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8
9 BEFORE THE DEPARTMENT OF BUSINESS OVERSIGHT
10 OF THE STATE OF CALIFORNIA

11
12 In the Matter of:) CFL FILE NO.: 60DBO-104155
13 THE COMMISSIONER OF BUSINESS)
OVERSIGHT,) STATEMENT OF ISSUES
14)
15 Complainant,)
16 v.)
17 SEZZLE, INC.,)
18 Respondent.)

19
20 The Complainant is informed and believes, and based upon such information and belief,
21 alleges and charges as follows:

22 I.

23 **Sezzle and its Application**

24 1. Sezzle, Inc. (Sezzle) applied to the Commissioner of Business Oversight
25 (Commissioner) for a lender’s license under the California Financing Law (Fin. Code, § 22000, et
26 seq.) (CFL) on or about September 24, 2019 (Application).

27 2. Sezzle was incorporated in Delaware on January 4, 2016 and its principal place of
28 business is located at 251 1st Avenue N, Suite 200, Minneapolis, Minnesota 55401.

1 (Fin. Code, § 22001, subd. (a).)

2 12. The Department of Business Oversight, through the Commissioner, has jurisdiction
3 over the licensing and regulation of persons engaged in the business of lending pursuant to the CFL.

4 13. “Upon reasonable notice and opportunity to be heard, the commissioner may deny the
5 application for a finance lender [if] [t]he applicant . . . has violated any provision of [the CFL] or the
6 rules thereunder or any similar regulatory scheme of the State of California or a foreign jurisdiction.”

7 (*Id.*, § 22109, subd. (a)(3).)

8 *General rule: Making loans requires a license*

9 14. It is a violation of the CFL to “engage in the business of a finance lender . . . without
10 obtaining a license from the commissioner.” (*Id.*, § 22100, subd. (a).)

11 15. A finance lender “includes any person who is engaged in the business of making
12 consumer loans” (*Id.*, § 22009.)

13 16. A consumer loan “means a loan . . . the proceeds of which are intended by the
14 borrower for use primarily for personal, family, or household purposes.” (*Id.*, § 22203.)

15 17. Put simply, a loan is a “grant of something for temporary use,” and the business of
16 lending money is the business of providing temporary use of money. (Black’s Law Dictionary (11th
17 ed. 2019); *Boerner v. Colwell Co.* (1978) 21 Cal.3d 37, 44 [a loan is the “hir[ing] of money”]; *Milana*
18 *v. Credit Discount Co.* (1945) 27 Cal.2d 335, 339.)

19 *An exception to the rule: non-evasive, bona fide credit sales are not treated as loans under the law*

20 18. In California, merchants may sell goods in exchange for cash (a “cash sale”) or in
21 exchange for a consumer’s promise to pay later (a “credit sale”). (*Verbeck v. Clymer* (1927) 202 Cal.
22 557, 562-563.)

23 19. Merchants may charge a premium for credit sales without the transaction being subject
24 to the state’s loan laws and without the premium being subject to the state’s usury limit. (*Id.* [“[T]he
25 owner of property . . . may offer to sell at a designated price for cash *or at a much higher price on*
26 *credit*, and a credit sale will not constitute usury however great the difference between the two prices
27”] [emphasis added]; *Milana*, 27 Cal.2d at 340.)

28 20. Although not regulated in California as loans, most credit sales payable in installments

1 are otherwise subject to consumer protection laws, including the Unruh Act (Civil Code, § 1801, et
2 seq.), which at the time of *Boerner* provided limits on credit sale premiums. (*See Boerner*, 21 Cal.3d
3 at 46.)

4 21. However, wary of misuse, California’s common law only excepts the making of *bona*
5 *fide* credit sales from the state’s lending laws. (*Id.* at 45.)

6 22. The CFL expressly incorporates the common law’s limited exception for credit sales.
7 (Fin Code, § 22054 [The CFL “does not apply to *bona fide* conditional contracts of sale¹ involving
8 the disposition of personal property”] [emphasis added].)

9 23. The CFL sets forth an additional limit, providing that only credit “sales agreements . . .
10 *not used for the purpose of evading*” the CFL are excepted from regulation under the CFL. (*Id.*
11 [emphasis added].)

12 24. “[T]he courts, alert to the resourcefulness of some lenders in fashioning transactions
13 designed to evade the usury law, have looked to the substance rather than the form of such
14 transactions in assessing their effect and validity, and in many cases have struck down . . .
15 arrangements bearing little facial resemblance to what is normally thought of as a ‘loan’ . . . of
16 money.” (*Boerner*, 21 Cal.3d at 44-45; *Milana*, 27 Cal.2d at 340 [“[C]ourts have been alert to pierce
17 the veil of any plan designed to evade the usury law and in doing so to disregard the form and
18 consider the substance.”].)

19 25. “[T]he issue is whether or not the bargain of the parties, assessed in light of all the
20 circumstances and with a view to substance rather than form, has as its true object the hire of money .
21 . . .” (*Boerner*, 21 Cal.3d at 44.)

22 26. In assessing the substance of a transaction, courts consider “[a]ll of the negotiations,
23 circumstances and conduct of the parties surrounding and connected with their contracts”
24 (*Milana*, 27 Cal.2d at 341.)

25 _____
26 ¹ Contracts documenting consumers’ promises to pay credit sales in installments are typically referred
27 to as “retail installment contracts.” (Black’s Law Dictionary (11th ed. 2019).) One example of retail
28 installment contracts are “conditional sales contracts,” which are “contract[s] for the sale of goods
under which the buyer makes periodic payments and the seller retains title to or a security interest in
the goods.” (*Id.*)

1 When substance may trump form: the role of the third-party financing institution

2 27. California law permits third parties to purchase a merchant's non-evasive, bona fide
3 credit sales contracts without such purchases necessarily subjecting the transactions to the state's loan
4 laws. (*Boerner*, 21 Cal.3d at 45 ["the fact of assignment *in and of itself* has no significant effect on
5 the characterization of the transaction according to its substance"] [emphasis in original].)

6 28. Nevertheless, extensive third-party involvement in the underlying credit sale may
7 cause transactions to be deemed loans, regardless of the form. (*Id.* at 50 [noting "the most
8 troublesome aspect of the subject transactions from the point of view of assessing their true
9 substance: the role of the third-party financing institution"].)²

10 29. Extensive third-party involvement may cause transactions to be deemed loans *even if*
11 *the underlying credit sale is bona fide*. (*Front Line Motor Cars*, 35 Cal.App.5th at 168 "[A]n
12 indisputable predicate fact in [prior cases] is that the credit sales were bona fide. The issue in those
13 cases was whether — given the buyers' and sellers' mutual intent to consummate bona fide credit
14 sales — the participation of the finance companies converted the credit sales into transactions
15 involving loans."].)

16 30. *Boerner* is the "seminal case differentiating a credit sale from a loan," (*Front Line*
17 *Motor Cars*, 35 Cal.App.5th at 164), and appears to set the boundary of permissible third-party
18 involvement in an otherwise non-evasive, bona fide credit sale.

19 31. Although no court in California has considered whether transactions like those
20 structured and marketed by Sezzle are loans, the common law provides three pertinent principles in
21 evaluating third-party participation when considering the substance of a transaction.

22 32. First, a transaction may be considered a loan, despite its form, if a third-party's
23 involvement with the merchant goes beyond that necessary to effectuate the purchase of credit sales.

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25 _____
26 ² (*See, e.g., id.*, 21 Cal.3d at 44 [considering whether third-party's purchase of vacation home
27 builder's credit sales constituted making a loan to consumer]; *Milana*, 27 Cal.2d at 340 [considering
28 whether third-party's purchase of merchant's account receivables constituted a loan to the merchant];
West Pico Furniture Co. v. Pacific Finance Loans (1970) 2 Cal.3d 594, 603-604 [same]; *Front Line*
Motor Cars v. Webb (2019) 35 Cal.App.5th 153, 164.

1 (*Glair v. La Lanne-Paris Health Spa, Inc.* (1974) 12 Cal.3d 915, 925 [“Where, as appears here, a
2 finance company assumes so close a relationship with a seller that it becomes an integral part of the
3 seller’s financing program, the finance company must” be considered a lender.])

4 33. Second, a transaction may be considered a loan, despite its form, if the role of the third
5 party and terms of the transaction are not fully disclosed to the consumer. (*See Boerner*, 21 Cal.3d at
6 53.)

7 34. Third, a transaction may be considered a loan, despite its form, if the third party does
8 not bear the full risk of consumer performance under the credit sale. (*See Milana*, 27 Cal.2d at 342;
9 *West Pico*, 2 Cal.3d at 605.)

10 III.

11 Findings

12 *Sezzle’s merchants make evasive credit sales contracts that are not bona fide.*

13 35. Unlike any reported California case on this issue, Sezzle markets its financing
14 products to consumers *before* the consumers have decided to shop at a particular merchant or to
15 purchase a particular product. Sezzle encourages its users to only shop at merchants who accept
16 Sezzle. The most prominent feature of Sezzle’s website is a directory or virtual mall of Sezzle
17 merchants, including promotions for “featured” merchants. Resulting from Sezzle’s direct consumer
18 marketing, Sezzle recruits new merchant with the claim that merchants who offer Sezzle “increase[]
19 sales and order volumes.” As Sezzle tells potential partners on its website, “[w]e’re especially
20 popular with younger users - shoppers 18 and older that might not have access to traditional lines of
21 credit.”

22 36. A *sine qua non* of a credit sale contract is a contract between a merchant and their
23 customer. However, Sezzle’s consumers and merchants do not enter into contracts with each other.
24 There is no existing contract for Sezzle to purchase, and there is no manifested intent from merchants
25 to make sales on credit to consumers. Sezzle’s contracting process with consumers is as follows:

26 i. Consumers can establish an account with Sezzle in advance of any purchase or
27 any visit to a merchant website. To create an account, consumers must agree to the Sezzle User
28 Agreement (User Agreement) and must “approve Sezzle to make a credit inquiry as an aid to approve

1 my use of Sezzle for this and future purchases.” Despite the reference to a specific purchase, the User
2 Agreement may be executed prior to the involvement of any Sezzle merchant or the contemplation of
3 any specific purchase.

4 ii. The User Agreement is between Sezzle and its users. Sezzle’s merchants are
5 not parties to the User Agreements. The User Agreement is a non-negotiable, clickthrough
6 agreement, subject to unilateral changes post-execution by Sezzle. The User Agreement is changed
7 by Sezzle often. The currently effective User Agreement is available online at
8 <https://legal.sezzle.com/user>.

9 iii. The first two sentences of the User Agreement, located in Section 1.1, declare
10 that “[t]his Agreement describes the terms between Sezzle . . . and you . . . for the financing provided
11 by Sezzle to you for the goods and/or services you purchased from the Sezzle Merchant. Through
12 this Agreement, Sezzle has extended you credit and the right to defer payment for the goods and/or
13 services you have purchased.” There are at least eight other parts of the User Agreement that refer to
14 Sezzle providing direct consumer financing.³ The “user” in the User Agreement is defined as the
15 “person or entity who uses Sezzle Services to purchase products or services from Merchants.”

16 iv. In the User Agreement, consumers also agree to Sezzle’s “Sezzle Card Holder
17 Addendum,” which is described in the User Agreement as follows: “Sezzle offers an interest free
18 installment loan/retail installment credit card that allows users to make purchases from Sezzle
19 Merchants (‘Sezzle Card’). Any purchase made using the Sezzle Card is subject to the Sezzle Card
20 Holder Addendum.”

21
22 ³ (See Sections 1.2 (“Sezzle may unilaterally decide to change this Agreement from time to time,
23 including your credit limit”); 2.1 (“Sezzle is a payment processing platform designed to allow
24 Users to finance and buy products today and pay for them later, through a down payment followed by
25 installment payments.”); 2.2 (referencing “your promise to pay the amount of the goods and services
26 financed by . . . Sezzle” and “confirming the financing of any purchases through . . . Sezzle”); 2.6
27 (“We provide you with financing for your purchases.”); 3.1 (“You can use Sezzle to pay for
28 purchases of goods and services from Sezzle Merchants”); 3.2 (“We may, at our discretion,
impose limits on the amount of money you can use to purchase goods or services”); 4.1
(obtaining authorization to identify “business risks that may exist to Sezzle in offering financing to
you”); and, separate “legal definition” for “Merchant Account” (“an account created with Sezzle by
the Merchant for the purposes of accepting Sezzle as a payment option”).)

1 37. Sezzle structured its merchants’ purported credit sales to evade any consumer
2 protection obligations Sezzle may have otherwise owed to consumers under the Unruh Act or the
3 federal Truth in Lending Act (15 U.S.C. § 1601 et seq.) by limiting the number of installment
4 payments to four.

5 Sezzle’s role in the transaction causes the transactions to be loans regardless of their form.

6 38. Sezzle’s involvement with its merchants goes well beyond any non-lending
7 relationship yet permitted by California courts, and the credit sales purportedly purchased by Sezzle
8 do not justify Sezzle’s extensive involvement. (*Compare Boerner*, 21 Cal.3d at 53 & n. 17 [noting
9 that third-party financier’s provision of forms to document transaction was “beneficial” given the
10 complicated nature of a sale of construction services secured by real property].) In addition to
11 purportedly purchasing merchants’ credit sales contracts, Sezzle provides its merchants marketing
12 services, payment processing services, consumer dispute resolution services, and interest-bearing
13 accounts in which merchants can park the revenue earned from Sezzle. Sezzle’s contracting process
14 with merchants is as follows:

15 i. To offer Sezzle as a payment option, merchants must create an account with
16 Sezzle through which merchants are asked to provide basic contact information, yearly sales, and
17 average order volume. And, to create an account, merchants must first agree to the Sezzle Merchant
18 Agreement (Merchant Agreement).

19 ii. The Merchant Agreement is between Sezzle and its merchants. Sezzle’s users
20 are not parties to the Merchant Agreement. The Merchant Agreement is a non-negotiable,
21 clickthrough agreement, subject to unilateral changes post-execution by Sezzle; although Sezzle does
22 promise that, “[i]f Sezzle makes any changes to this Agreement that it deems to be material, Sezzle
23 will make a reasonable effort to inform you of such changes, but it is your responsibility to review the
24 Agreement posted on our website from time to time to see if it has been changed.” The Merchant
25 Agreement is changed by Sezzle often. The currently effective Merchant Agreement is available
26 online at <https://legal.sezzle.com/merchant>.

27 iii. Like the User Agreement, the Merchant Agreement describes Sezzle’s product
28 as providing credit to consumers, rather than purchasing credit sales contracts from merchants. The

1 first sentence of Section 2.1, which purports to describe Sezzle’s service, states that “Sezzle is a
2 technology that enables Users [to] pay for purchases via an Interest Free Payment Plan.” The
3 merchant in the Merchant Agreement is the “entity who is using Sezzle Services to process payments
4 for products or services.” The merchant’s account is defined as “an account created with Sezzle by
5 the Merchant for the purposes of accepting Sezzle as a payment option”

6 39. Consumers using Sezzle are not fully informed of the role of Sezzle or all financing
7 terms. Sezzle reserves the right to unilaterally impose new fees on consumers subsequent to
8 execution of the User Agreement. Unlike *Boerner*, Sezzle’s merchants do not disclose cash and
9 credit prices, and do not disclose the fees merchants pay to Sezzle. And, unlike *Boerner*, Sezzle
10 prohibits merchants from charging a higher credit sale price, thereby ensuring that its merchants
11 make less from their credit sales than they would from a cash sale in which they would not pay
12 Sezzle’s fees.

13 40. Sezzle does not bear the full risk of loss from performance on the credit sales
14 contracts it purchases. The Merchant Agreement provides Sezzle an opportunity to review and
15 refuse providing financing for certain consumer purchases, despite the sale having already been
16 processed by the merchant. Section 4.1 of the Merchant Agreement provides that “[f]unds from
17 Sezzle transactions typically settle into your external bank account one (1) to seven (7) business
18 days after the product is shipped. The exact settlement time will depend on explicit agreements and
19 approval decisions made by Sezzle’s staff. In some cases, due to risk decisions, delayed shipment,
20 made-to-order products, or excessive Dispute levels, Sezzle may implement a settlement time longer
21 than this initial range.” Section 12.2 of the Merchant Agreement also provides that merchants
22 “agree to an extended funds settlement period of 42 days at account closure to ensure funds are
23 available for returns and refunds.”

24 *Policy considerations do not otherwise justify exempting Sezzle’s transactions.*

25 41. Unlike some of the reported cases in California, there are no countervailing policy
26 considerations justifying the exemption of Sezzle’s product from the state’s loan laws.

27 42. Sezzle’s financing product may be worse for consumers than comparable, regulated
28 options. For example, at least one Sezzle merchant allows consumers to use Sezzle to finance

1 purchase amounts as low as \$35.00. If a consumer used Sezzle to finance a \$35.00 purchase and was
 2 charged all fees provided under the User Agreement, the consumer would have paid an equivalent
 3 annual percentage rate (APR) of about 600% on their purchase. In comparison, in *Boerner*, the
 4 consumers were charged slightly more than the state’s usury limit. (*Boerner*, 21 Cal.3d at 44 n.5
 5 [two transactions at issue charged between 11.6-12.5% APR].)

6 43. Unlike *Boerner*, there is no direct indication from the Legislature that Sezzle’s
 7 underlying credit sales should be exempt from the Unruh Act or other consumer protection laws.
 8 And, unlike *Boerner*, there are no indications that Sezzle provides a unique financing alternative
 9 whose absence from the market in its current form would imperil commerce generally. (*Id.* at 46 n.
 10 11 [“To subject sales-finance companies to the usury acts, however, might constitute a death blow to
 11 this vital enterprise. Instalment [sic] credit is so expensive to service that a finance company often
 12 cannot operate profitably within the limitations of most usury acts.”]; *see also Glair*, 12 Cal.3d at
 13 925.)

14 IV.

15 Conclusion and Prayer

16 Sezzle’s purported purchasing of credit sale contracts between merchants and California
 17 consumers constitutes the making of loans under California law and, thus, requires a CFL license.
 18 “All of the negotiations, circumstances and conduct of the parties surrounding and connected with”
 19 the transactions show that Sezzle did not buy merchants’ credit sale contracts; Sezzle provided
 20 consumers temporary use of money.

21 WHEREFORE, IT IS PRAYED that:

22 Pursuant to Financial Code section 22109, subdivision (a), paragraph (3), Sezzle’s
 23 Application is denied due to Sezzle’s prior violations of Financial Code section 22100, subdivision
 24 (a), for engaging in the business of a finance lender without obtaining a license.

25 Dated: December 30, 2019
 26 Los Angeles, CA

MANUEL P. ALVAREZ
 Commissioner of Business Oversight

27 By _____
 28 Adam Wright
 Senior Counsel