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Consumer Lending Update

AUGUST 2018

CALIFORNIA SUPREME COURT: CONSUMER LOAN INTEREST RATES MAY BE UNCONSCIONABLE

California Financial Code (FC) Section 22303 sets forth the maximum numerical rates of interest which California Financing Law (CFL) licensees may charge on consumer loans for a bona *fide* principal amount of less than $2,500 (*i.e.*, usury). Section 22303 expressly excludes consumer loans of $2,500 or more from this usury limitation and no similar provision exists elsewhere in the FC that limits the numerical rate of interest on such larger loans. Nonetheless, the California Supreme Court recently held that interest rates charged on these larger loan amounts may be challenged on the basis of being "unconscionable." *De la Torre et al. v. Cashcall, Inc.*, 2018 Cal. LEXIS 5749 (Cal. Aug. 13, 2018).

The subject of this litigation was two unsecured $2,600 loans (just over the usury threshold), payable over 42 months with APRs of 96 percent and 135 percent, respectively. In 2014 two consumers brought a class action lawsuit against Cashcall alleging that the interest rates violated California's Unfair Competition Law (UCL). Under the UCL unfair competition means any unlawful, unfair or fraudulent business act or practice. Business & Professions (B&P) Code Section 17200. The borrowers did not allege that Cashcall deceptively advertised or failed to accurately disclose the loan terms. Rather, they alleged that the numerical value of the interest rates was so high as to be unconscionable, in violation of a rarely utilized provision of the CFL. Specifically, FC Section 22302 provides that loans found unconscionable under California Civil Code Section 1670.5 are deemed to be in violation of the CFL.

Initially, the federal district court for the Northern District of California granted Cashcall's motion for summary judgment. The court held that the UCL cannot be used as a basis for an unconscionability claim because it would impermissibly require the court to regulate economic policy in an area where the legislature has declined to do so. However, the Ninth Circuit took the case on appeal and certified the following question to the California Supreme Court: *Can the interest rate on consumer loans of $2,500 or more governed by FC Section 22303 render the loans unconscionable under FC Section 22302?* The court did not rule on whether Cashcall's interest rates were unconscionable, only whether they *could* be so.

The court held that FC Section 22302 expressly provides that unconscionability applies to the interest rates on consumer loans in excess of $2,500.

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The court reasoned that the reference in Section 22302 to the statutory codification of the unconscionability doctrine (in Cal. Civ. Code 1670.5) makes clear that "a court may find any contract or any clause of the contract unconscionable and refuse its enforcement." As such, the unconscionability doctrine applies to the terms of a loan contract, "one of which is undeniably the interest rate on the loan." Further, B&P Code Section 17200 treats "violations of other laws" as unlawful practices and thereby independently actionable. The court held that a violation of FC Section 22302 (unconscionability) satisfies the B&P Code Section 17200 "violations of other laws" requirement. Therefore, the plaintiffs had a valid independently actionable claim under B&P Code Section 17200 for the violation of FC Section 22302. The court remanded the case to the lower court to determine whether Cashcall's interest rates were unconscionable.

While the case directly addresses CFL licensees, all usury-exempt lenders in California, including banks and credit unions, need to be aware of it. The doctrine of unconscionability is a vague and fact-based standard that allows courts to inquire into the commercial setting, purpose and effect surrounding a contract's formation. For instance, if the lower court determines that Cashcall's interest rates are unconscionable, that would not preclude a different court from holding that a loan with the same or a higher rate was not. This is because the test for unconscionability is context-driven and will depend on the specific facts of each case. Although this does not guarantee that a borrower will prevail it likely ensures that a lender will have to spend time and resources defending these types of lawsuits. As such, lenders should read *De LaTorre* as saying all consumer credit is at risk of being subject to UCL claims premised on unconscionability.

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