIN. CODE § 22801(e).

61. *See* N.Y. FIN. SERV. § 802(f); CAL. FIN. CODE § 22801(e).

62. N.Y. FIN. SERV. § 801(i). Under the New York Final Regulations, recipient includes "all other recipients that control, are controlled by, or are subject to the common control of the recipient, if all such recipients receive the single offer of commercial financing simultaneously." N.Y. COMP. CODES R. & REGS. tit. 23, § 600.1(ae) (2023). As in the California Law, exceptions are available under the New York Law if a recipient is a vehicle dealer, a vehicle rental company, or an affiliate of either of the foregoing (so long as the financing is for $50,000). CAL. FIN. CODE § 22801(d); N.Y. FIN. SERV. § 802(h).

63. *See* N.Y. FIN. SERV. § 801(i).

64. CAL. FIN. CODE § 22800(n); N.Y. FIN. SERV. § 802(g). The utility of the thresholds is addressed in Part II.B.2.

65. N.Y. FIN. SERV. § 802(d); CAL. FIN. CODE § 22801(c).

66. *See* N.Y. FIN. SERV. § 802(e).

amounts; (7) a description of potential fees and charges not included in the finance charge (such as late payment fees); (8) any prepayment fees, and (9) a description of collateral requirements and security interests.[67] Such disclosures are required for closed-end financing, open-end financing, sales-based financing, factoring financing, and other forms of commercial financing.[68] The methods of calculation for the nine disclosure requirements vary slightly depending on the type of transaction.[69] For example, the total repayment amount may be an estimate for open-end financing, with providers assuming the maximum amount is drawn and held for the duration of the term.[70]

New York legislators had the benefit of seeing California's initial draft of their proposed regulations (initially published on September 11, 2020) prior to passing the New York Law.[71] Consequently, the New York Law provides greater detail regarding the substance of the disclosures than is present in the California Law. For example, the California Law simply states that providers must disclose the "total amount of funds provided" or the "amount financed."[72] On the other hand, the New York Law specifies that the amount (or maximum amount, if applicable) of financing and the disbursement amount, if any fees are deducted from the disbursement, must be disclosed.[73]

The Superintendent is responsible for promulgating regulations consistent with the purpose of the New York Law and appropriate for its "effective administration," including regulations regarding the calculation of metrics and formatting of the disclosures.[74] As with the California Final Regulations, the New York Final Regulations mandate specific verbiage and formatting requirements for the New York Law disclosures.[75]

67. *See* N.Y. FIN. SERV. §§ 803–807.

68. *See id.* § 801(d) (closed-end financing); *id.* § 801(c) (open-end financing); *id.* § 801(j) (sales-based financing); *id.* § 801(a) (factoring transactions).

69. *See id.* §§ 803–807.

70. *See id.* § 805(d).

71. *See Notice of Fourth Modifications to Proposed Regulations Under Div. 9.5 of Cal. Fin. Code Pro 01/18*, CAL. DEP'T OF FIN. PROT. & INNOVATION (Nov. 5, 2021), ttps://dfpi.ca.gov/wpcontent/uploads/sites/337/2021/11/Notice-of-Fourth-Modifications.pdf [https://perma.cc/LD7V-B747]; 2020 N.Y. Sess. Laws Ch. 369 (S. 5470-B) (McKinney) (stating that the New York Law was approved on December 23, 2020).

72. CAL. FIN. CODE §§ 22802(b)(1), 22803(a)(1) (West 2019).

73. *See* N.Y. FIN. SERV. § 804(a).

74. N.Y. FIN. SERV. § 811.

75. *See* CAL. CODE REGS. tit. 10, §§ 901(a)(1)–(3), 910(a)(2), 911(a)(2), 912(a)(2), 913(a)(2), 914(a)(2)(2022); N.Y. COMP. CODES R. & REGS. tit. 23, § 600.5 (2023).

Just as disclosure tables differ under the California Final Regulations based on the type of financing, formatting and content requirements vary under the New York Final Regulations depending on whether the proposed financing is a closed-end transaction, open-end credit plan, factoring arrangement, sales-based financing, lease financing, general asset-based financing, or any other classification of commercial-financing transaction.[76] The ratios for columns in disclosure tables (which remain the same for the different transaction types) specified in the New York Final Regulations align with the 3:3:7 ratio promulgated in the California Final Regulations.[77] The number of rows and columns required in the New York disclosure tables (which vary depending on the transaction type) differ from the number of rows and columns specified in the California Final Regulations due to an additional row for collateral requirements, which must be included in New York disclosure tables.[78] The Superintendent set the word limit for "short explanation[s]" at sixty words, which mirrors the California Final Regulations.[79] Unfortunately for commercial lending providers, they cannot create a form disclosure table which would cover required disclosures from every state because both the California Final Regulations and the New York Final Regulations require their state's required disclosures to be listed on a "separate document from any other contract, agreement, or other disclosure document . . . ."[80] However, the New York Final Regulations specify that an electronically transmitted "separate document" may appear in the same attachment or link if there are page breaks.[81]

As in the California Final Regulations, the New York Final Regulations supplement the New York Law with respect to the calculation of the numerical values in the required disclosures, with a particular focus on when the required disclosures would vary throughout the term of the financing.[82] For example, the New York Final Regulations specify that providers shall assume the applicable interest rate in effect at the time of

76. *See* CAL. CODE REGS. tit. 10 §§ 910–916; N.Y. COMP. CODES R. & REGS. tit. 23, §§ 600.6–.16.

77. *See* CAL. CODE REGS. tit. 10, § 901(a)(8); N.Y. COMP. CODES R. & REGS. tit. 23, § 600.5(g).

78. *See* CAL. CODE REGS. tit. 10, §§ 910–916; N.Y. COMP. CODES R. & REGS. tit. 23, §§ 600.6, .10–.16.

79. CAL. CODE REGS. tit. 10, § 901(a)(9); N.Y. COMP. CODES R. & REGS. tit. 23, § 600.5(h).

80. CAL. CODE REGS. tit. 10, § 901(a)(6); N.Y. COMP. CODES R. & REGS. tit. 23, § 600.5(e).

81. *See* N.Y. COMP. CODES R. & REGS. tit. 23, § 600.5(e).

82. *See id.* §§ 600.2, .6, .10–.16.

the disclosure, continuing throughout the term for fluctuating floating rates that cannot be "calculated in advance . . . ."[83] Relatedly, if payments vary with fluctuations in the interest rate, and therefore cannot be calculated in advance, providers are instructed to list the initial payment that would be due in the payment section of the required disclosures.[84]

In addition to breaking out the disbursement amount from the amount financed in the main disclosure table, the New York Final Regulations implemented California's requirement to have a separate "Itemization of Amount Financed" table showing the flow of funds.[85] Likewise, if third parties must be paid with the amount financed, providers must include a "short explanation[,]" highlighting that the funds paid directly to the recipient are subject to change as a result of the amount due to third parties.[86]

When providers are determining if an offer is below the $2,500,000 threshold—for exempted commercial-financing transactions—previous distributions (that have been repaid) are not included in the calculation of the approved credit limit for factoring transactions.[87] Additionally, as in the California Final Regulations, the New York Final Regulations carve out repaid distributions with respect to asset-based lending transactions and open-end financing when determining if the dollar-based exclusion is met.[88] The amount actually financed is used in all other types of transactions.[89]

In alignment with the California Final Regulations, the New York Final Regulations built in allowable tolerances, exempting minor inaccuracies in the disclosure statements.[90] As in California, a provider will be considered to be in compliance if the annual percentage rate disclosed is within certain small margins of error of the actual annual percentage

83. *See id.* § 600.2(b). This mirrors the California Final Regulations. *See* CAL. CODE REGS. tit. 10, § 901(a)(13).

84. *See* N.Y. COMP. CODES R. & REGS. tit. 23, §§ 600.10(f), .11(g). This mirrors the California Final Regulations. *See* CAL. CODE REGS. tit. 10 §§ 910(a)(6), 911(a)(7).

85. *See* CAL. CODE REGS. tit. 10, §§ 956(a), (b)(1)–(2); N.Y. COMP. CODES R. & REGS. tit. 23, § 600.17.

86. *See* N.Y. COMP. CODES R. & REGS. tit. 23, §§ 600.10–.12, .15–.16. This mirrors the California Final Regulations. CAL. CODE REGS. tit. 10, § 956(a)(3).

87. *See* N.Y. COMP. CODES R. & REGS. tit. 23, §§ 600.1(c), .19(c).

88. *See* CAL. CODE REGS. tit. 10, §§ 900(a)(3), 921; N.Y. COMP. CODES R. & REGS. tit. 23, §§ 600.1(d), .19.

89. *See* N.Y. COMP. CODES R. & REGS. tit. 23, § 600.19(d).

90. *See* CAL. CODE REGS. tit. 10, § 955; N.Y. COMP. CODES R. & REGS. tit. 23, § 600.4(a).

rate.[91] Providers will also not be penalized for inadvertent inaccuracies that are appropriately adjusted as long as the adjustment occurs within sixty days of discovering the inaccuracy and prior to the initiation of an action regarding the error.[92] Highlighting the preference for overestimating costs, New York providers will remain in compliance if they disclose costs that exceed what a provider would be required to disclose under the New York Final Regulations.[93]

With respect to enforcement, the New York Law states that upon finding a violation, the Superintendent may assess civil penalties in an amount not to exceed $2,000 for each violation or $10,000 for each willful violation.[94] If the New York Law was knowingly violated, the Superintendent may order restitution, permanent injunctions, preliminary injunctions, or other additional relief.[95]

In sum, New York has followed California in many respects but has deviated with respect to certain exceptions and exemptions, such as the thresholds for the *de minimis* providers and large transactions. As in California, the New York requirements impose strict and specific disclosure-reporting requirements. These requirements are burdensome and are not outweighed by the benefit to recipients of receiving disclosure information that is limited to a specific point in time.

C. North Carolina Commercial-Financing Disclosure House Bill

North Carolina began experimenting with commercial-financing disclosures when House Bill 969 (hereinafter, the North Carolina Bill) was introduced in the North Carolina House of Representatives on May 11, 2021.[96] Unlike in California and New York, experimentation is all North

91. In California, a provider complies if the annual percentage rate disclosed is (1) no more than 0.125% lower than the actual annual percentage rate; (2) no more than 0.25% lower than the actual percentage rate if such transaction has multiple advances, irregular payment periods, or irregular payment amounts, or (3) the percentage difference between the actual percentage rate and the percentage rate disclosed is 2.5% or less. CAL. CODE REGS. tit. 10, § 955(a); N.Y. COMP. CODES R. & REGS. tit. 23, § 600.4(a) (stating that the percentage difference between the actual percentage rate and the percentage rate disclosed shall be calculated as follows: "The annual percentage rate disclosed pursuant to section 600.3(a) shall be subtracted from the annualized rate determined in accordance with section 600.3(b), and the resulting difference shall be divided by rate disclosed pursuant to section 600.3(a) and multiplied by 100.").

92. N.Y. COMP. CODES R. & REGS. Tit. 23, § 600.4(b).

93. *See id.* § 600.4(c).

94. N.Y. FIN. SERV. § 812(a) (McKinney 2022).

95. *Id.* § 812(b).

96. H.B. 969, 2021 N.C. Gen. Assemb., Reg. Sess. (N.C. 2021).

Carolina has done so far with respect to commercial-financing disclosure regulation.[97] Given the North Carolina Bill was never passed, and in fact did not make it out of committee, regulations in North Carolina are not available for examination.[98]

The sponsors of the North Carolina Bill generally followed the example of New York, but the Bill (1) mirrored the California Law regarding the threshold for exempting larger transactions; (2) chose slightly different thresholds for when a signature is required; (3) omitted a borrower-specific exception for vehicle dealers, and (4) added registration requirements for lenders.[99] If the North Carolina Bill had been passed, "covered lender[s]" would have been required to deliver certain disclosure information to "borrower[s]" in North Carolina when extending commercial-financing offers.[100] Pursuant to the North Carolina Bill, borrowers would have been required to sign the disclosures before the covered lenders could proceed with the transaction.[101]

Under the North Carolina Bill, covered lenders include persons (whether or not registered pursuant to North Carolina's financial-services regulations) who extend specific offers of commercial financing to borrowers on their own behalf or on behalf of a third party.[102] As in California and New York, covered lender exceptions would have been available for (1) regulated entities (such as financial institutions and lenders regulated under the Farm Credit System), (2) *de minimis* covered lenders, and (3) technology service providers who will not be purchasing any interest in the commercial financing.[103] The *de minimis* exception would have matched the New York Law, covering persons who make no more than five commercial-financing transactions in North Carolina annually.[104] A transaction-specific exemption would have been available for transactions

97. *See id.*

98. *See id.*

99. *See id*. §§ 53-442 to -450; Part I.A–B, *supra*.

100. H.B. 969 §§ 53-443 to -447.

101. *See id.* § 53-449(a). The North Carolina Bill differs from the "prior to consummating" standard in the New York Final Proposed Regulations and California Final Regulations." *See* N.Y. COMP. CODES R. & REGS. Tit. 23, § 600.18; CAL. CODE REGS. tit. 10, § 920 (2022); *but see* N.Y. FIN. SERV. § 809 (McKinney 2022) (requiring signature "before authorizing the recipient to proceed further with the commercial financing transaction application").

102. *See* H.B. 969 § 53-441(6).

103. *Id.* §§ 53-442(a)–(b); *see* N.Y. FIN. SERV. §§ 802(a)–(c), (f); CAL. FIN. CODE §§ 22801(a)–(b), (e) (West 2019); CAL. CODE REGS. tit. 10, § 900(a)(24).

104. *See* H.B. 969 § 53-442(a)(3); N.Y. FIN. SERV. § 802(f).

secured by real property, just as in California and New York.[105] The North Carolina Bill's sponsors chose to align the transaction-amount exemption with the California Law, exempting transactions exceeding $500,000.[106] As in New York, a transaction-specific exemption would have been available for leases.[107]

Following the New York Law, unless a covered lender or transaction qualified for an exemption or exception, covered lenders under the North Carolina Bill would have been required to disclose to borrowers (1) the total or maximum amount of the financing and the amount disbursed after any fees are deducted; (2) the finance charge (which is the cost of financing, expressed as a dollar amount); (3) the annual percentage rate; (4) the total repayment amount; (5) the term (or estimated term); (6) the payment amounts; (7) a description of potential fees and charges not included in the finance charge (such as late-payment fees); (8) any prepayment fees, and (9) a description of collateral requirements and security interests.[108] Just as in New York, such disclosures would have been required for closed-end financing, open-end financing, sales-based financing, factoring financing, and all other forms of commercial financing, with the methods of calculation for the disclosures varying slightly based on the transaction type.[109] As in New York and California, the aforementioned disclosures would have needed to be on a document "separate from all other information to be signed by the borrower."[110]

In addition to the specified disclosures, the North Carolina Bill would have required covered lenders to complete a registration process.[111] The registration would have been administered through "the Nationwide Multistate Licensing System and Registry."[112] A covered lender would have then been required to correct or amend their registration information if it became materially inaccurate or incomplete.[113]

With respect to enforcement, the North Carolina Bill would have authorized the North Carolina Commissioner of Banks (the Commissioner)

105. H.B. 969 § 53-442(c)(1); N.Y. FIN. SERV. § 802(d); CAL. FIN. CODE § 22801(c).

106. H.B. 969 § 53-442(c)(2); CAL. FIN. CODE § 22800(n).

107. H.B. 969 § 53-442(c)(3); N.Y. FIN. SERV. § 802(e).

108. *See* H.B. 969 §§ 53-443 to -447; N.Y. FIN. SERV. §§ 803–807.

109. *See* H.B. 969 §§ 53-443 to -447; N.Y. FIN. SERV. §§ 803–807; *see also* H.B. 969 § 53-441(2) (closed-end financing); *id.* § 53-441(11) (open-end financing); *id.* § 53-441(13) (sales-based financing); *id.* § 53-441(7) (factoring transactions).

110. *Id.* § 53-449(a); *see* CAL. CODE REGS. tit. 10, § 901(a)(6) (2022); N.Y. COMP. CODES R. & REGS. tit. 23, § 600.5(e) (2023).

111. *See* H.B. 969 § 53-450(a).

112. *See id.* § 53-450(b).

113. *See id.* § 53-452.

to conduct examinations of covered lenders.[114] Costs and expenses of such examinations would have been paid for by the covered lenders unless the Commissioner were to waive the reimbursement requirement in "unusual circumstances and in the interest of justice . . . ."[115] To assist in enforcement, borrowers would have been able to send complaints to the Commissioner.[116] The statutory fines for non-compliance in the North Carolina Bill would have aligned with the New York Law, with a $2,000 fine for each violation or a $10,000 fine for each willful violation.[117] The Commissioner would have also been authorized to "[r]evoke, suspend, or refuse to renew a covered lender's registration" or to "[o]rder a covered lender to cease and desist from providing commercial financing."[118]

In sum, North Carolina is evaluating the advisability of a commercial-financing disclosure regime. While no law has yet been passed in North Carolina, the North Carolina Bill seems to indicate that with a few variations it would follow in North York's footsteps. However, for the reasons outlined above, it is not advisable for the Tar Heel State to enact laws and regulations like those implemented in California and New York.

II. THE VALUE OF COMMERCIAL-FINANCING DISCLOSURE REQUIREMENTS COMPARED TO THE CURRENT TRUTH IN LENDING ACT AND REGULATION Z

A. The Truth in Lending Act and Regulation Z

The Truth in Lending Act (TILA) was enacted on May 29, 1968, with Regulation Z making it effective only a year later.[119] The purpose of TILA was to safeguard consumers by assuring "a meaningful disclosure of credit terms . . . ."[120] The statement of purpose in Regulation Z echoes that sentiment and also adds that substantive protections are included within Regulation Z, such as certain recission rights, resolution procedures for

114. *See id.* § 53-453(a).

115. *Id.* § 53-453(b).

116. *See id.* § 53-454.

117. *See id*. § 53-457(a)(3); *see* N.Y. Fin. SERV. § 812(a) (McKinney 2022).

118. H.B. 969 §§ 53-457(a)(1)–(2).

119. *See* Consumer Credit Protection Act, Pub. L. No. 90-321, 82 Stat. 146 (1968) (codified as amended at 15 U.S.C. § 1601); Truth in Lending, 12 C.F.R. § 1026 (2019); FED. RSRV. BD., TRUTH IN LENDING ACT (Apr. 20, 2018), https://www.federalreserve.gov/supervisionreg/caletters/CA%2018-3%20attachment%20TILA%20Exam%20Procedures%20Final%20(April%202018).pdf [https://perma.cc/Y6DN-H3XZ] [hereinafter *TILA FRB Summary*].

120. *See* Consumer Credit Protection Act § 102.

billing disputes, limitations on certain credit card charges, and limitations on certain acts and practices with respect to home mortgages.[121] These protections, however, are not extended to all consumers.[122] Transactions over a certain dollar threshold, adjusted annually, are carved out of Regulation Z unless the transaction is secured by the consumer's home or a private education loan.[123] In 2023, the threshold for exemption under Regulation Z is $66,400.[124]

Throughout their history, spanning over five decades, TILA and Regulation Z have been amended numerous times.[125] A number of those amendments were aimed at implementing consumer protection regulations that go beyond the scope of mere disclosure, adding substantive protections for consumers.[126] In spite of numerous amendments, credit extensions to corporate entities or for commercial purposes are still generally not included within TILA and Regulation Z, the only exception being that credit card issuers must comply with certain issuance and unauthorized-use requirements, even if the credit card will be used for a business purpose.[127] In keeping with the trend in the states, however, H.R. 6054 was introduced in the U.S. House, which would expand TILA to cover commercial-financing transactions, with principal amounts equal to or less than $2,500,000, extended to "small business[es]."[128] H.R. 6054 would also, if passed, require disclosures for small-business commercial financing, similar to the requirements being discussed at the state level, such as (1) the financing amount; (2) annual percentage rate; (3) payment amounts; (4) the term; (5) the finance charge; (6) prepayment charges, and

121. *See* 12 C.F.R. § 1026.1(b).

122. *See generally id.* § 1026.3 (describing exempt transactions).

123. *See id.* § 1026.3(b).

124. *See id.* § 1026.3(b)(1)(i).

125. *See TILA FRB Summary*, *supra* note 119, at 1.

126. *See id.* at 1–3. Specifically, the change applied protections to a newly defined category of "higher-priced mortgage loans" (HPML) that includes virtually all closed-end subprime loans secured by a consumer's principal dwelling." *Id.* at 1. "The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act) amended TILA to include several provisions that protect the integrity of the appraisal process when a consumer's home is securing the loan." *Id.* at 3.

127. *See id.* at 8; Truth in Lending, 12 C.F.R. § 1026.3(a) (2019).

128. H.R. 6054, 117th Cong. §§ 191(11), 192 (2021). Small businesses are independently owned and operated, not dominant in their field of operations, and under the size limits established by the Small Business Administration. *See* 15 U.S.C.A. § 632 (West 2023).

(7) collateral requirements.[129] As of the date of this publication, H.R. 6054 has not progressed from the committee stage.[130]

As with the California Law and Final Regulations, the New York Law and Final Regulations, and the North Carolina Bill (hereinafter, the Specified State Legislation), rules vary in Regulation Z depending on the type of transaction.[131] Regardless of the type of transaction, the finance charge and annual percentage rate are "central" to the uniform disclosures which TILA sought to implement.[132] Examples of other items which must be disclosed under Regulation Z (depending on the transaction type and circumstances) include (1) the amount financed; (2) payment schedules; (3) prepayment penalties; (4) creditor contact information; (5) information regarding the Consumer Financial Protection Bureau (CFPB) or Department of Housing and Urban Development (HUD) counseling services; (6) periodic statements, and (7) security interests.[133]

Substantive provisions in TILA and Regulation Z that go beyond pure disclosure requirements are similar to those prevalent in home-mortgage financings, and include (1) restrictions on prepayment penalties; (2) prohibitions or limitations on certain loan terms for high-cost home mortgages[134]; (3) required pre-loan counseling for high-cost home mortgages or negative amortizing home mortgages for first-time buyers[135]; (4) restrictions against loan originators steering consumers into transac-

129. H.R. 6054 §§ 193(a)(1)–(a)(7).

130. *See All Information (Except Text) for H.R.605-Small Business Lending Disclosure Act of 2021*, CONGRESS.GOV, https://www.congress.gov/bill/117th-congress/house-bill/6054/all-info [https://perma.cc/XYT6-3B4X] (last visited Mar. 9, 2023).

131. *See TILA FRB Summary*, *supra* note 119, at 5.

132. *Id.* at 11.

133. *See id.* at 30–37; *e.g.* Truth in Lending, 12 C.F.R. §§ 1026.18(b), (g), (m), .20(d), .38(o), .41 (2019).

134. *TILA FRB Summary*, *supra* note 119, at 76 ("Certain loan terms, including negative amortization, interest rate increases after default, and prepayment penalties are prohibited for high[-]cost mortgages. Others, including balloon payments and due-on-demand clauses, are restricted."); *see id.* at 70 (stating that no prepayment premiums are allowed for high-cost mortgages, and a prepayment premium which is payable longer than thirty-six months after closing or exceeds 2% would classify a mortgage as a high-cost mortgage).

135. *Id.* at 91 ("A creditor may not extend a negative amortizing mortgage loan to a first-time borrower in connection with a closed-end transaction secured by a dwelling, other than a reverse mortgage or a transaction secured by a timeshare, unless the creditor receives documentation that the consumer has obtained homeownership counseling from a HUD certified or approved counselor.").

tions based on the originator's economic interest[136]; (5) prohibitions against mandatory arbitration; (6) evaluations regarding a consumer's ability to repay a loan for high-cost home mortgages[137]; and (7) rescission rights.[138] Substantive consumer-protection regulations that are not mortgage-related are also sprinkled throughout TILA and Regulation Z. For example, the following restrictions apply to credit card issuers: (1) mandatory evaluations of a consumer's ability to repay, (2) fee limitations of 25% of the initial credit limit (other than penalties or fees for optional services) during the first year after an account is opened, (3) penalties must be "reasonable and proportional[,]" and (4) prohibition of unsolicited credit cards.[139] Additional substantive protections in TILA include required billing procedures; limitations on marketing and advertising, and rights to cancel student loans before funds are received.[140] H.R. 6054, if passed, would limit fees on commercial refinancing, in addition to requiring disclosures.[141]

By allowing for exceptions from disclosure and administrative requirements, TILA and Regulation Z embody the financing principle that the perfect should not be the enemy of the good. In bona fide personal financial emergencies, consumers can waive waiting periods (after receiving home-mortgage disclosures) and recission rights with respect to home mortgages.[142] Similarly, creditor exemptions are available to encourage financing to underserved or needy consumers. For example, creditors are exempt from providing certain mortgage disclosures—if doing so is needed to avoid or prevent a foreclosure—and creditors are exempt from setting up escrow accounts for higher-priced home mortgages for rural or underserved borrowers.[143] Certain exemptions are also available for small

136. *Id.* at 88 ("Loan originators are prohibited from directing or 'steering' consumers to loans based on the fact that the originator will receive greater compensation for the loan from the creditor than in other transactions the originator offered or could have offered to the consumer, unless the consummated transaction is in the consumer's interest.").

137. *Id.* at 126 ("Creditors originating certain mortgage loans are required to make a reasonable and good faith determination at or before consummation that a consumer will have the ability to repay the loan. The ability-to-repay requirement applies to most closed-end mortgage loans; however, there are some exclusions . . . .").

138. *See, e.g.*, 12 C.F.R. §§ 1026.15, .23, .32(a)(iii), (d), .34(a), (e), .36(h), (k), .43.

139. 12 C.F.R. §§ 1026.51–.52; *TILA FRB Summary*, *supra* note 119, at 136–38 (stating that credit card issuers cannot charge a penalty fee exceeding $27 for the first late-payment violation, and credit card issuers cannot charge penalty fees that are more than the dollar-cost of the violation).

140. 12 C.F.R. §§ 1026.13, .16, .48(d), .57.

141. *See* H.R. 6054, 117th Cong. §§ 194–195 (2021).

142. *See* 12 C.F.R. §§ 1026.15(e), .19(f), .23(e).

143. *See id.* §§ 1026.3(h), .35(b)(2)(iii).

servicers and creditors.[144] Given the temporary nature of the loan, short-term loans with a term of a year or less are exempt from escrow-account requirements for higher-priced home mortgages, appraisal requirements for higher-priced home mortgages, and the ability to pay determination for home mortgages.[145]

State laws are preempted by TILA to the extent they contradict the general provisions, credit-transactions sections, credit-advertising sections, and the corresponding regulations in Regulation Z.[146] However, state laws do not preempt TILA to the extent they require additional information or more detailed disclosures.[147] State disclosure requirements may be substituted (except for disclosures for finance charges, annual percentage rates, and high-cost home mortgages) for TILA and Regulation Z disclosure requirements if the state disclosure requirements are "substantially the same in meaning . . . ."[148]

Under TILA, there are no allowable discrepancies for finance-charge errors with respect to open-end transactions.[149] Conversely, the finance charge on closed-end transactions will be considered accurate if the discrepancy is (1) within $5 if the amount financed is less than or equal to $1,000; (2) within $10 if the amount financed exceeds $1,000, or (3) within $100 less than the actual amount, or an unlimited amount over the actual amount, if secured by real property or a dwelling.[150] Mortgage-related disclosures also provide a 10% cumulative tolerance for third-party fees and recording fees listed on the loan estimate.[151]

With respect to the annual percentage rate, Regulation Z allows fluctuations of 0.125% for regular transactions and open-end transactions or 0.25% for irregular transactions (with multiple advances).[152] Unlike the California Final Regulations and the New York Final Regulations, the annual-percentage-rate tolerances in TILA measure discrepancies both above

144. *See, e.g.*, *id.* §§ 1026.35(b)(2)(iii), .41(e)(4) (stating that certain small creditors are exempt from escrow-account requirements for high-cost home mortgages and stating that certain small creditors are exempt from providing periodic statements for home mortgages).

145. *See id.* §§ 1026.35(b)(2)(i)(C), (c)(2)(v), .43(a)(3)(ii).

146. *See id.* § 1026.28(a); *TILA FRB Summary*, *supra* note 119, at 67.

147. *See TILA FRB Summary*, *supra* note 119, at 67–68.

148. *See id.*; 12 C.F.R. § 1026.28(b).

149. *See TILA FRB Summary*, *supra* note 119, at 11.

150. *Id.*; 12 C.F.R. § 1026.18(d).

151. 12 C.F.R. § 1026.19(e)(3)(ii)(A).

152. *Id.* §§ 1026.14(a), .22(a); *TILA FRB Summary*, *supra* note 119, at 32.

and below the actual rate.[153] In practice, however, there would not be anything to rectify or adjust if the borrower is paying less than they anticipated. For mortgages, an additional tolerance is provided if the disclosed rate corresponds with the disclosed finance charge, and the finance charge would be considered accurate.[154]

While the CFPB was granted rulemaking authority for TILA under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010,[155] supervisory authority remains with the creditors' various federal regulators.[156] Regulators under TILA include: the CFPB, the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve Board (the Fed), the Federal Trade Commission, the Securities and Exchange Commission, the Farm Credit Administration, and the Secretaries of Transportation and Agriculture.[157]

When administrative agencies enforce TILA, the allowable tolerances are broadened.[158] Except for cases of willful violations and transactions with ten years or more of scheduled amortization, a tolerance of 0.25% greater or less than the actual rate, along with a corresponding tolerance for the finance charge, is allowed.[159] Administrative agencies can, or shall in the case of certain egregious violations, require creditors to make adjustments to the accounts of borrowers so that they will not pay a finance charge exceeding the lesser of the finance charge actually disclosed or the dollar equivalent of the annual percentage rate actually disclosed.[160] However, administrative agencies will not order an adjustment if a creditor corrects an error and adjusts the borrower's account themselves within sixty days of discovering an error.[161]

In addition to administrative enforcement, creditors can be held liable for TILA violations civilly, including with respect to class actions, which are capped at the lessor of $1,000,000 or 1% of the creditor's net worth.[162] Furthermore, creditors may be fined criminally in an amount not to exceed $5,000, and may be imprisoned for up to a year for willful and knowing

153. *See* CAL. CODE REGS. tit. 10, §§ 955(a), (c) (2022); N.Y. COMP. CODES R. & REGS. tit. 23, §§ 600.4(a), (c) (2023); 12 C.F.R. § 1026.22(a); *TILA FRB Summary*, *supra* note 119, at 32–33.

154. *See* 12 C.F.R. § 1026.22(a).

155. *See TILA FRB Summary*, *supra* note 119, at 1–3.

156. 15 U.S.C.A. § 1607 (West 2022).

157. *See id.*

158. *See id.* §§ 1607(e)(1)–(7).

159. *Id.* § 1607(e)(1).

160. *Id.*

161. *Id.* § 1607(e)(6).

162. *Id.* § 1640(a)(2)(B).

violations.[163] As in the California Final Regulations and the New York Final Regulations, TILA allows creditors to correct mistakes within sixty days of discovering them without incurring liability as long as an action is not initiated before the error is corrected.[164] Financial institutions can also avoid civil liability for incorrect disclosures by showing that the violation "was not intentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to avoid any such error."[165]

B. Notable Differences Between the Truth in Lending Act and the Specified State Legislation

1. Ease of Compliance

Despite the number of trees that would perish in printing the contents of TILA and Regulation Z, it is easier to comply with TILA and Regulation Z than an array of state commercial-financing disclosure laws. When complying with TILA and Regulation Z, creditors (1) only have one central law and set of regulations to comply with; (2) have the benefit of forms and examples provided by legislators; (3) have the benefit of compliance manuals and worksheets provided by regulators and, (4) are allowed broader administrative tolerances.

Since TILA and Regulation Z are federal statutes and regulations, respectively, creditors must comply with a single "set" of requirements.[166] Alternatively, the "patchwork nature of state requirements" for commercial financing would be expensive to implement.[167] However, under TILA, state laws are preempted only if they contradict or are inconsistent with certain provisions of TILA and Regulation Z.[168] Furthermore, TILA and Regulation Z explicitly authorize the inclusion of additional or more detailed disclosures required by states and will even allow the substitution of substantially similar state-law disclosures (other than with respect to finance charges, annual percentage rates, and high-cost mortgages) for its own requirements.[169]

163. *Id.* § 1611.

164. CAL. CODE REGS. tit. 10, § 955 (2022); N.Y. COMP. CODES R. & REGS. tit. 23, § 600.4(b) (2023); 15 U.S.C.A. § 1640(b).

165. 15 U.S.C.A. § 1640(c).

166. *See* U.S. CONST. Art. VI, cl. 2

167. Rocha, *supra* note 5.

168. *See* Truth in Lending, 12 C.F.R. § 1026.28(a) (2019).

169. *Id.* § 1026.28(b); *TILA FRB Summary*, *supra* note 119, at 1–3.

If H.R. 6054 passed, commercial-financing lenders would look to the new expanded TILA—and implementing regulations from the CFPB—for finance charge and annual percentage rate disclosure requirements.[170] However, H.R. 6054 makes plain that "[n]othing . . . may be construed to prevent a provider from providing or disclosing additional information on a small business financing . . . ."[171] This means that federal protections notwithstanding, commercial-financing lenders would *still* have to analyze the various state commercial-financing disclosure laws with respect to the other required disclosures to determine if such state disclosures are inconsistent, substantially the same, or "additional."[172] Any "additional" state disclosures would still have to be accounted for in the disclosure statements that commercial-financing lenders generate.[173] Therefore, even if federal expansion of TILA preempted state commercial-financing disclosure laws for certain disclosures, states are nevertheless creating a patchwork of unnecessary and duplicative laws by implementing their own commercial-financing disclosure laws.

With respect to forms, Regulation Z includes appendices with sample clauses, flow charts, and examples for consumer lenders.[174] Formatted forms and tables are even included for several of the required disclosures.[175] Except for one table for the Itemization of the Amount Financed, the California Final Regulations and the New York Final Regulations do not offer any formatted tables for providers.[176] Both the California Final Regulations and the New York Final Regulations list a specific ratio for the column formatting in disclosure schedules, without giving providers the courtesy of a template form.[177] Furthermore, both the California Final Regulations and the New York Final Regulations require specific numbers of rows and columns for different types of commercial transactions, with the order disclosures already pre-determined.[178] However, in spite of the specificity regarding where a required item is located within a table, nei-

170. *See* H.R. 6054, 117th Cong. §§ 191–195 (2021); 12 C.F.R. § 1026.28; *TILA FRB Summary*, *supra* note 119, at 1–3.

171. H.R. 6054 § 195(a).

172. *See* H.R. 6054 § 193; 12 C.F.R. § 1026.28.

173. *See* H.R. 6054 § 193; 12 C.F.R. § 1026.28; *TILA FRB Summary*, *supra* note 119, at 1–3.

174. *See, e.g.*, 12 C.F.R. § 1026, App. G–H.

175. *Id.*

176. CAL. CODE REGS. tit. 10, § 956(b) (2022); N.Y. COMP. CODES R. & REGS. tit. 23, § 600.17(b) (2023).

177. *See* CAL. CODE REGS. tit. 10, § 901; N.Y. COMP. CODES R. & REGS. tit. 23, § 600.5.

178. *See* CAL. CODE REGS. tit. 10, §§ 910–916; N.Y. COMP. CODES R. & REGS. tit. 23, §§ 600.6, .10–.16.

ther New York nor California saw fit to provide an example to assist providers in their compliance efforts.[179]

In addition to providing forms to aid compliance, various regulators under TILA and Regulation Z have made examination procedures publicly available.[180] For example, both the Fed and the CFPB publish worksheets that examiners will complete during an examination.[181] These worksheets have flow charts, yes-or-no questions, and references to applicable Regulation Z citations.[182] Undoubtedly, these worksheets would be invaluable to creditors for both setting up a compliance program and auditing existing compliance programs.

With respect to enforcement, TILA expands the allowable tolerances, except for certain exclusions, to 0.25% greater or less than the actual rate and a corresponding tolerance for the finance charge.[183] On the other hand, neither the California Final Regulations nor the New York Final Regulations include allowable tolerances for understating finance charges.[184] Additionally, the California Final Regulations and the New York Final Regulations only have an allowable tolerance for regular transactions of 0.125% or less than the actual annual percentage rate, or a percentage difference of 2.5% or less.[185] Regulation Z also offers safe harbors with respect to administrative adjustments and for non-numeric clerical errors on final mortgage disclosures if corrected disclosures are sent, regardless of arrival, within sixty days of closing.[186] The California Final Regulations and the New York Final Regulations specifically carve out overstating costs, unlike TILA; but in practice, overstating costs would

179. *See generally* CAL. CODE REGS. tit. 10 (failing to provide example forms); N.Y. COMP. CODES R. & REGS. tit. 23 (failing to provide example forms).

180. *See generally TILA FRB Summary*, *supra* note 119, at 149–326 (detailing various examination procedures). *See also* CONSUMER FIN. PROT. BUREAU, INTERAGENCY CONSUMER L. & REGULS.: TILA (2021), https://files.consumerfinance.gov/f/documents/cfpb_supervision-and-examination-manual_tila-exam-procedures_2021-10.pdf [https://perma.cc/FL84-R2ZR] [hereinafter *TILA CFPB Guide*].

181. *See TILA FRB Summary*, *supra* note 119, at 320–26; *TILA CFPB Guide*, *supra* note 180, at 378–84.

182. *See TILA FRB Summary*, *supra* note 119, at 320–26; *TILA CFPB Guide*, *supra* note 180, at 378–84.

183. Truth in Lending, 12 C.F.R. § 1026.22(a) (2019).

184. *See generally* CAL. CODE REGS. tit. 10 (failing to include allowable tolerances for understating finance charges); N.Y. COMP. CODES R. & REGS. tit. 23 (failing to include allowable tolerances for understating finance charges).

185. CAL. CODE REGS. tit. 10, § 955(a); N.Y. COMP. CODES R. & REGS. tit. 23, § 600.4(a).

186. 12 C.F.R. § 1026.19(f).

not result in any needed adjustments anyway.[187] Thus, as a whole, TILA and Regulation Z offer more meaningful dispensations from compliance than the California Final Regulations and the New York Final Regulations.

2. *Value-Add*

The difficulty that lenders[188] would face in complying with disclosure regulations, and any costs associated therewith (borne by either the lenders themselves or, more realistically, passed on to the borrowers[189]), must of course be weighed against the potential benefit of the disclosures to borrowers. In that calculation, the benefit of financial disclosures received by commercial borrowers are negligible compared to the value-add that the current version of TILA and Regulation Z provide to consumers, given (1) the sophistication and financial acumen of the persons each seeks to protect; (2) the presence of substantive provisions, and (3) the penalties for noncompliance.

TILA was passed, in addition to creating substantive protections for consumers, to standardize how loan costs are calculated and disclosed so that consumers could compare different financing options.[190] Similarly, the California DFPI has indicated they believe the California Final Regulations will provide "useful information to small-business owners . . . ."[191] State commercial-financing disclosure laws may provide information to small-business owners, but the passage of such laws assumes—patronizingly—that small-business owners are incapable of evaluating the costs of different loans. This assumption runs headlong into the long-recognized distinction drawn between the law's protection of consumers and its protection of businesses.

The premise that average consumers should be protected from business entities who may exploit them is a central tenet across broad swaths of the law, including employment, healthcare, environmental, food and beverage, banking and financial services, unfair and deceptive trade prac-

187. *See* CAL. CODE REGS. tit. 10, § 955(c); N.Y. COMP. CODES R. & REGS. tit. 23, § 600.(4)(c).

188. As used in the remainder of this Article, "lender" refers to the common use of the word. It encompasses statutorily-defined providers and covered lenders (as applicable).

189. As used in the remainder of this Article, "borrower" refers to the common use of the word. It encompasses statutorily-defined recipients and borrowers (as applicable).

190. *See* OFF. OF FIN. READINESS, TRUTH IN LENDING ACT: CONSUMER PROTECTION FOR BORROWING MONEY, https://finred.usalearning.gov/assets/downloads/FINRED-TruthLendingAct-FS.pdf [https://perma.cc/EC3U-489C].

191. Rocha, *supra* note 5.

tices, securities, and antitrust.[192] This distinction is largely premised on the difference in resources and bargaining power between the average individual and the average business. The law of secured transactions provides an example of this dichotomy in the context of the costs of financing: Article 9 of the UCC limits the enforceability of after-acquired property clauses to ten days after receipt of a loan with respect to consumer goods.[193] Furthermore, the UCC deems a general description of collateral insufficient with respect to consumer transactions or consumer goods.[194] As a doctrinal matter, then, the traditional consumer-business distinction in the law is ignored in both the Specified State Legislation and in H.R. 6054.

The probable effects of these laws and regulations also run counter to the established consumer-business dichotomy. Even assuming an informational benefit would accrue to small businesses by extending consumer-financing disclosure laws to them, the marginal benefit would be likely captured only by the small businesses themselves without trickle-down protections to individual consumers. This is because increased lender compliance costs from commercial-financing disclosure laws will be passed down to small businesses and ultimately to their customers.[195] Therefore, importing the disclosure requirements used in consumer transactions into commercial transactions cuts against established practice in financing law—protecting consumers.

Aside from these common problems, there are important differences between the Specified State Legislation and H.R. 6054 and TILA and Regulation Z that counsel in favor of continued separation. For one thing, the dollar thresholds in the Specified State Legislation and H.R. 6054, as compared to the consumer provisions in TILA and Regulation Z, show the differences in the types of borrowers the legislation seeks to protect. The current version of TILA and Regulation Z exempt transactions over a cer-

192. It is true that antitrust laws protect smaller businesses from monopolistic conduct, but both direct and indirect purchasers are ultimately affected by fostering competition. The recovery of damages for antitrust is limited to direct purchasers under federal law. However, many states recognize the trickle-down nature of price fixing and allow indirect purchasers to recover damages for state antitrust violations. *See* Jonathan T. Tomlin & Dale J. Giali, *Federalism and the Indirect Purchaser Mess*, 11 GEO. MASON L. REV. 157, 161 (2002).

193. N.Y. U.C.C. § 9-204(b)(1) (McKinney 2022).

194. *See id.* § 9-108(e)(2).

195. *See generally* Rocha, *supra* note 5 ("Scott Pearson, a Los Angeles-based lawyer . . . who represents lenders, said the patchwork nature of state requirements will make the compliance process for lenders 'very costly and difficult,' and ultimately make credit more expensive for businesses.").

tain threshold, which is adjusted annually, unless a consumer could lose his or her home or the transaction is a private student loan.[196] It is important to note that certain student loans are likely carved out of the threshold exclusion because they would disproportionally affect younger (and presumably more vulnerable) borrowers and would not be discharged in bankruptcy unless a "certainty of hopelessness" was proven.[197]

The Specified State Legislation and H.R. 6054 also include a threshold above which the required disclosures would no longer apply.[198] However, neither the Specified State Legislation nor H.R. 6054 included an adjustment mechanism to increase the threshold for inflation, suggesting that the dollar amount was an arbitrary number, not aimed at true financial acumen.[199] Furthermore, the threshold in the New York Law and H.R. 6054 is set at an enormous $2,500,000, presumably covering far more than loans to mom-and-pop operations.[200]

Perhaps due to TILA's application to consumer transactions, TILA has never been only about disclosures.[201] In addition to disclosures, some of TILA's original legislative purposes were to restrict wage garnishment and create further consumer-finance regulations.[202] Today, to protect against the specific abuses in financing to which individual consumers are susceptible, TILA and Regulation Z contain consumer protections that go beyond pure disclosure.[203] For example, restrictions on prepayment penalties, recission rights, steering, and prohibitions against mandatory arbitration are included within TILA and Regulation Z.[204] Thus, it is unlikely that merely regulating disclosure and licensing would have the same impact for commercial borrowers that the current TILA and Regulation Z has for consumers. But if H.R. 6054 passed, its provision limiting refinancing

196. Truth in Lending, 12 C.F.R. § 1026.3(b) (2019).

197. *See* 11 U.S.C.A. § 523(a)(3) (West 2022); Rucha Pandit, *Lending a Hand Instead of Breaking the Bank: The Imperative Need to Resolve the Circuit Split for Determining Undue Hardship for Section 523(a)(8) Student Loan Discharges*, 13 WM. & MARY BUS. L. REV. 299, 318 (2021).

198. *See* Part I, *supra*; H.B. 969, 2021 N.C. Gen. Assemb., Reg. Sess. § 53-442 (N.C. 2021); CAL. FIN. CODE § 22800(n) (West 2023); N.Y. FIN. SERV. § 802(g) (McKinney 2022); H.R. 6054, 117th Cong. § 191(11) (2021).

199. *See* Part I, *supra*; H.B. 969 § 53-442; CAL. FIN. CODE § 22800(n); N.Y. FIN. SERV. § 802(g); H.R. 6054 § 191(11).

200. *See* Part I.B, *supra*; N.Y. FIN. SERV. § 802(g); H.R. 6054 § 191(11).

201. *See* Part II.A, *supra*; *TILA FRB Summary*, *supra* note 119, at 1–3.

202. *See* Consumer Credit Protection Act, Pub. L. No. 90-321, 82 Stat. 146 (1968) (codified as amended at 15 U.S.C. § 1601); *TILA FRB Summary*, *supra* note 119, at 1–4.

203. *See TILA FRB Summary*, *supra* note 119, at 1–4.

204. *See id.*

fees with respect to small-business borrowers would give it the potential to have a greater impact than the Specified State Legislation.[205]

In terms of benefits to borrowers, it is not only the requirements of TILA and Regulation Z, but also their remedies that are better than the Specified State Legislation. TILA allows individuals, and even classes (subject to recovery limitations), to bring civil lawsuits against their creditors for damages of up to twice the finance charge.[206] Administrative enforcement under TILA and Regulation Z is also focused on compensating the borrowers, allowing agencies to order the adjustment of borrower accounts to align with the costs that were disclosed.[207] H.R. 6054, however, is silent with respect to penalties and enforcement, but presumably the existing enforcement and penalty rules in TILA and Regulation Z would apply if H.R. 6054 passed.[208]

On the other hand, the New York Law and North Carolina Bill allow (or would have allowed, in the case of the North Carolina Bill) for fines, imposed by the state regulators, of $2,000 for each violation and $10,000 for each willful violation, in each case payable to the state, rather than the borrower.[209] Under the New York Law, a recipient could receive restitution for willful violations only if the Superintendent chooses to order restitution.[210] The North Carolina Bill focused solely on punishing covered lenders rather than compensating borrowers, allowing the Commissioner to order covered lenders to cease and desist from providing commercial loans in North Carolina.[211] The California Law and California Final Regulations are silent with respect to enforcement penalties.[212]

3. *Invested Lenders: Bridge Loans and Additional Tranches*

As suggested above, there are significant differences between the goals of obtaining financing for individuals and small businesses. Significantly, contrary to consumer-lending relationships, lenders subject to commercial-financing disclosure laws may have interests that align with

205. *See* H.R. 6054 § 194.

206. 15 U.S.C.A. § 1640(a) (West 2022).

207. *See id.* § 1607(e).

208. *See generally* H.R. 6054 (failing to mention any adjustments to current administrative penalties and enforcement).

209. H.B. 969, 2021 N.C. Gen. Assemb., Reg. Sess. § 53-457(a)(3) (N.C. 2021); N.Y. FIN. SERV. § 812(a) (McKinney 2022).

210. N.Y. FIN. SERV. § 812(b).

211. H.B. 969 § 53-457(a)(2).

212. *See generally* 2018 Cal. Legis. Serv. Ch. 1011 (S.B. 1235) (West); CAL. CODE REGS. tit. 10, §§ 900–956 (2022) (failing to mention enforcement penalties).

borrowers. For example, a commercial lender may be an equity owner in the commercial borrower and receive a return if the borrower succeeds. Additionally, lending more money to a cash-strapped company so they can position themselves to pay back an initial loan is a logical strategy in commercial lending, but a ludicrous decision in a consumer-lending context.

Bridge loans, as the name implies, are short-term debt arrangements designed to keep start-up companies from going under until they complete an equity raise (the metaphorical other side of the river).[213] Bridge loans can infuse funds into a company quicker than equity investments, which require time-consuming negotiation.[214] Ordinarily, bridge loans will be converted into equity once the next round of equity financing takes place, which may occur within a few weeks or up to a year.[215] By their nature, bridge loans are not expected to continue as debt and typically do not require the periodic payment of interest (although interest does accrue).[216] If the loan does convert into equity before maturity, lenders will either get additional equity or become equity holders. If a bridge loan does not convert, accrued interest will be paid in a lump sum. Most of the time bridge loans are made by existing equity investors in the company to keep the company afloat, so the investors can recoup at least some of their investment.[217] Thus, generally, the motive of the lenders is not necessarily to make more money (especially not in the short term) but to protect the money they have already invested. Negotiating bridge loans is typically a straightforward process as both sides are focused on getting the borrower out of a difficult spot.

As a practical matter, venture-capital borrowers considering bridge loans will not aimlessly shop around for more compelling financing terms as they are unlikely to receive any offers from persons who do not already have a vested interest in the early-stage company and often urgently need capital. Furthermore, the typical financial disclosures do not align with the nature of bridge loans. Periodic payments and prepayment premiums, for example, are not going to be relevant for bridge loans, as they are designed to be converted and do not require periodic interest payments.

Similarly, lenders may have an incentive to keep a company operating, even if such lenders have only provided debt financing to the borrow-

213. David J. Kendall, *Venture Capital Lending: Usury and Fiduciary Duty Concerns*, 33 COLO. LAW. 49, 49 (2004).

214. *Id.*

215. *Id.* at 50.

216. *Id.*

217. *See id.*

er. As an attorney who specializes in financing to emerging companies, I have received numerous calls from lender-clients instructing me to amend their financing documents to allow them to lend additional funds, so the borrower can pay its employees. Unlike open-end financing, these lenders did not anticipate making additional advances when the initial documentation was agreed upon. Rather, analogous to the calculus with bridge loans, some lenders lend funds when other persons would not because failing to do so would put their initial and larger loan at risk.

III. RECOMMENDATIONS

Due to the drastically different cost-benefit analysis of consumer-financing disclosures—as compared to commercial financing—and the potential differences in incentives of lenders, the passage and implementation of state commercial-financing disclosure laws is not advisable. Notwithstanding the admirable impulse to protect small businesses, requiring lenders to familiarize themselves with a swath of new and sometimes conflicting state requirements and develop new internal compliance procedures would increase the cost of financing—perhaps sharply—while many of the "benefits" they would achieve rest on tenuous assumptions.

As suggested above, the Specified State Legislation (and H.R. 6054, too) assumes that small businesses are sufficiently like individuals in their capacity to evaluate the costs of different loans that disclosure requirements traditionally reserved for consumers are needed. Yet the large statutory loan thresholds belie this assumption: some of these laws reach businesses that almost certainly possess sufficient resources to scrutinize competing financing offers.[218] Moreover, with some exceptions, penalties for violations of these laws require payments to the state rather than to the borrower, unlike traditional remedies for aggrieved consumer borrowers. Lastly, certain incentives of businesses are not adequately addressed; particularly, the possibility of shared ownership and the profit motivation of continuing operation. Therefore, there are strong arguments that the entire enterprise of expansion should be abandoned—whether by the states or at the federal level.

Nevertheless, the passage of H.R. 6054 in lieu of an array of state laws is preferable, given that (1) it would be easier for lenders to comply with one law; (2) H.R. 6054 has a substantive provision to tip the scale on the cost-benefit analysis, and (3) remedies in TILA and Regulation Z allow borrowers to be compensated. If a federal option is not feasible, a uniform and coordinated approach would be better than the current system

218. *See supra* note 64 and accompanying text.

of differing state requirements. Yet the cost-benefit analysis in either H.R. 6054 or a coordinated state approach—given the inherent differences between consumers and small businesses and the possibility of interested lenders—still points toward not heavily regulating commercial-financing disclosures.

The below recommendations would ease the burden on lenders and small businesses which state commercial-financing disclosure laws would inevitably create. These recommendations are also generally applicable to H.R. 6054, with the exception of Part III.C.

A. Bridge Loans Exception

Under the California Law, enforcement authority is granted to the DFPI commissioner over providers *licensed* under California's banking and financing laws.[219] California does allow an exemption from licensing for commercial bridge loans made by statutorily defined "venture capital compan[ies,]" which must (1) maintain at least 50% of their assets in venture capital equity investments and (2) hold, after the loan converts to equity, a material equity interest in the borrower in question.[220] Given the silence regarding enforcement of non-licensed providers, it is unclear whether the California Law offers an exception for bridge loans as regards disclosure requirements. At a minimum, California lawmakers should make it explicitly clear that bridge loan providers, who are not subject to licensing requirements, will not be subject to the commercial-financing disclosure laws. In fact, Regulation Z supports the notion that short-term loans should be subject to fewer regulations, as temporary loans (for a year or less) are exempt from certain high-priced and general home-mortgage requirements in Regulation Z.[221]

California's commercial bridge-loan licensing exception should also be broadened. The statutory requirements to be considered a commercial bridge loan would almost always be satisfied, given the nature of bridge loans. While it is odd that California even has a principal threshold—set, as it is, at a miniscule $5,000—loans will inevitably clear the first bridge-loan hurdle.[222] Given that the vast majority of bridge loans have less than three-year terms and are made because the lender has an equity investment (or seeks to convert the loan into equity), the second prong

219. *See* CAL. FIN. CODE § 22805 (West 2019).
220. CAL. FIN. CODE § 22062(b)(1).
221. *See* Truth in Lending, 12 C.F.R. §§ 1026.35(b)(2)(i)(C), .43(a)(3)(ii) (2019).
222. *See* CAL. FIN. CODE § 22062(b)(3)(A).

would be easily met as well.[223] Lastly, the exclusion of real property from the collateral package for secured bridge loans would not be a major issue, because the cost and time involved in mortgaging the real property would likely lead to its exclusion.[224]

For the California Law exclusion requirements, however, it should not matter: The emphasis should be solely on the lender's relationship with, and interests in, the company in which the lender is providing funds. Whether a lender is "typically in the business of making equity investments" does not change their motives with respect to the borrower in question. At a minimum, the aggregate-asset test should be expanded to include debt investments to accommodate funds that make both debt and equity investments in the ordinary course of their business. However, limiting the analysis to the relationship with the borrower in question would be preferable.

Currently, the New York Law, New York Final Regulations, North Carolina Bill, and H.R. 6054 do not contain any exceptions for unlicensed entities or commercial bridge loans.[225] Rather, the North Carolina Bill explicitly states that covered lenders subject to enforcement include unregistered persons.[226] Prior to implementation (in the case of the New York Law) and passage (in the case of the North Carolina Bill and H.R. 6054), a commercial bridge-loan exception should be added. As North Carolina and New York did with their commercial-financing disclosure bill and law, looking to California's licensing exception for commercial bridge loans is a viable starting point. New York, North Carolina, and the U.S. House, however, should focus on the incentives of a lender with respect to a specific borrower, rather than on the lender's portfolio.

B. Broadening Amendment Exceptions

As discussed, not only prior or anticipated equity investments, but also prior debt investments in a company can influence a lender. Furthermore, if a commercial borrower has taken out a loan with a particular lender, they would likely have already made payments and familiarized themselves with the financing documents. Also, small businesses would only need to focus on the terms that were changing, not the entire body of

223. *See id.* § 22062(b)(3)(B).

224. *See id.* § 22062(b)(3)(C).

225. *See generally* 2020 N.Y. Sess. Laws Ch. 369 (S. 5470-B) (McKinney); S. 898, 2021–2022 Leg. Sess. (N.Y. 2021); N.Y. COMP. CODES R. & REGS. tit. 23 (2023); H.B. 969, 2021 N.C. Gen. Assemb., Reg. Sess. (N.C. 2021); H.R. 6054, 117th Cong. (2021) (all failing to include exceptions for unlicensed entities or commercial bridge loans).

226. *See* H.B. 969 §§ 53-441(6), -457.

the loan agreement. Thus, the utility of a summary of terms via required disclosures would be moot and amendments should not require additional disclosures. At a minimum, exceptions should be available for amendments that increase the amount financed, or that are made in anticipation of, or to resolve, a default.

Currently, the New York Final Regulations make it clear that the language "at the time of extending a specific offer" includes proposed amendments to an existing agreement if the amendment would increase the finance charge or annual percentage rate.[227] The amendment-disclosure requirement in the California Final Regulations aligns with the New York Final Regulations with respect to the annual percentage rate; however, amendments that increase only the finance charge do not require additional disclosures in California.[228] An exception to the requirement to deliver disclosures in connection with an amendment is available in both California and New York if the amendment would resolve a borrower's default.[229] The North Carolina Bill and H.R. 6054, however, do not provide details on when a specific offer will be deemed to be extended, which likely would have been addressed in regulations if the North Carolina Bill and H.R. 6054 had passed.[230]

An increase in just the principal amount would necessarily cause an increase in the finance charge (which measures fees and interest as a dollar amount, instead of a percentage). At a minimum, New York should revise the amendment disclosure requirements to exempt amendments that only increase the finance charge. Doing so would allow lenders to forgo providing disclosures when the only change is an increase in the principal amount, without any revisions to the interest rate or fee percentage. If the North Carolina Bill and H.R. 6054 are passed, North Carolina and the CFPB should follow the California amendment requirements when developing regulations (instead of the New York amendment requirements) and only require additional disclosures if the annual percentage rate changes. Surely small businesses are sophisticated enough to understand that if the amount of financing increases, the dollar amount of interest and payments will increase, even if the percentage stays constant. Exempting amendments to the principal amount would allow lenders to send funds to

227. *See* N.Y. COMP. CODES R. & REGS. tit. 23, § 600.1(f)(1) (2023).

228. *See id.*; CAL. CODE REGS. tit. 10, § 900(a)(5)(B) (2022).

229. *See* CAL. CODE REGS. tit. 10, § 900(a)(5)(B); N.Y. COMP. CODES R. & REGS. tit. 23, § 600.1(f)(2).

230. *See generally* H.B. 969; H.R. 6054 (both lacking details on when a specific offer will be deemed extended).

small-business borrowers quickly, instead of requiring an additional disclosure requirement.

Similarly, California and New York should expand their existing default-resolution exception (and North Carolina and the CFPB should do the same) to include *anticipated* defaults. Obviously, borrowers do not wish to default on their financing arrangements. It is a bad sign for investors, vendors, and other lenders if a borrower defaults. Accordingly, many commercial borrowers will reach out to their lenders to negotiate an amendment, preventing a default under the financing agreements. Broadening the exception would be a beneficial change for small businesses, given that lenders are more likely to agree to a pre-default amendment if the lender would not be subject to additional disclosure requirements.

C. Financial Emergency Exception and Larger Margins of Error

Requiring lenders to jump through unnecessary regulatory hoops when a willing commercial borrower has an immediate need for cash makes the perfect the enemy of the good. Indeed, evaluating different financing options in a uniform table will be of little consolation to a small-business owner if the business fails before it can receive financing. In the healthcare context, an emergency room does not require a patient to complete paperwork before offering aid if the patient has a life-threatening, immediate medical need. Likewise, in the consumer lending context, TILA and Regulation Z give credence to the notion that sometimes any financing is better than no financing, allowing consumers to waive waiting periods after receiving home mortgage disclosures and recission rights with respect to home mortgages.[231] Ideally, commercial borrowers should be able to waive all disclosures required by commercial-financing disclosure regulations if they are experiencing a financial emergency. The stated disclosures will likely not alter a cash-strapped borrower's decision to consummate the deal, and requiring disclosures could cause unnecessary delay.

At a minimum, lenders should be granted a larger margin of error for discrepancies in the required disclosures if the borrower acknowledges they are experiencing a financial emergency. Currently, the margin for understating the annual percentage rate in both California and New York is set at no more than 0.125% lower than the actual annual percentage rate for regular transactions and no more than 0.25% lower than the actual percentage rate for irregular transactions, or a percentage difference of no

231. *See* Truth in Lending, 12 C.F.R. §§ 1026.15(e), .19(f), .23(e) (2019).

more than 2.5%.[232] The North Carolina Bill is silent with respect to pre-prescribed allowable tolerances.[233] TILA's administrative enforcement tolerance of 0.25% greater or less than the actual rate, excluding willful violations and transactions with ten years or more of scheduled amortization, would apply to H.R. 6054 (if passed), unless a different tolerance for commercial financing was set forth in new regulations.[234] A larger margin for error for the annual percentage rate would allow lenders to make a good faith effort to comply with disclosures without fear that their haste could subject them to penalties. While the current California Final Regulations and New York Final Regulations only provide allowable tolerances for the annual percentage rate, larger margins for cases of financial emergency should track with any additional tolerances that are adopted.[235]

D. Additional Allowable Tolerances

In addition to annual-percentage-rate tolerances, states should also include allowable tolerances for other required disclosures. Such a change would align with the current version of TILA and Regulation Z, as Regulation Z forgives small errors with respect to the finance charge.[236] Furthermore, the administrative enforcement section of TILA waives finance-charge discrepancies corresponding with allowable tolerances in the annual percentage rate, in recognition that the finance charge is used to calculate the annual percentage rate.[237] The other required disclosures are also linked together in such a way where a mistake in one could lead to a mistake elsewhere. For example, the payment amounts would contribute to the calculations of the finance charge and annual percentage rate. In addition, the total repayment amount is calculated by adding the finance charge to the amount disbursed.[238] At a minimum, states and the CFPB (if H.R. 6054 is passed) should ensure that the annual-percentage-rate tolerances (and finance charge tolerances, if applicable) are considered concerning the other disclosures.

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232. *See* CAL. CODE REGS. tit. 10, § 955(a); N.Y. COMP. CODES R. & REGS. tit. 23, § 600.4(a).

233. *See* H.B. 969 (not discussing allowable tolerances).

234. *See* 15 U.S.C.A. § 1607(e) (West 2022).

235. *See* CAL. CODE REGS. tit. 10, § 955(a); N.Y. COMP. CODES R. & REGS. tit. 23, § 600.4(a).

236. *See* 12 C.F.R. § 1026.18(d).

237. *See* 15 U.S.C.A. § 1607(e).

238. *See, e.g.*, N.Y. FIN. SERV. § 804 (McKinney 2022).

E. Streamline Disclosure Requirements Among States

Perhaps the biggest hurdle to lenders attempting to comply with state commercial-financing disclosure laws is the plurality of the endeavor.[239] Currently, the Specified State Legislation would force providers to have a separate form for each state.[240] Thus, lenders would have to determine where a business is located and deliver disclosures for that state. The North Carolina Bill would require disclosures to borrowers who are "operating" in North Carolina, opening up lenders to the hassle of delivering a disclosure for every state a business operates in, rather than merely in its state of formation or where the chief executive office is located.[241] The California Final Regulations and New York Final Regulations, only applying to recipients of financing offers who principally direct or manage their business from California or New York, respectively, are more manageable than the North Carolina Bill.[242] Today, modern society's mobility further complicates the decision of which state disclosure should be required. If a business with open-end financing moved its operations to a different state, it is unclear whether disclosures from the new state would be required when additional advances are made.

If H.R. 6054 is not passed, states should adopt a uniform set of disclosure requirements, rather than create a myriad of different state regulations for lenders to fumble with. Given that states recognized the advisability of having a uniform code to govern commercial transactions, it is reasonable to assume that disclosure requirements covering commercial lending would likewise benefit from uniformity.[243] Allowing the Uniform

239. *See* Rocha, *supra* note 5 ("Scott Pearson, a Los Angeles-based lawyer . . . who represents lenders, said the patchwork nature of state requirements will make the compliance process for lenders 'very costly and difficult,' and ultimately make credit more expensive for businesses.").

240. *See* CAL. CODE REGS. tit. 10, § 901(a)(6); N.Y. COMP. CODES R. & REGS. tit. 23, § 600.5(e); H.B. 969, 2021 N.C. Gen. Assemb., Reg. Sess. § 53-449(a) (N.C. 2021).

241. *See* H.B. 969 § 53-441(1).

242. *Compare* CAL. CODE REGS. tit. 10, § 954 ("For the purpose of determining whether a recipient's business is "principally directed or managed from California" as described in subdivision (a), a provider may rely upon (i) any written representation by the recipient as to whether it is principally directed or managed from California or (ii) the business address provided by the recipient in the application for financing."), *and* N.Y. COMP. CODES R. & REGS. tit. 23, § 600.24(b) ("For the purpose of determining whether a recipient's business is 'principally directed or managed from New York,' a provider may rely upon any written representation by the recipient as to whether it is principally directed or managed from the state of New York, or may rely upon the business address provided by the recipient to the provider in the application for financing or any other financing documents."), *with* H.B. 969 § 53-441(1).

243. *See, e.g.*, N.Y. U.C.C. (McKinney 2022).

Law Commission or the American Law Institute (the architects of the UCC) to create disclosure standards for the states is preferable to federal regulation, as it would allow states to have a voice and keep enforcement authority.[244] If H.R. 6054 is passed, however, states should repeal their existing commercial-financing legislation and regulations and rely on the federal legislation, once it is effective. While a federal regime may not have the disclosures and penalties exactly as the states wish, it should nonetheless be sufficient to accomplish their goals. If states do not repeal their own legislation after H.R. 6054 is passed, it would necessitate compliance with not only a collection of state laws, but also the federal legislation.

Uniformity would be beneficial not only to lenders but also to borrowers. Having a uniform system of disclosure requirements would also get rid of the disincentivizing effect that stricter commercial-financing disclosure laws have on willingness to lend to small businesses in those jurisdictions. Furthermore, the cost of compliance with disclosure regulations (which would inevitably be passed down to the borrower) would likely be lower in a uniform system.

CONCLUSION

In summary, number of states have passed or introduced legislation requiring commercial-financing lenders to provide certain disclosures to prospective borrowers.[245] The states appear to be inspired by the consumer-lending disclosure requirements in TILA,[246] and a bill has also been introduced in the U.S. House, which would expand TILA to include commercial-financing disclosures.[247]

Commercial-financing disclosures would require lenders to list financial terms like annual percentage rates, annual charges, and payment amounts.[248] Such required disclosures would be bolstered by additional regulations, specifying the exact verbiage and location of certain terms on disclosure charts.[249] Simply, a cost-benefit analysis shows that complying

244. *See Uniform Commercial Code: Summary*, UNIF. L. COMM'N, https://www.uniformlaws.org/acts/ucc [https://perma.cc/8ZDP-KU5U].

245. *See* Montgomery, *supra* note 4; Rocha, *supra* note 5.

246. *See* Part II.A, *supra*. .

247. *See* H.R. 6054, 117th Cong. (2021).

248. *See* Part I, *supra*.

249. *See id*.

with an expanded TILA and Regulation Z, rather than an array of inconsistent state commercial-financing disclosure laws, is favorable.[250]

As federal law, TILA and Regulation Z do not require lenders to familiarize themselves with legislation and regulations from multiple jurisdictions.[251] But if H.R. 6054 expanded TILA to cover commercial-financing transactions, lenders would still have to comply with other state requirements that are not contrary to H.R. 6054. Federal regulators of TILA and Regulation Z also provide forms and compliance manuals to aid lenders in their compliance efforts.[252] Furthermore, federal regulators are more lenient with respect to small errors than the California Final Regulations and the New York Final Regulations allow their regulators to be.[253]

While consumer-financing disclosure requirements in the current version of TILA seek to protect the most vulnerable consumers, commercial-financial disclosure laws seek to protect businesses from their lenders. Unlike consumers, it is safe to assume that businesses possess the financial knowledge necessary for evaluating different financing offers without the aid of uniform disclosure charts.[254] Given the inherent differences between consumer financing and commercial financing, situations may arise in the commercial-financing context which align the interest of the borrower and the lender—the continuation of the borrower as a going concern.[255]

Due to these differences between consumer lending, commercial lending, and the applicable disclosure requirements, states should revise their requirements to better suit the needs of small businesses. Similarly, if H.R. 6054 becomes law, the CFPB should broaden certain exemptions and tolerances (within Regulation Z) with respect to commercial financing. Commercial bridge loans and amendments, which merely increase the principal amount, should be excluded from commercial-financing disclosure requirements.[256] In the case of a financial emergency of a borrower, lenders should either be exempt from disclosure requirements altogether or be provided greater latitude for potential errors.[257] As a general rule, allowable tolerances should be explicitly granted with respect to the fi-

250. *See* Part II.B, *supra*.
251. *See id.*
252. *See* Part II.B.1, *supra*.
253. *See id.*
254. *See* Part II.B.2, *supra*.
255. *See id.*
256. *See* Part III.A–B, *supra*.
257. *See* Part III.C, *supra*.

nance charge and other disclosure items, given their interconnectivity to the annual percentage rate.[258] Lastly, if H.R. 6054 is not passed, states should create a uniform system of disclosure requirements (similar to the UCC) to facilitate compliance and avoid disincentivizing lenders from providing financing in certain states.[259] If H.R. 6054 is passed, states should repeal their existing commercial-financing legislation and rely on the federal regime.

Corporations may be people, but legislators risk unintentionally hurting their people, instead of protecting them, by failing to recognize that comparing consumer lending to commercial lending is like comparing apples to oranges. After all this time, why extend TILA and consumer protections to commercial lending transactions now?

258. *See* Part III.D, *supra*.
259. *See* Part III.E, *supra*.