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Case No. S241434
IN THE SUPREME COURT
OF THE STATE OF CALIFORNIA

EDUARDO DE LA TORRE and LORI SAYSOURIVONG,
individually and on behalf of all others similarly situated,
Plaintiffs/Petitioners,

v.

CASHCALL, INC.,
Defendant/Respondent,

On Certified Questions from The United States Court of Appeals for the Ninth Circuit
Pursuant to California Rule of Court 8.548
Ninth Circuit Case Nos. 14-17571, 15-15042

PETITIONERS' CONSOLIDATED ANSWER TO AMICUS CURIAE BRIEFS IN SUPPORT OF RESPONDENT

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INTRODUCTION

The two amicus curiae briefs[1] in support of Respondent CashCall, Inc., seek to convince this Court that it would be wise policy to permit lenders to charge excessive interest rates on loans of $2500 or more that are governed by the California Finance Lenders Law. (Fin. Code, §§ 22000 *et seq.*; all undesignated statutory references are to this Code.) These amici argue that lenders are already highly regulated; that authorizing courts to declare interest rates unconscionable would subject lenders to vague standards; and that judicial application of California's settled law of unconscionability will leave both lenders and consumers worse off.

These arguments are not only wrong, they are misdirected. The California Legislature has already expressly granted courts the authority to determine whether a loan contract specifying an excessive interest rate on a loan of $2500 or more can render the loan unconscionable. The plain language of Sections 22302 and 22303 demonstrates this legislative intent, and the legislative history confirms it. The policy arguments of CashCall's amici cannot eradicate the statutory text.

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[1] Plaintiffs refer to the brief in support of CashCall submitted by the Civil Justice Association of California and the California Chamber of Commerce as the "CJAC Brief," and the brief in support of CashCall submitted by the California Financial Service Providers Association, Financial Service Centers of America, Community Financial Services Association of America and Online Lenders Alliance as the "CFSP Brief."

ARGUMENT

I. CRITICISMS OF THE UNCONSCIONABILITY DOCTRINE ARE IRRELEVANT BECAUSE THE LEGISLATURE HAS ALREADY DETERMINED THAT THE DOCTRINE APPLIES TO EXCESSIVE INTEREST RATES.

CashCall's amici devote considerable attention to criticizing the unconscionability doctrine as unsuitable to govern interest rates, and they suggest that access to credit will be diminished if lenders cannot charge excessive interest rates on loans of $2500 or more. First, these criticisms are directly refuted by Plaintiffs' amici, who include the Center for Responsible Lending. (*See* Ctr. for Responsible Lending *et al.* Br. p. 37.) Even more critically, however, the California Legislature rejected these criticisms of the unconscionability doctrine when it "expressly directed courts to engage in unconscionability analysis *three times*: (a) in enacting Civil Code section 1670.5; (b) in amending the [Consumers Legal Remedies Act] to prohibit unconscionable consumer contracts; and (c) in enacting Financial Code section 22302." (Cal. Attorney General Br. 25-26 (emphasis in original); *see id.* at p. 15 (noting the Legislature "rejected the contention that unconscionability is too vague").)

As for the narrow issue of statutory interpretation before this Court, neither of CashCall's amici says much. The brief of the California Financial Service Providers Association, Financial Service Centers of America, Community Financial Services Association of America, and Online Lenders Alliance (together, "CFSP") simply assumes that Section 22302 does not apply to the loans

at issue here. Hence, its discussion of "extensive regulation" of the loans in question under federal and state law fails even to mention Section 23302 as a form of regulation. (CFSP Br. pp. 14-17.)

For its part, the Civil Justice Association of California and the California Chamber of Commerce (together, "CJAC") suggest it would be absurd to read Section 22302 to authorize courts to determine that interest rates are unconscionable. (*See* CJAC Br. p. 12.) To the contrary, applying the plain meaning of Section 22302 yields no absurd result. It would simply recognize that the unconscionability doctrine applies to consumer finance lenders—just as it does *all other* lenders. (Cal. Attorney General Br. p. 18.)

CJAC also reads Section 22302 to apply to all loan terms except interest rates. (CJAC Br. p. 12.) But the language of Section 22302 does not support that reading (Petitioners' Reply Br. p. 10)—a conclusion also reached by the California Attorney General.[2]

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[2] The Attorney General agrees with Petitioners that Section 22302 applies to interest rates. In a footnote, however, the Attorney General misunderstands Petitioners to say "that a hypothetical loan for less than $2,500 with an interest rate under the limits in the Financial Code section 22303 could never be unconscionable." (Cal. Attorney General Br. p. 16 n.4). In this hypothetical, Plaintiffs had in mind the approach stated in the Uniform Commercial Credit Code. *Cf.* Uniform Consumer Credit Code § 5.108, comment 6 ("Subsection (8) prohibits a finding that a charge or practice expressly permitted by this Act is in itself unconscionable. However, even though a practice or charge is authorized by this Act, the *totality* of a particular creditor's conduct or loan terms may show that the practice or charge is part of an unconscionable determination. Therefore, in determining unconscionability, the creditor's total conduct, including that part of

Contrary to the approach of CashCall's amici, an "appraisal of the wisdom or unwisdom of a particular course consciously selected by the [Legislature] is to be put aside in the process of interpreting a statute. Once the meaning of an enactment is discerned . . . the judicial process comes to an end." (*Tennessee Valley Auth. v. Hill* (1978) 437 U.S. 153, 194.). That meaning is discerned by the statutory text, and it is confirmed by legislative history. In section 22302, the Legislature declared that section 1670.5 "applies to the provisions of a loan contract that is subject to this division," and nowhere did it exempt "interest rates" from such "provisions." In doing so, the Legislature reaffirmed that the unconscionability doctrine applies to excessive interest rates, and it "strengthen[ed]" penalties for lenders that charge unconscionable interest. (Cal. Attorney General Br. p. 15.) This is consistent with the Legislature's longstanding view that the unconscionability doctrine may be applied to govern consumer contracts and financial products, and that courts are well-equipped to determine unconscionability.

CashCall's amici nevertheless claim that applying the unconscionability statute to CashCall's loans would authorize judicial rate caps. (CFSP Br. p. 28.) To the contrary, unconscionability is a far broader and more searching consumer protection doctrine. Unlike simple rate caps, the unconscionability doctrine applies to *all* loan terms, including, but not limited to interest rates, and requires

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his conduct which is in accordance with the provisions of this Act, may be considered.") (emphasis added).

courts to examine loan terms factually, in their commercial setting and according to their practical effect, under the well-recognized standards the courts have long established. (Ctr. for Responsible Lending *et al.* Br. pp. 4-7, 9-22.)

As this Court has recognized in discussing the "price unconscionability doctrine,"[3] unconscionability "regulate[s] not only the sale of bank services but the sale of groceries, automobiles, furniture or medical services." (*Perdue v. Crocker Nat'l Bank* (1985) 38 Cal.3d 913, 943.) Petitioners are unaware of any industry or transaction the Legislature or the courts have exempted from section 1670.5 since its enactment nearly 40 years ago. Neither CashCall nor its amici cite any such exemptions. By enacting Section 23302, the Legislature eliminated any doubt that by lowering the rate caps, it was not granting an unconscionability exemption to the subprime installment lending industry. This Court should reject the industry's attempt to obtain from this Court what the Legislature has denied.

CJAC asks "Why, one should reasonably ask of such an interpretation, would the Legislature set detailed rates for loans under $2500 while setting no maximum interest rate charges for loans above that amount, but delegate to the judiciary unbridled authority to set whatever rates it feels under the circumstances is 'conscionable' or 'unconscionable'?" (CJAC Br. p. 13.) The Department of Corporations answered this question in its Enrolled Bill Report in 1985, confirming that although it was lowering the interest-rate ceiling it was also

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[3] Cal. Attorney General Br. pp. 8-13; Consumer Amici Brief pp. 7-12.

*"preserving the consumer protection provisions of **all laws**."* (CashCall RJN Ex. 4 (p. 76 of 90.) (emphasis added).) These "consumer protection provisions" included the unconscionability doctrine expressly invoked in Section 22302. This statutory construction of the relationship between Sections 22302 and 22303 is reasonable, consistent, and readily reconciles the two provisions. It is controlling. (Petitioner's Opening Br. p. 7; Cal. Attorney General Br. pp. 15-19.)[4]

CJAC also asks "And why would the financial lending community support a bill — SB 447 (1985), which it indisputably did — that delegated such immense, uncabined authority to courts to enjoin and order restitution or disgorgement to all borrowers who entered into loan contracts above $2500?" (CJAC Br. pp. 13-14.) The legislative history, however, shows that the original bill was amended on July 15, 1985 to add new section 23302 in response to the Attorney General's objection that the industry's version of the bill failed to protect borrowers against "exorbitant rates." (Petitioners' RJN Ex. "D".) The intent of the Legislature is revealed by the statute the Legislature actually passed, not by what the "lending community" might be supposed to have supported.

CashCall's amici echo CashCall's central theme that by imposing rate caps on loans below $2500, the Legislature intended to leave interest on other consumer loans under the CFL to the free market. (Respondent's Answer Br. pp.

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[4] Contrary to CJAC, this approach also makes good sense. Whereas lenders can structure loans so as to "skirt" specific regulations, "unconscionability is more resistant to evasion." (Bender, *Rate Regulation at the Crossroads of Usury and Unconscionability* (1994) 31 Hous. L. Rev. 721, 739.)

28-29.) These amici claim there is a "highly competitive" market for subprime installment loans in California. (CFSP Br. pp. 11-13; CJAC Br. pp. 17-19.) Even if there were a competitive market for these loans, however, that does not exempt the loans from the unconscionability statute. This Court has provided perhaps the best rebuttal to amici's claim that "free market" transactions are exempt from the unconscionability law:

> Defendant also argues that underlying both the 1980 and 1982 Acts is the philosophy that service charges as well as interest rates should be set by market forces, not government regulation. Defendant's argument mistakes the purpose of the provisions of state law at issue here [including § 1670.5]. Those provisions are part of the common law governing *all* commercial transactions; they regulate not only sale of bank services but the sale of groceries, automobiles, furniture or medical services. The duty of good faith and fair dealing, *and protection against unconscionable contracts*, has never been thought incompatible with a free and competitive market. *Defendant is really asking for a market free of those restraints against oppression and overreaching applicable to all other commercial operations.*

(*Perdue,* 38 Cal. 3d at 943 (emphasis added).)

Amici's assertions of a competitive market are nevertheless unsubstantiated by the record. The DBO report CFSP cites in support of this claim, in fact, does not evidence competition in this particular market. (CFSP Br. pp. 11-12; *see also* CJAC Br. pp. 18-19.) The 2016 DBO Report shows that state-licensed lenders made 400,000 unsecured loans in the $2,500-5,000 range in 2016, and that 60% of those had APRs of 100% or higher. But the CBO reports do not report the number of different lenders that made these loans, what relative market shares were, or otherwise indicate whether the market was competitive, monopolistic, or

oligopolistic. Loan volume, standing alone, does not establish whether a market is concentrated or competitive because there could be many lenders or few; the DBO reports simply do not say.

In any event, the evidentiary record in the District Court demonstrated that CashCall was the only significant source of such loans during the class period in this case, 2004-2011. (*See* Suppl. Excerpts of Record ("SER"), 1-SER-pp. 16-17, 181-184; 10-SER-pp. 2505-2506; 2508-2509; 11-SER-2719.) Indeed, CashCall's CFO testified that during the class period that CashCall had a "unique" product and faced "no competitors:"

> *Q. You state that, "It's a unique product offering [CashCall's $2,500 installment loan] with high customer demands." Why did you feel it's a unique product offering?*
>
> *A. There's still no other product out there that is an installment loan that's based on a simple interest calculation, no prepayment penalty. It distinguishes itself amongst — it's not a payday loan, it's not a normal bank loan, it's the niche in between.*
>
> *Q. What other companies have occupied that niche with CashCall?*
>
> *A. I believe the last point of the page says, "No competitors."*
>
> Q. Oh, okay. Is that still the case?
>
> A. There --

MR. COHEN: Objection; calls for a legal conclusion and speculation. You can answer.

THE WITNESS: *There are some minor players in the space that are offering installment-based loans.*

Q. BY MR. LEVY: When did they come into the space?

A. I don't recall. It would have been after this point. After the market came back [that is, after the close of the class period in July 2011].

(10-SER-pp. 2508-2509 (emphasis added).)

CFSP asserts that the triple-digit interest rates "are tempered by consumers' ability to go elsewhere." (CFSP Br. p. 13.) Yet CFSP asserts, without support, that "[s]ubprime borrowers rely on the challenged loans because they lack alternatives." (*Id.* at p. 18.) In opposing CashCall's summary judgment motion, Petitioners showed that payday loans, tax refund anticipation loans, auto title loans, pawnshop loans, etc., are not comparable to CashCall's $2,500 installment loans because they are not unsecured loans with loan amounts and maturities comparable to CashCall's loans. (Petitioners' Ninth Circuit Reply Br. pp. 35-36.) This lack of alternatives, coupled with CashCall's market dominance during the class period from June 2004 through mid-July 2011, establishes an oligopolistic market in which CashCall was able to dictate loan terms and interest rates. (*Id.* at pp. 35-36, 45-46.)

CFSP argues that "the risk of judicially imposed caps would force borrowers into worse options" (CFSP Br. p. 21), such as paying bills late, bouncing checks with accompanying NSF fees, bank account closures, utility service interruption, and foregoing needed medical treatment[5] (*Id.* at pp. 21-24). CFSP, however, ignores that by lending to subprime borrowers at 96% and 135% interest rates payable over 42 and 36 months, CashCall converted low- or non-interest-bearing debt into unaffordable debt, costing 3-4 times the amount borrowed. (Excerpts of Record ("ER") 111; SER 23, 280-281, 352, 1482, 1493-1494.)

CashCall applied a 35-40% "acceptable default rate" in underwriting its $2,500 loans, and the actual default rate during the class period was nearly half, 45%. (SER 21, 290-291, 492-493, 2425-2427, 2435-2437, 2443-2445, 2450-2451.) CashCall loans subjected defaulting borrowers to the same economic hardships CFSP claims to bemoan—paying other bills late to appease CashCall, incurring NSF fees to CashCall and bank accounts due to CashCall's squeeze on their bank accounts (exacerbated by CashCall's requirement that borrowers authorize CashCall to take payments electronically directly from the borrower's bank accounts), bank account closures due to drainage by CashCall, and potentially unpaid utility bills. (*See generally* Petitioners' Opening Br. p. 4.)

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[5] California requires hospitals and other health care providers to provide discounted "charity care" low-income consumers and a payment plan. (Health & Safety Code, §§ 127400-127462.)

Amici's arguments boil down to the assertion that it is better policy for consumers to be burdened with unconscionable loans—loading unaffordable debt on already financially distressed individuals and families, and subjecting them to aggressive collection activity from CashCall, bank account sweeps, and CashCall's negative credit reporting that makes it even more difficult to qualify for new credit—than to have no loans at all (which is by no means a necessary, nor even a likely, result of Petitioners' position). By enacting section 22302, the Legislature rejected Amici's suggested abdication of the courts' traditional role in determining unconscionable practices. CashCall's amici are the ones urging "economic policy" on the courts.

II. THE CLAIMS OF UNCONSCIONABILITY IN THIS CASE ARE NOT VAGUE OR AMBIGUOUS AND DO NOT REQUIRE THE COURTS TO ENGAGE IN "ECONOMIC POLICYMAKING."

Both CJAC and CFSP assert that the class claims of unconscionability in this case are vague, ambiguous, or both. For example, CJAC asserts that the "standard of unconscionability" itself is "vague and amorphous." (CJAC Br. p. 22; *see generally* pp. 22-26.) CFSP characterizes the Court's role in assessing unconscionable contracts as "ad hoc judicial second-guessing of interest rates," to create the ruse of uncertainty for lenders. (CFSP Br. pp. 17-18.)

Amici make no principled attempt to ascertain the intent of the Legislature in enacting sections 22302 and 22303. Instead, they invite this Court to disregard that intent entirely by suggesting that the Legislature acted unwisely in subjecting

interest rates to judicial scrutiny under section 1670.5. (CFSP Br. pp. 17-18; CJAC Br. pp. 22-26.) Amici's "economic policymaking" arguments are thinly-veiled requests for this Court to simply ignore section 22302 on policy grounds.

Nevertheless, amici's arguments are unsupported and without merit. CFSP relies on a quote from *Cel-Tech Communications v. Los Angeles Cellular Telephone Co.* (1999) 20 Cal. 4th 163, 185. (CFSP Br. p. 17.) But *Cel-Tech* was not an unconscionability case, and the mandates of Financial Code section 22302 and Civil Code section 1670.5 were not before the *Cel-Tech* Court. *Cel-Tech* was addressing the "unfairness" prong of the UCL, but no such claim is being made in this case. The claim in this case is instead brought under the "unlawful" prong of the UCL, which this Court has consistently construed as authorizing "borrowing" a violation of any law as a predicate for an "unlawful" business practice. (*See* pp. 21-22, *infra*.)

The amicus brief from the California Attorney General directly refutes amici's assertion that the unconscionability claim under California law is vague or rudderless:

> As the legislative history for Civil Code section 1670.5 shows, the Legislature considered unconscionability to have a "well-understood meaning" based on '[a] multitude of cases." (See *ante* p. 15.) Respondent's view of unconscionability as "a vague and malleable" concept (see Def.'s Answer Br. at 10) is not shared by the Legislature,

which rejected the same arguments when enacting Civil Code section 1670.5.

(Cal. Attorney General Br. p. 25; *see also* pp. 8-12 ("price unconscionability" doctrine); 13-15 (legislative history of §1670.5).)

This Court has consistently and faithfully applied that "well-understood meaning" to section 1670.5 in its jurisprudence since 1979, when the statute was enacted and codified the common law doctrine. (*See, e.g., Baltazar v. Forever 21, Inc.* (2016) 62 Cal.4th 1237, 1243-1245 (reviewing general principles of unconscionability); *Sonic-Calabasas A, Inc. v. Moreno* (2013) 57 Cal. 4th 1109, 1153 (*Sonic II*).)

The Consumer Amici Brief demonstrates exhaustively that over the course of centuries, the unconscionability rules have been applied to pricing cases and have developed the same "well-understood" meaning as section 1670.5 has in California. (Ctr. For Responsible Lending *at al.* Br. pp. 24-29; *see also* pp. 13-18, 31-41.) The cited sources, individually and in combination, squarely refute the bald suggestion by CashCall's amici that section 1670.5 is untethered and incapable of understanding by business entities and courts alike.

CJAC claims that interest rate unconscionability requires a "cost benefit analysis" because that is "the favored means of evaluating financial regulations governing interest rates …." (CJAC Brief p. 24.) CJAC cites no case law to support this claim. None of this Court's cases cites "cost benefit analysis" as a factor to be considered in adjudicating whether one or more price terms is

substantively unconscionable. *(E.g., Perdue, supra*, 38 Cal.3d at 926-927; *see also* Ctr. For Responsible Lending *at al.* Br. pp. 21-24 (identifying and discussing the factors identified in *Perdue).*)

CJAC goes on to state that cost-benefit analysis "[w]ould logically apply when courts try to regulate interest rates based on unconscionability," citing and quoting from Posner and Weyl, *Cost-Benefit Analysis of Financial Regulations: A Response to Criticisms* (2015) 124 Yale L. J. Forum 246. (CJAC Brief p. 24.) But there is nary a word about unconscionability in that article. And there is no mention there of courts or anything having to do with unconscionability adjudication. The article is exclusively about the cost-benefit analysis of financial regulation using bank capital requirements as its prime example. (*Cost-Benefit Analysis of Financial Regulations*, *supra*, 124 Yale L.J. at p. 248.) It was written to refute the criticisms of the leading critic of the authors' theory that financial regulators should use cost benefit analysis to evaluate financial regulations. (*Id.* at p. 246.)

In sum, the doctrine of unconscionability, which section 1670.5 codified and delegated exclusively to "the courts" for application, is a long-established and well-developed *judicial* doctrine, and does not reflect "economic policymaking," as both CashCall and its amici contend. The amici supporting Petitioners persuasively refute the suggestion that courts should abstain from adjudicating legitimate claims of price unconscionability. (Cal. Attorney General Br. pp. 25-26; Ctr. For Responsible Lending *at al.* Br. pp. 31-41.)

III. APPLYING THE UNCONSCIONABILITY DOCTRINE TO CASHCALL'S LOANS WOULD NOT IMPAIR ACCESS TO NEEDED CREDIT.

CashCall asserts that borrowers will be deprived of needed credit if these loans could be held unconscionable. CFSP makes the same assertion but offers neither data nor argument to support its theory. (CFSP Brief pp. 17-25.) Rather, CFSP's argument is based entirely on *payday lending* data, and it echoes the claims of payday lenders, who make high-cost, very short-term loans without regard to borrowers' ability to repay them. Not only does this case not involve payday loans—which consist of very small dollar amounts and very short term loans unlike CashCall's at issue here with loan terms of 42 and 36 months —but there has also been no data showing impaired access to needed credit in states that have affirmed the remedy that Petitioners seek here.

First, CFSP does not cite any study concluding that applying unconscionability law would impair access to the installment loans at issue here—$2,500 or more loans payable not in 31 days, but over three to four years at sustained interest rates of well over 100%. Conspicuously, CFSP provides the Court no evidence of any impact on installment lending in other states where the unconscionability laws have been applied to loans like CashCall's. (*See* Ctr. For Responsible Lending *et al.* Br. p. 28, n. 29 (reporting that the unconscionability doctrine has been applied to consumer lending in at least 14 states, including

Alabama, Colorado, Idaho, Indiana, Iowa, Kansas, Louisiana, Maine, New Mexico, Oklahoma, South Carolina, West Virginia, Wisconsin, and Wyoming).) "Despite the application of the unconscionability doctrine to interest rates in these states, the consumer lending industry apparently remains sufficiently profitable to continue operating in each of them." (*Id.*)

Nor does CFSP cite any evidence of credit foreclosure in New Mexico, where the Supreme Court in *State ex rel. King v. B&B Inv. Grp., Inc.* (N.M. 2014) 329 P.3d 658, 672, held that the elimination of interest rate caps did not displace the application of state unconscionability law to high-cost signature loans.

Nevertheless, even as to payday loans, CFSP's arguments are unavailing. In California, payday loans are regulated by the Deferred Deposit Transaction Law (Financial Code §§ 23000 *et seq.*), not by the CFL (Financial Code §§ 22000 *et seq.*). In California, a payday loan (a "deferred deposit transaction") is the deferral of the deposit of a customer's personal check, not to exceed $300, for up to 31 days. (Fin. Code, § 23035.) The fee for a payday loan cannot exceed 15% of the face amount of the check. (*Id.*, § 23036, subd. (a).)

CFSP's assertions with respect to payday loans are negated by the fact that fifteen states and the District of Columbia have effectively prohibited high-cost payday lending by instituting interest rate caps of 36% or less, and studies show

that borrowers have not been deprived of needed credit or suffered other adverse consequences that CFSP claims would result.[6]

Similarly, in 2008, the Arkansas Supreme Court shut down payday lending in the state, holding that a state law authorizing payday lending violated the state constitution's usury cap of 17%. (*Mcghee v. Arkansas State Board of Collection* (Ark. 2008) 289 S.W.3d 18.) Lenders argued to the Supreme Court that banning the loans would diminish access to needed credit. (*Id.* at p. 28.)

In a survey seven years later, former payday borrowers reported results similar to those in North Carolina: that in the years following the Supreme Court's decision they employed other strategies to meet cash shortfalls, and that they were better off without the high-cost loans. (Meredith Covington & Jennifer Johnson, *Into the Light: A Survey of Arkansas Borrowers Seven Years after State Supreme Court Bans Usury Payday Lending Rates*, Southern Bancorp Community Partners (April 2016) pp. 5-6).[7])

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[6] For example, a study commissioned by the North Carolina Commissioner of Banks after that state eliminated payday lending concluded that the absence of payday loans had no significant impact on the availability of credit in North Carolina and identified an array of financial options that low- and moderate-income individuals used during a financial shortfall. (Ctr. for Community Capital, University of North Carolina at Chapel Hill, *North Carolina Consumers After Payday Lending: Attitudes and Experiences with Credit Options* (Nov. 2007) p. 1.) These options included formal alternatives, such as the use of a credit card or cash advance, and informal assistance such as help from friends and family. The study found that nearly nine out of ten households surveyed thought that payday lending was a bad thing, and this overwhelmingly negative view of the product did not vary significantly for households that had experienced a financial shortfall.

[7] Available at http://southernpartners.org/pp/PP_V43_2016.pdf