The Consumer Finance Observer

A periodic update on legal developments in consumer finance

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White Paper: Litigation and Enforcement Considerations for FinTech PPP Lenders

By: Michael W. Ross and Jacob D. Alderdice

The Paycheck Protection Program (PPP)—Congress’s signature small business relief program in the historic Coronavirus Aid, Relief, and Economic Security Act (CARES Act)—was rolled out in early April to immediate, overwhelming demand and weeks of questions and controversy. Borrowers quickly soaked up its initial $349 billion, leading Congress to authorize an additional $310 billion in funding in late April. Subsequent months saw continued interest and controversy, with Congress stepping in multiple times both to loosen restrictions on various aspects of the program and to extend its application deadline and forgiveness windows.

The PPP has been an experiment unprecedented in scope and scale, based on federally-backed, forgivable loans to small businesses distributed through private lenders. According to recent reports, nearly 5,500 PPP lenders have issued nearly 5 million loans totaling $518 billion in funds. Due to its rapid, unprecedented, and untraditional nature, there continues to be interest from various quadrants on lenders and borrowers, including from regulators and law enforcement, plaintiffs’ attorneys, Congress, and the press. This article addresses the areas for potential enforcement or litigation activity to watch for lenders, particularly FinTech lenders that have participated in the program. Because of their especially high volume of lending activity, FinTech lenders should stay attuned to these developments.

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I. BACKGROUND

A. PAYCHECK PROTECTION PROGRAM

As noted above, Title I of the CARES Act created the PPP, which authorized billions of dollars in forgivable loans for small businesses. Under the program—administered by the US Small Business Administration (SBA)—qualified private lenders lend to eligible businesses (generally those with under 500 employees) under a streamlined application and underwriting process. Eligible borrowers, in turn, can obtain forgiveness of the loan amount by submitting an application to the lender providing certain information, including certifications that the applied-for forgiveness amount was used for eligible purposes (principally maintaining payroll). The precise requirements surrounding eligibility and forgiveness have been subject to various regulatory and legislative updates—and as well as litigation—in the months since the passage of the CARES Act.

B. DATA CONCERNING LENDERS

To date, there have been nearly 5 million individual loans issued pursuant to the program by almost 5,500 lenders, totaling over $518 billion. Although banks with over $50 billion in assets have played a prominent role, issuing 36% of the total dollar amount in loans, smaller lenders have been the most active. Over 5,300 of the individual lenders have been banks with less than $10 billion in assets, issuing over 2.5 million loans for a total of approximately $231 billion—accounting for 44% of the total funds expended pursuant to the program.

FinTech lenders have also played a significant role in the program. According to Federal Reserve data, FinTech lenders were the biggest source of loans in 2019 for small businesses with medium and low credit profiles. For the PPP, less than two dozen FinTech lenders were responsible for issuing over 166,000 loans and distributed a total of $4.7 billion, issuing almost 8,000 loans per lender, the highest number for any category reported on by the SBA. News reports have also highlighted how one smaller bank generated a significant volume of PPP loans partnering with FinTech companies for loan origination.

II. GOVERNMENT OVERSIGHT AND ENFORCEMENT

The PPP is subject to numerous forms of government oversight, giving PPP borrowers and lenders good reason to stay informed on the latest developments in the space.

A. SMALL BUSINESS ADMINISTRATION

The CARES Act itself designates the SBA as principally in charge of enforcement and oversight of the PPP, including an appropriation of an additional $25 million for the SBA Office of the Inspector General. The SBA has indicated it will engage in audits of certain borrowers (e.g., those seeking forgiveness for loan amounts above $2 million). Given the large size of the program and the limited resources at SBA, it is anticipated SBA’s oversight may be stretched thin with respect to oversight.

B. DEPARTMENT OF JUSTICE

With the loosened requirements for borrowers, expansive scope, and the attractiveness of forgivable loans, early commentators predicted that PPP would be a “playground for fraud.”[1] The Department of Justice has announced over twenty criminal prosecutions for fraud committed under the program, all of which pertain to borrowers who made false representations in their applications in order to obtain PPP funds for their own personal use.[1]

C. OFFICES OF INSPECTOR GENERAL (OIGS)

The CARES Act provides for the Offices of Inspector General (OIGs), including SBA as mentioned, to take an active role in overseeing and enforcing the Act’s requirements and rooting out fraud, waste, and mismanagement. To further these efforts, the CARES Act created a new Pandemic Response Accountability Committee (PRAC) charged with overseeing the federal government’s entire response to the COVID-19 pandemic, including all funds distributed pursuant to that response. In addition to conducting its own audits and reviews, including with subpoena power, PRAC coordinates among the various OIGs. Thus far, PRAC has created a website that allows the public to track the distribution of COVID-19-related funding, has issued three reports of its own, and has compiled OIG reports from other agencies related to the COVID-19 pandemic response.

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D. FEDERAL TRADE COMMISSION

Pursuant to Section 5(a) of the Federal Trade Commission Act (FTCA), the FTC is empowered to file a complaint and civil investigation against businesses that engage in “[u]nfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce.” 15 U.S.C. § 45.

The Federal Trade Commission (FTC) has already exercised its authority to police PPP activity. Early on, the FTC filed a complaint related to the PPP, and it has also issued warnings to several other companies. On April 17, 2020, the FTC filed suit against a financial services company that provides assistance to small businesses and assists them in applying for SBA loans. See Federal Trade Commission v. Pante Investments, LLC et al, No. 1:20-cv-0017 (D.R.I.). In that suit, the FTC alleged that the company deceptively represented itself as a lender under the PPP when it was not. Shortly after the FTC filed suit, it entered into a settlement agreement in which the company agreed to disclose that it was not a lender in the program.

On two other occasions, the FTC has issued warning letters to other companies for engaging in similar practices. On May 18, 2020, the FTC announced that it was sending warning letters to two companies because their “marketing would lead consumers to believe they are affiliated with the SBA, or that consumers can apply on their sites for loans through” the PPP. The websites included claims like “Your Paycheck Protection Program Loan starts here!” On June 24, 2020, the FTC and SBA sent similar warning letters to six other online companies. In each case, the FTC directed the companies to take immediate action to remove such claims.

E. CONSUMER FINANCE PROTECTION BUREAU

The Consumer Financial Protection Bureau (CFPB) may also engage in enforcement efforts. To date, the CFPB has only issued general guidance related to the PPP including statements encouraging compliance with the Equal Credit Opportunity Act (ECOA)—which prohibits discrimination in lending—and providing a portal for small business owners to submit complaints online if they believe they were discriminated against based on race, sex, or other protected categories. The agency’s most recent fair lending report in April 2020 focused to some degree on discrimination and small business lending.

III. PRIVATE LITIGATION

The PPP has already subjected lenders (and the SBA) to waves of private litigation, in a variety of areas.

A. NON-PROGRAM REQUIREMENTS AND PREFERENCES

Early on, a PPP lawsuit was brought against Bank of America (BoFA) for allegedly imposing its own eligibility requirements, beyond those provided for under the CARES Act, on PPP borrowers. See Profiles, Inc. v. Bank of Am. Corp., No. CV SAG-20-0894, 2020 WL 1849710, at *1 (D. Md. Apr. 13, 2020). The plaintiffs alleged that by imposing certain requirements, such as requiring the borrower to have a pre-existing lending account with BoFA, the bank was prioritizing its larger, pre-existing customers. But the court denied the plaintiffs’ requested relief and held that the CARES Act did not authorize a private right of action for borrowers to sue private lenders, and that the Act permitted banks to impose their own lending requirements. Many similar suits have followed. In some of these, the plaintiffs have asserted claims under the Sherman Act, 15 U.S.C. § 4, and other state law claims—such as state consumer protection laws, which may provide a more flexible standard—instead of attempting to bring claims under the CARES Act.

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[1] consumerfinance.gov/about-us/blog/fair-equitable-access-credit-minority-women-owned-businesses/


B. FAILURE TO PAY “AGENT FEE” LAWSUITS

More recently, lawsuits have been filed across the country by accounting firms and others alleging that lenders violated of the CARES Act and various state laws by not paying “agent fees” to plaintiffs who allegedly assisted borrowers in filling out and submitting PPP loan applications. The gist of these suits is that, in implementing the PPP, the SBA allegedly required lenders to pay fees to agents who assisted in facilitating borrower loan applications. There have been over a dozen such lawsuits filed in various courts across the country, and plaintiffs in several of the cases have moved to consolidate the cases before the Judicial Panel on Multidistrict Litigation.

The Treasury Secretary Mnuchin was asked about the agent fee litigation in recent testimony before Congress. In a hearing before the House Committee on Financial Services, Secretary Mnuchin stated that he would consider issuing more guidance to clear up “any confusion” about whether banks were required to pay agent fees to accounts and others, and noted that the guidance that was issued stated “that banks could pay agent fees out of the fees that they received,” and that it “was intended to be based upon a contractual relationship between the agent and the bank.”

C. OTHER LAWSUITS

Although the prior two categories of lawsuits constitute the large majority of suits filed against private lenders, there have been other types of suits as well. These include cases about covenants in existing loans. In early May, hotel operators in several states brought declaratory judgment actions in New York and Florida federal courts, seeking a ruling that their participation in PPP would not trigger prohibitions on additional indebtedness in other, pre-existing loan agreements, because the forgivable PPP loan should not constitute “debt.” Shortly after filing suit, the creditors agreed to allow the plaintiffs to participate in the PPP notwithstanding existing loan documentation, and the plaintiffs dismissed the lawsuits voluntarily.

Securities litigation has also begun. In Guofeng Ma v. Wells Fargo & Co., et al., the plaintiff filed a securities class action against Wells Fargo pursuant to Sections 10(b) and 20(a) of the Securities Exchange Act and Rule 10b-5, alleging that Wells Fargo and its leadership made false and misleading statements by failing to disclose that Wells Fargo planned to improperly allocate their PPP lending, causing its stock price to fall. Id., No. 3:20-cv-03697 (N.D. Cal.) (filed Jun. 4, 2020).

IV. LIKELY AREAS OF FOCUS FOR FINTECH LENDERS

FinTech lenders have largely been spared from the above-described legal proceedings thus far. Given its enormous size, however, the litigation and enforcement landscape for PPP is still in its early stages. As forgiveness applications begin—and with information about PPP lending now being disclosed more widely—public scrutiny over the lending program will only grow.

We foresee a few main areas of likely focus for FinTech lenders.

First, over the past several years, the FinTech industry has faced scrutiny from state regulators and the CFPB. Those regulators have pursued consent orders, enforcement actions, and investigations concerning an array of companies in the FinTech space, including those engaging in lending. Many of these actions have been based on broadly worded unfair and deceptive acts and practices (UDAP) authority shared by state regulators, the FTC, and the CFPB (whose authority also includes “abusive” practices). The breadth of enforcement authority over practices deemed unfair, deceptive, or abusive, investigation makes it a potential tool for regulators of activity in this space.

Another area of focus may be fair lending. Some public reports have claimed that minority-owned businesses may have had more difficulty obtaining PPP loans or have received a low proportion of total funds from the SBA program. As relevant to the FinTech space, regulators have highlighted the potential for the use of artificial intelligence in lending decisions as a potential concern for discriminatory impact. Thus, the use of algorithms, machine learning, or similar tools may raise fair lending considerations for lenders to remain attuned to.


[b]For a discussion of that issue, see our article in Law360, linked to here: law360.com/articles/1180800/data-misuse-enforcement-is-focusing-on-3-key-areas. Additional insights are posted on Jenner's consumer law blog, available here: consumer.jenner.com/.
New York State’s Department of Financial
Services Leads in Innovation and Enforcement
By: Jeremy M. Creelan

From its birth in 2011, New York State’s Department of Financial Services (DFS) has been at the cutting edge of financial services regulatory initiatives. Today, under the leadership of Superintendent Linda Lacewell, DFS continues that tradition on both the licensing and enforcement fronts.

UPDATES AND EXPANDS ITS PIONEERING VIRTUAL CURRENCY LICENSING REGIME

In June 2020, DFS issued new Proposed Guidance to streamline the processes by which virtual currency entities that are already licensed under its “BitLicense” regulation (23 NYCRR Part 200), adopt or list new coins without prior DFS approval. The Department’s original BitLicense regulation was issued in June 2015—the first of its kind in the nation—and has facilitated the issuing of 25 licenses or charters. The new Guidance requires that licensed virtual currency entities seeking to adopt or list new coins without such pre-approval must adopt a robust coin-listing policy that addresses the governance, risk assessment, and monitoring of the coin’s impacts. DFS also issued a framework for “Greenlisting” new coins via a DFS webpage that records all coins approved for virtual currency entities. Together, these steps are expected to speed-up and reduce the burdens of listing of new coins. See dfs.ny.gov/apps_and_licensing/virtual_currency_businesses/gn/notice_vc_busact_lic_app_procedure/files.

FILES FIRST CYBERSECURITY ENFORCEMENT ACTION

In July, DFS announced its first enforcement action under its first-in-the-nation Cybersecurity Regulation, Part 500 of Title 23 of the New York Codes, Rules, and Regulations. The charges against First American Title Insurance Company included allegations that the company mishandled and failed to timely resolve the vulnerabilities in its cybersecurity. See dfs.ny.gov/system/files/documents/2020/07/ea20200721_first_american_notice_charges.pdf.
Seila Law LLC v. CFPB Analysis

By: Julian J Ginos

From a consumer law perspective, the stakes in Seila Law LLC v. Consumer Financial Protection Bureau could hardly have been higher—the petitioner challenged, among other things, the Consumer Finance Protection Bureau’s (CFPB) very existence. At the end of this term, a divided US Supreme Court let the CFPB live, but stripped its Director of the removal protections Congress adopted to create independence. In so doing, the Court continued its recent trajectory of limiting Congressional restraint of Presidential removal powers, with implications that extend beyond the realm of consumer finance regulation to implicate the administrative state writ large.

BACKGROUND

Seila Law LLC (a law firm specializing in debt-related legal services) petitioned the Court in its effort to resist a Civil Investigative Demand (a CID) on the ground that it was void ab initio because the CFPB’s structure—which permitted removal of the Director for “inefficiency, neglect of duty, or malfeasance in office” only—violated the Constitution’s separation of powers. The Court granted certiorari to consider whether the Director’s removal protection violated the separation of powers, and, if so, whether that protection was severable from the rest of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). Because the Government agreed with the petitioner that the removal protection was unconstitutional, the Court appointed separate counsel as amicus to defend the decision below.

THE OPINION OF THE COURT

The Court held that the removal protection violated the separation of powers, with support from Chief Justice Roberts and Justices Thomas, Alito, Gorsuch, and Kavanaugh. The Court explained that the Constitution’s “Vesting Clause” obliges the President to “take Care that the Laws be faithfully executed”—necessitating the ability to command the obedience of executive officers via threat of removal. The only two exceptions, the Court explained, were (a) for-cause removal protection for “a multimember body of experts, balanced along partisan lines, that performed legislative and judicial functions and was said not to exercise any executive power” (the FTC, as analyzed in Humphrey’s Executor v. United States[1]), and (b) for-cause removal protection for inferior officers—i.e., those who need not be Presidentially appointed and Senate approved—“with limited duties and no policymaking or administrative authority” (stemming from United States v. Perkins[2] and, more recently and famously, Morrison v. Olson, which upheld an independent counsel statute[3]).

The Court held that neither exception applied to the unprecedented power of the CFPB Director. It noted that Congress had bestowed for-cause removal protection on principal officers capable of acting unilaterally in only four prior instances—the Comptroller of the Currency, the Office of the Special Counsel (OSC), the Social Security Administration (SSA), and the Federal Housing Finance Agency (FHFA). The Court distinguished the first three, and noted the FHFA not only was highly controversial at the time it passed into law (recently, and as a companion to the CFPB statute), but had also already been unconstitutional by an appellate court. Writing separately, Justices Thomas and Gorsuch stated that the Court should have overruled precedent allowing removal restrictions for multimember expert agencies (Humphrey’s Executor), which would affect multiple federal agencies.

In dissent, four justices (Justice Kagan writing for Justices Ginsburg, Breyer, and Sotomayor) rejected the majority’s explication of Presidential removal power as unlimited save for two narrow exceptions. The dissent noted the lack of textual basis for a removal power, the presence of textual support for a Congressional role in administering executive offices, and the existence of other powerful agencies led by a single official not removable at will. The dissent also rejected the majority’s reliance on an unproven premise, namely, that a single-member leadership model is harder for a President to sway than a multimember one.

Ultimately, seven justices agreed that the removal provision was severable from the rest of Dodd-Frank, which allows the CFPB to continue its work. Justices Thomas and Gorsuch dissented on this point, expressing skepticism that the Court has the power to sever unconstitutional statutory provisions, and contending the Court should simply decline enforcement of the CID.

The Court remanded for consideration of whether a Director who was not subject to the unconstitutional removal restriction had validly ratified the CID.

CONCLUSION

Seila Law represents another limitation on Congressional power to protect an administrative agency from Presidential authority. Though this may resemble a victory for those who chafed at the Director’s power as former Director Richard Cordray wielded it, the decision’s short-term impact could actually undermine that constituency—if this year’s election results in a new administration, the incoming President will have the power to remove Director Kathy Kraninger immediately. With respect to what comes next, there plainly will be ratification disputes, and one interesting question will be the effect of Seila Law on tolling agreements and the CFPB’s ability to rely on them.

REGULATORS ADOPT RULE REJECTING MADDEN

By: Michael W. Ross, Amy Egerton-Wiley, William S.C. Goldstein, and Maria E. LaBella

Last month, the Office of the Comptroller of the Currency’s (OCC) adopted a final rule clarifying that the terms of a national bank’s loans remain valid even after such loans are sold or transferred. The rule was intended to reject the Second Circuit’s decision in Madden v. Midland Funding, 786 F.3d 246 (2015). The Federal Deposit Insurance Corporation (FDIC) followed suit later in the month, adopting a rule to clarify that interest rates on state bank-originated loans are not affected when the bank assigns the loan to a nonbank. These steps do not resolve all of the uncertainty surrounding the decision, as discussed further below. Indeed, several state regulators have filed suit challenging them.

THE OCC RULE REJECTING MADDEN

On June 2, the OCC adopted a final rule rejecting the Madden decision. See Permissible Interest on Loans That Are Sold, Assigned, or Otherwise Transferred, 85 Fed. Reg. 33,530 (June 2, 2020) (to be codified at 12 C.F.R. pts. 7 & 160). The rule, which fully adopted the OCC’s November 2019 proposed rule, states that interest rates on a loan issued by a national bank are not affected when the bank assigns the loan to a third party. In its analysis, the OCC cites “valid when made” principles but notes that it does not do so “as independent authority for this rulemaking but rather as tenets of common law that inform its reasonable interpretation of section 85 [of the National Bank Act].”

The OCC rule unmistakably rejects Madden’s holding that a bank’s transfer of a loan can affect the validity of the loan’s interest rate, and reaffirms the “valid when made” doctrine that the Madden court failed to address.

OPPOSITION TO THE OCC’S RULE

Commentators raised three main objections to the OCC’s rule. First, some commentators questioned the OCC’s authority to issue the rule. The OCC took the position that the Chevron doctrine allows it to interpret the National Bank Act’s silence on the effect of a national bank assigning loans to a third party. Second, others argued that the rule could promote predatory lending. The OCC rejected this argument as well, affirming its “strong” opposition to predatory lending practices, and pointing to earlier OCC guidance on managing third-party relationships. Third, some argued that the rulemaking did not comply with Administrative Procedure Act requirements. The OCC disagreed.

Notable among the rule’s opponents were 22 State Attorneys General, who lamented that the rule would “expand the availability of exploitative loans that trap borrowers in a never-ending cycle of debt.” Others voiced support for the rule, applauding the certainty it provides for banks and other loan market participants.

AMBIGUITIES MOVING FORWARD

The rule does not resolve all of the confusion surrounding Madden. It does not address the separate issue of how to determine when a bank is the “true lender” of a loan. Among other several developments regarding that issue (which we will cover separately), the OCC has separately put out a proposed rule on that issue. Specifically, in determining whether state usury or consumer protection laws apply to lending decisions involving nonbank entities, some courts have asked whether a bank or a nonbank lender has the “predominant economic interest” in a loan. If the nonbank has the predominant economic interest in the loan, courts applying this doctrine will treat the nonbank as the “true lender,” even if the loan technically originated on the bank’s balance sheet. The comment period on the true lender rule is open until September 3, 2020.”

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Additionally, the scope and effect of the OCC’s rule remain uncertain. As noted, some objectors stated that it did not comply with the Administrative Procedure Act, which could be the subject of future challenges. State regulators from New York, California, and Illinois have already stepped into the fray with litigation challenging the rule, and that litigation will be one to watch.

AN ANALOGOUS MOVE BY THE FDIC

On June 25, the FDIC took a similar step to clarify that interest rates on state bank-originated loans are not affected when the bank assigns the loan to a nonbank. It finalized a rule identical to the OCC’s for loans originated and sold by state banks (rather than national ones). As a result, the “valid when made” doctrine is now codified—at least as an administrative matter—for all state and federally chartered depository institutions. Whether there will be challenges to these rules remains to be seen.

Mitigating COVID’s Additional Disparate Impact

By: Kali N. Bracey and Damon Y. Smith

As data began pouring in from cities and states hit hard by COVID-19 it became clear that, even though the virus is color blind, certain racial and ethnic communities were suffering a disproportionate impact from the disease. See, e.g., npr.org/2020/04/09/831174878/racial-disparities-in-covid-19-impact-emerge-as-data-is-slowly-released, last visited on July 24, 2020. In particular, African Americans who contract COVID-19 have higher death rates, caused by underlying conditions and lack of access to health care. Id. Similarly, women- and minority-owned businesses may be disproportionately impacted by this crisis due to preexisting economic conditions such as lack of access to credit. See, e.g., mbda.gov/page/executive-summary-disparities-capital-access-between-minority-and-non-minority-businesses, last visited on July 24, 2020.

When Congress passed the CARES Act to provide desperately needed funds to impacted industries, they waived statutory and regulatory requirements that could delay the delivery of that aid. However, in recognition of the disparate conditions described above, Congress did not provide waivers of the Fair Housing Act, 42 U.S.C. § 3602 et. seq. and the Equal Credit Opportunity Act, 15 U.S.C. § 1691 et. seq.

The Fair Housing Act (FHA) prohibits discrimination in the sale or rental of housing because of race, color, national origin, religion, sex, familial status, and disability. With very few exceptions, homebuyers, homeowners, renters, and prospective renters are protected from discrimination based on these classifications in all aspects of the financing and provision of housing. The FHA prohibits both intentional discrimination and policies and decisions that are not intentionally discriminatory, but have a disproportionate and adverse impact against a protected class. If a plaintiff is able to show that the disproportionate adverse impact exists, the burden shifts to the defendant to prove that there is a legitimate, non-discriminatory business need for the policy or decision.

For example, the CARES Act requires single-family loan servicers and multifamily property owners that have federally-backed mortgages to permit forbearance agreements and stay evictions for borrowers and renters that have a COVID-19 related loss of income.
Proposed Amendments to Prop 65

By: Kate T. Spelman and Amy Egerton-Wiey

Proposition 65 warnings are familiar to any business that manufactures, distributes, or supplies consumer products for sale in California. Enacted through a ballot initiative in 1986 as “the Safe Drinking Water and Toxic Enforcement Act,” Proposition 65 requires businesses to provide “clear and reasonable” warnings to consumers regarding exposure to certain carcinogenic and/or toxic chemicals identified by the California EPA’s Office of Environmental Health Hazard Assessment (OEHHA).

Recent amendments—and proposed amendments—to the Proposition 65 warning regulations purportedly seek to clarify ambiguities related to the who, what, where, and when of providing safe harbor warnings under the law. With respect to internet purchases, however, the proposed amendments arguably go farther than simply clarifying the existing law, requiring e-commerce businesses to provide multiple warnings not required of brick-and-mortar retailers.

I. RECENT AMENDMENTS ADDRESSING RESPONSIBILITY FOR PROPOSITION 65 WARNINGS

OEHHA’s most recent amendments to the Proposition 65 warning regulations became effective on April 1, 2020. These amendments clarify the roles of upstream sellers and retail sellers in providing Proposition 65 warnings to consumers.

The warning regulations previously provided that upstream sellers (including manufacturers, distributors, and importers) could satisfy the Proposition 65 warning requirement with either an on-label warning, “or by providing a written notice directly to the authorized agent for a retail seller.” This “written notice” provision created confusion for upstream businesses involved in complicated supply chains or otherwise without knowledge of the final retail seller of the product at issue. The April 2020 amendments helpfully clarify that upstream sellers are only required to provide Proposition 65 notices to their direct customers, which in some cases may be other manufacturers or distributors as opposed to retailers. The April 2020 amendments also clarify that an upstream seller may deliver such notice to its customer’s ‘legal agent’ if that customer has not selected an ‘authorized agent’ for purposes of Proposition 65.

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Moreover, the warning regulations previously imposed on retailers the obligation to provide Proposition 65 warnings to certain consumers after obtaining “actual knowledge” of a covered exposure, with “actual knowledge” defined as “specific knowledge of the consumer product exposure received by the retail seller from any reliable source.” This definition proved ambiguous, and the April 2020 amendments clarify that a retailer has “actual knowledge” only when “the retail seller receives information from any reliable source that allows it to identify the specific product or products that cause the consumer product exposure.” The April 2020 amendments also limit “actual knowledge” to knowledge received by a retailer’s “authorized agent or a person whose knowledge can be imputed to the retailer.” This revision limits retailers’ legal exposure in the event a lower-level employee fails to take action after they obtain knowledge of a covered exposure.

II. PROPOSED AMENDMENTS ADDRESSING METHODS FOR COMMUNICATING PROPOSITION 65 WARNINGS

OEHHA has also proposed several additional amendments to the 2016 warning regulations that are currently making their way through the rulemaking process. These proposed amendments address Proposition 65’s safe harbor provisions as they apply to internet and catalog sales, as well as the sale of alcoholic beverages. As explained further below, while OEHHA has characterized these amendments as clarifications, industry groups have warned that one of the proposed amendments represents a “dramatic change to the safe harbor warning regulations.”

INTERNET AND CATALOG SALES

Under the current safe harbor regulations, a Proposition 65 warning provided in connection with an internet or catalog purchase must appear on the seller’s website or in the catalog as specified in Article 6 Section 25602(b) and (c), and must be transmitted using one or more of the methods specified in Section 25602(a). The Section 25602(a) transmission methods include posted signs or shelf tags, on-label warnings, and warnings “provided via any electronic device or process that automatically provides the warning to the purchaser prior to or during the purchase of the consumer product, without requiring the purchaser to seek out the warning” (the electronic warning). Pursuant to the plain language of the regulations, online sellers may—and often do—satisfy Proposition 65’s safe harbor regulations for e-commerce by providing website and electronic warnings only.

According to OEHHA, the agency “has received a number of inquiries from affected businesses concerning the requirement in the safe-harbor regulations to provide both a warning for sales on the internet or through a catalog, and a warning with or on products delivered to consumers.” Thus, OEHHA proposes to “clarify” the requirement by making the following revisions to the regulations:

- Making clear that the warning requirements for internet and catalog purchases as described in Section 25602(b) and (c) apply must be satisfied in connection with the warnings for specific product, chemical and area exposure enumerated in Section 25607, et seq.;
- Specifying that internet purchases include mobile device applications; and
- Limiting the use of the electronic warning method to “physical retail location[s].”

The last of these three proposed revisions has caused significant concern in the business community. A coalition of 26 business organizations, including the California Chamber of Commerce (the coalition), submitted a comment to OEHHA characterizing the proposed revision as a “dramatic change to the safe harbor warning regulations, not a clarification.” According to the coalition, limitation of the electronic warning option to “physical retail locations” will force businesses to provide on-label warnings for all products sold through the internet, thereby resulting in two warnings for such products—one on the seller’s website or mobile application, and one on the label. The coalition expressed concern that this change would require businesses to overhaul their Proposition 65 warning programs after having just significantly revised the programs as recently as 2018, and could spur frivolous litigation.

Moreover, the coalition’s concerns appear justified. As written, OEHHA’s proposed amendment would seemingly require e-commerce businesses that previously provided online-only warnings to provide additional warnings on the products themselves, resulting in a two-warning requirement for online sellers while permitting physical retailers to continue providing a single warning at the point of sale.

ALCOHOLIC BEVERAGE WARNINGS

The proposed amendments also revise the Proposition 65 warning requirements for the sale of alcoholic beverages. While the existing regulations require specific warnings for alcoholic beverages sold “through package delivery services,” the proposed regulations would require product-specific warnings “prior to or during the purchase of the product” for any deliveries of alcoholic beverages directly to consumers.

The proposed amendments also impose a separate warning requirement for alcoholic beverages sold over the internet or through a catalog. For such sales, a warning must be provided “prior to or contemporaneously with the delivery of the product” on either the shipping container or package, or by email or text message as part of the e-receipt or confirmation of purchase. This proposed revision would bring the Proposition 65 warning regulations in line with a recent settlement between the California Attorney General and numerous e-commerce businesses, including DoorDash and Postmates, that sell or facilitate the sale of alcohol online.

In light of OEHHA’s proposed amendments, e-commerce businesses should prepare for the possibility that they may be forced to update their compliance programs yet again should they seek the continued shelter of Proposition 65’s regulatory safe harbor.
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