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By Email

Department of Business Oversight
Legal Division
Attn: Mark Dyer, Regulations Coordinator
1515 K Street, Suite 200
Sacramento, California 95814-4052

Re: PRO 07/17 – INVITATION FOR COMMENTS ON PROPOSED RULEMAKING MONEY TRANSMITTER ACT: AGENT OF PAYEE

Dear Mr. Dyer:

On behalf of PayPal, Inc. ("PayPal"), Sidley Austin LLP submits this comment letter to the California Department of Business Oversight (the "DBO") in response to its invitation for comments on a potential rulemaking ("Invitation") regarding the agent of the payee exemption (the "Exemption") to the California Money Transmission Act (the "Act").[1] PayPal appreciates the opportunity to provide input on the Invitation. As a California-licensed money transmitter since 2002, PayPal has participated in the rapid growth of the payments sector. Interpreting the Exemption broadly will foster development of new and innovative payment products, and contribute to the continued growth of the sector. This benefits California consumers by making it easier to reliably send money and make payments without exposing consumers to new risks, and benefits California as a whole by helping the state maintain its position as the nation's leader in technological innovation.

We are providing initial comments on the topics highlighted by the DBO in the Invitation to suggest, on behalf of PayPal, interpretive approaches for the DBO to consider as it begins work on a potential rulemaking. While a broad interpretation is consistent with the statutory text of the Exemption, the intent of the legislature in enacting the Exemption, and the regulatory objectives of the DBO in administering the Act, the DBO's rulemaking efforts must balance the public policy interest in facilitating commercial activity with the need to provide adequate protections for consumers. Accordingly, we limit our commentary to three specific issues that any rule implementing the Exemption should address.

First, any formal interpretation of the language of the statute should define "goods and services" to encompass a wide scope of commercial transactions, including charitable donations. This would mean that a money transmitter may use the Exemption when acting as agent of a

[1] Cal. Fin. Code § 2010(l).

charitable organization. Second, in transactions that involve multiple money transmitters standing between payor and payee, each payment processor involved in the transaction should be eligible to use the Exemption on the same transaction. Finally, the DBO's interpretation should clarify that the disclosure of the existence of an agent of the payee to the payor in a transaction is legally irrelevant to whether the Exemption could be used. Although PayPal has broad authority to transmit funds for California customers under its money transmitter licenses, PayPal supports the effort to exempt transfers in these specific areas because doing so will make it simpler to complete transfers without any increase in risk to payors. PayPal looks forward to an opportunity to continue its dialogue with the DBO regarding the Exemption as the rulemaking process moves forward, and to respond to specific regulatory language proposed by the DBO once available.

I. Interpretive Principles and Legislative History

The first step in any analysis of a statute is to read the enacted text. By its terms, the Exemption applies to transactions where the "recipient of the money or other monetary value is an agent of the payee" and the "delivery of the money or other monetary value to the agent satisfies the payor's obligation to the payee."[2] A payee is a party that is owed money or value as a "provider of goods or services," and a payor is a party that owes money or value as a "recipient of goods or services."[3] The statutory language thus sweeps broadly, and would cover handling of funds as agent of a payee in *all* transactions for goods or services. It is a fundamental tenet of statutory construction that legislative history should not be used unless the language of the statute itself is ambiguous, which is not the case here.[4] Thus, the text of the statute simply does not require a resort to legislative history where the language of the statute itself is not limited to any particular type of good or service or platform through which goods or services might be offered or provided.

The DBO rightly notes in the Invitation that, based on the legislative history of Assembly Bill 2209, which codified the Exemption, the legislature particularly wished to ensure that online marketplace transactions not be regulated as money transmission under the Act. As it appears

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[2] Cal. Fin. Code § 2010(l).

[3] Cal. Fin. Code §§ 2010(l)(2), (3).

[4] *See Meza v. Portfolio Recovery Associates*, LLC, 243 Cal.Rptr.3d 569, 577 (Cal. 2019) (citing *City of San Jose v. Superior Court*, 214 Cal.Rptr.3d 274, 279-80 (Cal. 2017)) (providing that in reviewing a statute the words should be given their ordinary, everyday meaning and that if the meaning is not ambiguous or absurd, the language controls); *Perrin v. U.S.*, 444 U.S. 37 (1979) ("A fundamental canon of statutory construction is that, unless otherwise defined, words will be interpreted as taking their ordinary, contemporary, common meaning."); *U.S. v. Shreveport Grain & Elevator Co.*, 287 U.S. 77, 83 (1932), quoting *Hamilton v. Rathbone*, 175 U.S. 414, 421 (1899) (providing that legislative history should be "given consideration in determining the meaning of a statute, but only where that meaning is doubtful. They cannot be resorted to for the purpose of construing a statute contrary to its plain terms .... Like other extrinsic aids to construction, their use is to solve but not to create an ambiguity").

that online marketplaces and e-commerce transactions were at the forefront of at least some legislators' minds, including the bill's sponsor, Assembly Member Dickinson, the DBO is correct that any implementing regulations should not disrupt application of Cal. Fin. Code §2010(l) to online marketplaces and other e-commerce transactions.

Nevertheless, even if the legislature's primary concern was online marketplaces and e-commerce transactions, that motivation cannot be read to limit the broader scope of the Exemption they finally enacted. As noted above, the statutory text makes no reference to e-commerce, or to similar concepts. However, Assembly Bill 2209 added the definition of "e-commerce" to the Act, and used the term in certain substantive changes to the Act. The legislature did not use that term in the Exemption. If the legislative intent had been to limit the Exemption to e-commerce transactions, the legislators could have used the newly defined term as a limitation in Section 2010(l). Instead, they elected not to do so, confirming that Section 2010(l) must be read as written, *i.e.*, as a broad exemption for entities that handle payments for payees, regardless of how those payments originated.

Accordingly, while the expressed priorities of the bill's sponsor and certain of its supporters indicate that the DBO should take special care not to interpret that Act in a way that would interfere with the application of the Exemption to online marketplace transactions and e-commerce, the references to marketplace transactions and e-commerce do not provide a basis to interpret the statute in a manner that restricts its application to *only* online marketplace transactions and e-commerce.[5]

II. Policy Recommendations

As stated above, PayPal believes that any regulation implementing the Exemption should include three specific provisions. First, the rule should define the Exemption broadly, and expressly state that the Exemption applies to charitable donations. Second, the rule should state that each payment processor in a transaction involving multiple money transmitters may use the Exemption. Third, the rule should clarify that the presence of an agent of the payee need not be disclosed for the Exemption to apply. We address each of these issues in turn.

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[5] *See N.L.R.B. v. SW General, Inc.*, 137 S.Ct. 929, 942 (2017) ("What Congress ultimately agrees on is the text that it enacts, not the preferences expressed by certain legislators."); *Oncale v. Sundowner Offshore Services, Inc.* 523 U.S. 75, 79 (1998) ("[I]t is ultimately the provisions of our laws rather than the principal concerns of our legislators by which we are governed.")

A. The DBO Should Define "Goods or Services" Broadly, and Include Charitable Giving Within the Scope of Activities Eligible for the Exemption.

Financial Code Section 2010, subdivision (l) makes the Exemption available in connection with the provision and receipt of goods or services. The DBO seeks comment as to whether "goods or services" should be further defined and what limitations may exist on these terms. In general, the DBO should define these terms to encompass all commercial exchange of assets, rights, benefits and interests for consideration. This interpretation is consistent with both the broad ordinary meaning of the terms, and the discretion exercised by the legislature in choosing not to define what constitutes "goods or services." Merriam-Webster defines a good as "something that has economic utility or satisfies an economic want."[6] It defines a service as "the work performed by one that serves [including] contribution to the welfare of others."[7] Neither of these definitions cabins what could be considered a good or a service when exchanged in commerce. Instead, both support a broad reading of the statute.

Defining these terms broadly ensures that the statute does not serve as an artificial barrier to technological development and commercial deployment of payment platforms, whether new e-commerce providers and businesses, or existing companies seeking to expand the scope of their activities. According to the legislative history, the legislature's intent at the time of the Exemption's enactment was to ensure the Act "does not create unnecessary barriers to entry for new entities wishing to enter the payments space."[8] This suggests a focus on the means of funds transmission, rather than an exclusive focus on the subjective purpose for which the funds are being transmitted (that is, the good or service being exchanged). Indeed, seeking to differentiate between different types of goods and services could create operational difficulties for payment service providers. In many instances, such companies lack visibility into the details of the goods or services for which the funds transmitted are being exchanged.[9] The changes necessary for a payment service provider to obtain that information would be immense, requiring implementation of new technologies at significant financial cost. Thus, taking both the statutory language and practical limitations into account, the terms "goods" and "services" should be defined expansively in any formal rulemaking by the DBO.

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[6] See "Good." Merriam-Webster.com (Mar. 8, 2019), available at https://www.merriam-webster.com/dictionary/goods.

[7] *See* "Service." Merriam-Webster.com (Mar. 8, 2019), *available at* https://www.merriam-webster.com/dictionary/services.

[8] Assemb. Roger Dickenson, Assemb. Comm. Banking & Fin., 2013-2014 Sess., AB 2209, at Comments (Cal. 2014) (indicating the purposes of AB 2209 are a continuation of those supporting AB 786 (passed Oct. 4, 2013)).

[9] Service providers and acquiring banks rely on representations from merchants that transactions are lawful and do not violate certain standards.

Moreover, this definition should permit charitable donations to be covered by the Exemption when a charity uses an agent to receive payments. A donor (payor) may sometimes receive tangible "goods" in partial exchange for their donation, but always receives "services," in the form of their funds being applied to advance a particular cause. As indicated above, the ordinary understanding of the term "services" does not require that services benefit only the party that has paid for them. If a "service" is "the work performed by one that serves [including] contribution to the welfare of others," a charity that applies a donor's funds to achieve that donor's charitable intent is contributing to the welfare of both the donor and the direct beneficiaries of the charity. For example, if a donor makes a contribution to the American Heart Association, it is the donor's specific intent for Association to use that money to fund cardiovascular medical research and public education. That the benefits from the research and education performed by the Association may not directly accrue to the donor does not detract from the fact that a service is being performed, not only for those directly benefited by such research but also for the donor who sought to achieve that benefit. In exchange for their donation, the donor has still achieved his or her goal of applying funds in pursuit of an intended public objective, a very real benefit received from the charity.

Ensuring that charitable contributions are covered by the Exemption would also be consistent with the intent of the legislature to protect innovative payment platforms. In the years since the enactment of the Exemption, numerous crowdfunding and charitable giving websites have come into existence. These sites serve as aggregation and delivery vehicle for donations made to an individual or cause (*e.g.*, Indiegogo, CrowdRise, or GoFundMe). There is no meaningful technical difference between these sites and those on which individuals can crowdfund for new products or to support businesses, each of which would be covered by the Exemption. Employing a narrow definition of goods and services which excludes charitable giving would arbitrarily differentiate between payment platforms, and create arbitrary barriers to entry for service providers in this space.

Treating charitable giving as ineligible for the Exemption would also result in inconsistent treatment of traditional goods or services under the Act. Charitable giving may involve receipt of a material benefit by a donor in conjunction with their making a charitable contribution.[10] Common examples include receiving tickets to a dinner or concert in exchange for a donation to the hosting organization, or being given a tote bag, tee shirt, or similarly-branded item in exchange for making a charitable contribution. Treating charitable giving as outside the scope of goods or services could lead to the odd result that two transactions involving the exact same tangible item – say, concert tickets – would be treated differently by the Act. It would be an odd result for the DBO to determine that the California legislature intended to

[10] This type of donation is referred to by the Internal Revenue Service ("IRS") as a "quid pro quo contribution." *See* Charitable Contributions – Quid Pro Quo Contributions, *accessible at* https://www.irs.gov/charities-non-profits/charitable-organizations/charitable-contributions-quid-pro-quo-contributions.

discriminate against those payments made for a predominantly charitable purpose, in favor of those made for a purely commercial purpose. Similarly, such an interpretation would then raise difficult questions regarding all sorts of commercial transactions where a payment is being made to purchase a gift. Would payment for concert tickets, or a shirt, no longer qualify for the Exemption if the buyer did not intend to use the tickets or shirt, but rather had the item delivered to a third party as a gift? Many e-commerce sites provide this option, which clearly was not intended to be excluded from the Exemption's scope.

Accordingly, given that a payor can rightly be deemed to receive a good or service in exchange for a charitable contribution, and given further that treating charitable (or gift) giving as ineligible for the Exemption would lead to peculiar results, the DBO should treat charitable giving as eligible for the Exemption in any future rulemaking.

B. Each Money Transmitter in a Multiple-Intermediary Transaction Should be Eligible to Use the Exemption.

Financial Code § 2010(l) provides that for purposes of the Exemption, the delivery of money or monetary value to an agent must satisfy the payor's obligation to the payee, and defines the payor as the "recipient" of the goods or services. The DBO has asked whether the definition of "recipient" should be limited to persons who intend to consume, use or experience the good or service, in effect limiting the definition of "payors" to end users. The question indicates an overly narrow interpretation of the Exemption, as well as an arbitrary preference for certain business models over others.

It would be inappropriate to read the definition of "payor" to bar application of the Exemption when more than one intermediary, each acting for the payee, facilitates the delivery of funds to the ultimate provider of goods or services. Indeed, a typical online marketplace payment might take the form an end user (payor) making payment to the marketplace acting as agent of the ultimate seller (payee), and the marketplace in turn providing those funds to another agent of the seller (payee) to complete the delivery of payment. Provided the person that initiated the payment is protected (in that their obligation to pay has been satisfied), the DBO should look at the transaction as a whole in applying an agent of the payee exemption, rather than focus on a limited definition of "payor" that could result in only applying the Exemption to an agent that receives funds directly from the end user or only to the agent that is the last step in the delivery to the payee.

As previously noted, the legislature intended, at a minimum, that the Act should not be applied in a manner that would burden online marketplaces that facilitate small businesses providing their goods and services to consumers at more competitive pricing. Much of the supporting testimony reflected in the legislative history was based on the premise that costs associated with money transmission licensure would ultimately fall on the small businesses that would "be forced to pay more to bring their products and services to market, thus harming

themselves and consumers" or threaten the economic viability of certain platforms, preventing these business from being able to easily reach consumers at all.[11]

An interpretation of the Act that would provide the Exemption only if one entity sits between the provider of the goods or services and the end user is inconsistent with the reality of e-commerce and payment processing. For example, the payment flow for online marketplaces generally includes at least one, and often multiple, payment processors that assist in the facilitation of the payments in addition to the marketplace itself. If the DBO were to interpret the Exemption in a manner that would not allow for multiple intermediaries, the result would be to eliminate the Exemption for the very industry that the legislature most directly sought to support.

For example, assume that a consumer makes a payment to a marketplace and, based on commercial agreements among that marketplace, a payment processor and the merchant/service provider, the end user's obligation to make the payment is satisfied as soon as the marketplace receives those funds in payment for the merchant's goods or services. The payment flow in such a scenario would look like this:

End User → Marketplace → Processor → Merchant

For reasons of specialization and scale, the marketplace, which receives payment in the first instance on behalf of the provider/payee, will generally rely on a payment processor, also acting as an agent of the merchant/service provider, to pass the funds from the online platform to the merchant/service provider. In determining if the Exemption applies to the payment processor's activity, the DBO should not ask whether the marketplace "received" a service from the merchant and therefore qualifies as a "payor" merely because the payment processor receives the funds directly from the marketplace. Rather, the transaction should be examined as a whole; the question is (i) whether the end user, as "payor" has received a good or service from the merchant, as "payee," and (ii) whether the marketplace or processor is acting as the agent of the merchant/payee. The answer to both these questions is "yes." Thus, an exemption that would have been available if the marketplace had elected to perform the payment activity itself should not automatically become unavailable because it is more efficient and cost effective for the marketplace to deliver funds to a payment processor acting for the merchant, as long as both the marketplace and the payment processor satisfy the requirements necessary to be an agent.

In this regard, we note that the DBO previously has expressed the view that the payor's obligation to pay can only be extinguished once, and that if the payor's obligation to the payee is satisfied with the receipt of payment by the first party in a chain (the marketplace in the above example), it could not also be satisfied by the receipt of payment by the second party in the chain

[11] Sen. Noreen Evans, S. Banking & Fin. Inst. Comm., 2013-2014 Sess., AB 2209 (Dickenson), at Summary of Arguments in Support (Cal. 2014).

(making the payment processor in the example above ineligible to be an agent of the payee). This is an overly narrow reading of the statute, which provides "delivery of the money or other monetary value to the agent satisfies the payor's obligation to the payee." The focus of this language clearly is on whether the payor is exposed to payment risk by having delivered funds to the payee's agent. As long as the payor does not have such risk, the intent of the Act, and the Exemption in particular, is satisfied.

Furthermore, as long as both the marketplace and payment processor have agreed with the payee to act as the payee's agent for payment and have agreed that receipt of funds by the marketplace or the payment processor satisfies the payor's obligation to the payee, the language of the statute is literally satisfied as well. There can be no dispute that payment to the marketplace "satisfies the payor's obligation to the payee;" the only question is whether the subsequent transfer to the payment processor meets that standard. However, if the payment processor and the payee have agreed, for example, that "receipt of payment by [the marketplace or the payment processor] as your agent constitutes receipt of the payment by you and satisfies the payor's obligation to you," the standard set by the Act has been met. While it would be true that the payor's obligation had already been satisfied when funds were delivered to the marketplace, it is also true that the payor's obligation remained satisfied when funds were delivered to payment processor. Moreover, in most cases, the payee would already have received the good or service purchased in advance of receipt of funds by either the marketplace or the payment processor. For example, payment for a ride obtained using a rideshare app is not made until the ride is complete, so the rider/payor is never exposed to risk of delivery of funds without delivery of services. Since the legislative objective was to protect the payor against payment risk, it would be contrary to legislative intent to take the position that payment "satisfaction" can only be a momentary event rather than a status that continues from the time funds are received by the marketplace, through delivery to the payment processor and ultimately to the payee.

Accordingly, rather than requiring the DBO and participants to examine each individual leg of a transaction to determine if the "payor" in such leg "receives" a good or service, the DBO should look to the transaction as a whole, and determining whether (i) the entity receiving funds is acting as an agent to the provider of the good or the service and (ii) whether the obligation of the person from which the payment for the good or service originated has been satisfied prior to or contemporaneous with the receipt of money by that agent. By examining the transaction as a whole, the DBO can review the true nature of the complete transaction, rather than look at the individual components of transaction that could not reasonably exist outside of the transaction as a whole.

C. The DBO Should Affirm That Disclosure of the Existence of an Agent of the Payee in a Transaction is Legally Irrelevant to the Availability of the Exemption.

From the perspective of a payor, there is no difference between a disclosed and an undisclosed agent of the payee. By expressly stating that the disclosure of the existence of an

agent of the payee to a payor is legally irrelevant to the determination of whether the Exemption applies, the DBO would provide needed clarity to payment processors regarding their business model. Further, the DBO would provide the same clarity to business owners who might seek to outsource their payment function, but who are concerned about the risk of business interruption should an undisclosed payment processor face regulatory action. The sole reason for treating disclosed and undisclosed agents differently under the Exemption would be if acceptance of payment by an agent created additional risk to the payor. In such a situation, it could be argued that a payor should be advised whether an agent is participating in a transaction, so as to make an informed choice as to whether or not to take on such risk. However, such disclosure is not a precondition to agency rights and obligations.

Under basic principles of agency law, a payor tendering payment to the agent of a payee extinguishes that payor's obligation to the ultimate payee.[12] The terms of the Exemption further reinforce this protection, requiring that agent and payee, not the payor, enter into a written contract for the agent to act as agent of the payee.[13] Combined, these two protections mean that, from a payor's perspective, the introduction of an agent to a payment transaction does not add risk to the transaction of which a consumer should be made aware. Given that a payor is protected from loss in the event of a failure of the agent, the DBO should therefore be indifferent from a consumer protection standpoint as to whether funds are being accepted by a payee directly, or by an undisclosed payment processor acting as agent of the payee standing between parties. Indeed, from a payor perspective, entering a card number or other payment device information at a website would be entirely consistent with the expectation that the payor has a satisfied his/her payment obligation to the payee, regardless of the independent choice the payee has made to utilize one or more payment processors to handle funds on the payee's behalf. Thus, regulatory acknowledgment of the lack of difference between disclosed and undisclosed agents would serve to reduce uncertainty in the payments space, and would facilitate business use of payment providers as agents of the payee as intended by the California legislature.

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[12] *See, e.g.*, Restatement (Third) of Agency § 6.07(2) (Am. Law Inst. 2006) ("A third party's payment to or settlement of accounts with an agent discharges the third party's liability to the principal if the agent acts with actual or apparent authority in accepting the payment or settlement."); *accord* Restatement (Second) of Agency §§ 181, 206, 207 & cmt. a ("[A third party] can properly make performance of the contract to the agent"), 300 (Am. Law Inst. 1958).

[13] Cal. Fin. Code § 2010(l).

On behalf of PayPal, we welcome ongoing discussion with the DBO regarding these important issues. Please feel free to contact me with any questions you may have. Thank you for your consideration of this matter.

Sincerely,

David E. Teitelbaum

cc: Andrea Donkor, PayPal
Andrew McElmeel, PayPal