No. S241434

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IN THE SUPREME COURT

FOR THE STATE OF CALIFORNIA

EDUARDO DE LA TORRE *et al.*,

Plaintiffs, Appellants, and Cross-Appellees,

vs.

CASHCALL, INC.,

Defendant, Appellee, and Cross-Appellant.

ANSWER BRIEF ON THE MERITS

On a Certified Question from the United States Court of Appeals for the Ninth Circuit, Case No. 14-17571
[Cal. Rules of Court, rule 8.548]

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I. INTRODUCTION

The Ninth Circuit asked whether the interest rate on loans of $2,500 or more, governed by California Financial Code Section 22303, can be unconscionable under Section 22302.[1] The answer is no. The California Finance Lender Law (FLL, Fin. Code, § 22000 et seq.) comprehensively regulates consumer finance lending, and the Legislature has chosen to exempt loans of $2,500 or more from *any* rate regulation. This is not mere legislative silence. It reflects the Legislature's deliberate policy decision to *remove* pre-existing interest rate caps on loans of $2,500 or more and to allow the market to set rates on these loans. In doing so, the Legislature stated that consumer finance lenders like CashCall, Inc. "can charge whatever interest rate they want" on these loans, which are "exempt from the interest rate ceilings of the Financial Code."[2] The Legislature was clear about what it was doing: "[t]he effect of lowering the interest rate ceiling [from $5,000 to $2,500] is to eliminate rate regulation as a form of regulation of loans made under these laws."[3]

Plaintiffs want to re-impose an interest rate cap by obtaining a judicial determination that the fully disclosed interest rates on more than 135,000 of CashCall's loans are unconscionable. The effect of Plaintiffs' lawsuit would be a judicially created interest rate cap of 90 percent (or some other rate determined by the federal court overseeing this case). That result is contrary to the express terms of the FLL.

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[1] All undesignated statutory references are to the Financial Code.
[2] Motion for Judicial Notice (MJN) Ex. 2.
[3] MJN Ex. 3. "Ceiling" means the highest principal loan amount subject to statutory limits (or "caps") on interest rates. The FLL legislative history occasionally refers to an interest rate cap itself as a "ceiling."

Section 22303 is part of a comprehensive, uniform regulatory scheme overseen by the Department of Business Oversight (Department). Plaintiffs' interpretation would upend that uniform regulatory scheme and turn interest rate regulation into an ad hoc judicial process with each court free to impose its own interest rate cap. That is clearly not what the Legislature intended when it amended the FLL in 1985.

Plaintiffs' interpretation would also undermine two of the purposes of the FLL. First, allowing court-imposed interest rate caps would restrict access to credit. CashCall makes loans to subprime borrowers who have poor credit histories and present a higher risk of default than prime borrowers. The interest rates CashCall and other lenders charge on subprime loans reflect the high cost and risk of lending to such borrowers. Interest rate deregulation promotes access to credit by providing lenders the flexibility to make credit available in markets where the cost otherwise would be prohibitive. The uncertainty and unpredictability imposed by ad hoc decisions of "unconscionability"—a vague and malleable concept that offers scant guidance for adjudicating interest rate challenges on an individual, let alone class- or industry-wide, basis—would drive lenders out of the market, depriving consumers of credit options.

Second, allowing borrowers to challenge fully disclosed interest rates would undermine competition. Rather than setting rates based on competitive market forces, lenders would be forced to set their rates in compliance with prior court injunctions, or in anticipation of how some future unknown court would evaluate their rates. Different courts might impose different "not unconscionable" rates based on each judge's view of the facts and arguments presented in a particular case. The consumer credit market would become largely irrelevant as it devolved from a uniform

regulatory regime to ad hoc adjudications "with no prospect of certainty or stability in the respective rights and duties of the parties." (*Harris v. Capital Growth Investors XIV* (1991) 52 Cal.3d 1142, 1167, superseded by statute on other grounds, Civ. Code, § 52, subd. (f).)

The answer to the Ninth Circuit's question is no. Allowing a court to adjudicate Plaintiffs' claim is directly contrary to the Legislature's policy decision to remove the interest rate caps on these loans.

II. STATEMENT OF FACTS

A. CashCall's Business Model.

CashCall is a licensed finance lender that offers unsecured term loans to subprime borrowers. (4-SER-931 ¶ 14, 4-SER-933 ¶ 18.[4]) Historically, traditional lenders, like banks, would not lend to subprime borrowers, who have been limited to alternative loan products, such as payday loans, tax refund anticipation loans, and auto title loans, which carry many unfavorable terms, in addition to very high interest rates.[5] (4-SER-941 ¶ 39; 4-SER-953 ¶ 72; 4-SER-983.) CashCall's loans, in contrast, did not impose onerous risk-shifting terms, such as prepayment penalties or requiring security. (7-SER-1492-93 ¶¶ 3-6.)

Offering unsecured subprime loans is risky, because these borrowers default at significantly higher rates than prime borrowers. (7-SER-1493 ¶

[4] "ER" and "SER" refer, respectively, to the Excerpts of Record and Supplemental Excerpts of Record filed in the Ninth Circuit.

[5] The loans at issue here are not payday loans, which are regulated under a separate statutory framework that permits annual percentage rates (APRs) of 460 percent or more. (See Fin. Code, § 23035, subd. (a); *id.*, § 23036, subd. (a); http://www.dbo.ca.gov/forms/CDDTL/CDDTL-001-Payday_Loan_Trifold_PDF-FINAL-(Rev.08-13).pdf, at p. 2 ["A 15% fee is equivalent to an annual percentage rate (APR) of 460% for a two-week loan."].)

5; 4-SER-931 ¶ 13.) CashCall seeks to limit the default risk through careful underwriting, which resulted in it rejecting more than 72 percent of loan applications. (7-SER-1493 ¶ 5.) Nonetheless, 45 percent of the Class members defaulted on their loans—a slightly higher default rate than the 40 percent rate that CashCall anticipates in its profitability model. (6-SER-1264 ¶ 21.) Neither figure is an "acceptable default rate," as Plaintiffs argue. (Petitioners' Opening Brief (POB) pp. 3-4.) Rather, the default rates demonstrate the high costs and risk inherent in lending to subprime borrowers, which is why CashCall must charge higher interest rates. (4-SER-937 ¶ 28; 4-SER-938 ¶ 31.) Plaintiffs' own expert agreed that CashCall must charge higher rates: "by pursuing a high-volume, unsecured consumer lending model targeted at higher risk, subprime borrowers, CashCall incurs higher expenses in the form of advertising costs, cost of funds and default costs, which ultimately increases the annual percentage rate (APR) CashCall must charge borrowers in order to achieve its targeted profitability." (4-SER-1093-94 ¶ 99; see also 4-SER-1085 ¶ 85; 5-SER-1118:9-1119:3; 5-SER-1140:10-1141:2.)

CashCall used trial and error to determine the appropriate interest rate for its loans. Prior to the Class period, the interest rate for CashCall's $2,600 loan product (the amount borrowed by nearly all Class members) was 79 percent. But CashCall could not make a profit at that rate due to its high costs and the high default rate, so it raised the rate to 87 percent, and then to 96 percent, where the rate remained from August 2005 to July 2009, when CashCall raised it to 135 percent. (7-SER-1493-94 ¶ 8, 1497 ¶ 23, 1499 ¶ 35.) Notwithstanding these admittedly high interest rates, CashCall did not make excessive profits, and did not even reach its targeted profitability of 15-20 percent. (1-ER-41:15-17; 7-SER-1499 ¶ 34.)

Under its broad authority to regulate finance lenders (*see* Fin. Code §§ 22704-22718, 22750-22752), the Department conducted comprehensive, multi-week onsite audits of CashCall in 2004, as well as in 2007 (when the interest rate was 96 percent) and 2010 (when the interest rate was 135 percent). (8-SER-1696-97, 1914-24.) During these examinations, the Department reviewed extensive documentation regarding CashCall's loans and communications with borrowers. (8-SER-1696 ¶ 13.) The Department never took regulatory action against CashCall based on its interest rates. (8-SER-1696-97 ¶¶ 14-16.)

B. The Competitive California Credit Market.

The California credit market, including the subprime market, is highly competitive. According to Plaintiffs' consumer protection experts, "thousands" of comparable loans were available to Class members. (5-SER-1147:6-1148:2, 5-SER-1247-50 ¶¶ 11-16.)

The undisputed evidence also showed that CashCall's interest rates compare favorably to other loans available to subprime borrowers. During the Class period, the average APR on payday loans ranged from 411 percent to 429 percent; the APR on tax refund anticipation loans averaged 149 percent; and the APR on auto title loans ranged from 120 percent to 300 percent. (4-SER-983.)

In addition, the Department's annual reports evidence a robust market for loans. (3-SER-516-669.) For example, when the operative complaint in this action was filed in 2010, the Department reported that licensed lenders made 253,878 unsecured loans. (3-SER-638; see also 3-SER-516-798; MJN.) The Department's reports also show that CashCall's interest rates are not outliers. In 2010, for example, a total of 37,077 loans

were made with principal amounts of $2,500 or more and APRs of 100 percent or more, and 28,950 loans of $2,500 or more were made with APRs between 40 and 99 percent, many of which undoubtedly exceeded Plaintiffs' 90 percent unconscionability cut-off. (3-SER-641-642; MJN.) The Department's annual reports for other years during the Class period confirm that, in each year, there were tens of thousands of loans at rates exceeding Plaintiffs' 90 percent unconscionability cut-off. (3-SER-516-798; MJN.)

C. CashCall's Disclosure of Interest Rates and Loan Terms.

CashCall does not "deflect[] the borrower from critical information about the loan's real cost and risk," as Plaintiffs argue. (POB p. 3.) To the contrary, CashCall's interest rate disclosures exceeded regulatory requirements. Whenever CashCall's advertisements mentioned interest, they stated the highest rate or noted generally that the loans carried a high interest rate. (7-SER-1692 ¶ 7.) CashCall's website always included links to interest rate information. (6-SER-1262 ¶¶ 8-9.) In addition, CashCall's loan agents disclosed the interest rate whenever an applicant asked about loan terms—a practice evidenced by recordings of Class member loan applications. (4-SER-810-11 ¶¶ 18-24; 4-SER-908-921; 3-SER-506.)

CashCall's promissory notes included prominent Truth-in-Lending Act (TILA) disclosures that listed the annual percentage rate (APR), the finance charge, the amount financed, and the total payments if the loan went to term. (6-SER-1465; 6-SER-1264 ¶ 19; 6-SER-1469; 6-SER 1263 ¶ 16.) All promissory notes after August 2005 (when the interest rate was raised to 96 percent) contained the following disclaimer:

THIS LOAN CARRIES A VERY HIGH INTEREST

RATE. YOU MAY BE ABLE TO OBTAIN CREDIT UNDER MORE FAVORABLE TERMS ELSEWHERE. EVEN THOUGH THE TERM OF THE LOAN IS 42 MONTHS, WE STRONGLY ENCOURAGE YOU TO PAY OFF THE LOAN AS SOON AS POSSIBLE . . . .

(6-SER-1263 ¶ 15) (capitalization and bolding in original.)

After the loan funded, CashCall sent each borrower an email that reiterated all material loan terms, including the interest rate. CashCall would also make a "Welcome Call" to each borrower, during which CashCall reiterated the loan terms, including the interest rate. (4-SER-810 ¶ 16; 6-SER-1263-64 ¶ 17.) At any time, borrowers could review an online amortization schedule that listed every scheduled payment, including the amount applied to principal and interest. (6-SER-1264 ¶¶ 18, 19.)

D. The Class.

The Class is defined as: "All individuals who, while residing in California, borrowed from $2,500 to $2,600 at an interest rate of 90% or higher from CashCall, Inc., for personal, family, or household use at any time from June 30, 2004, to July 10, 2011."[6] (2-ER-195:5-7.)[7] A total of 135,288 loans were made to Class members. (6-SER-1261 ¶ 3.)

The average Class member's FICO score was less than 600, well

---

[6] Plaintiffs' selection of the 90 percent interest rate cut-off was a tactical response to CashCall's argument in opposition to class certification that individual issues predominated because the interest rates varied. Their revised class definition excluded the original plaintiff, whose loan carried a 59 percent interest rate (5-SER-1232:22-24), as well as borrowers with loans that had interest rates of 79 percent and 87 percent. Those rates are admittedly high compared to rates charged to prime borrowers. However, under Plaintiffs' theory, these rates apparently would not be unconscionable. That sort of arbitrary line-drawing underscores that Plaintiffs' theory amounts to economic regulation plain and simple.

[7] See *O'Donovan v. CashCall, Inc.* (N.D. Cal. 2011) 278 F.R.D. 479.

below the cut-off for borrowers to be considered subprime.[8] (4-SER-935-36 ¶ 24.) Class members testified about bankruptcies, defaults, and other problems that limited their credit options, and many of those who testified (including the class representatives) used alternative loan products, such as payday loans and auto title loans. (5-SER-1176:10-25, 1185:3-15, 1192:7-15, 1193:13-1194:1, 1204:2-19, 1223:7-22; 2-SER-348:20-22, 361:16-362:8, 368:19-369:22.)

The performance of the Class loans clearly demonstrates the risks of lending to subprime borrowers. Despite CashCall's careful underwriting practices, 45 percent of the loans to the Class (60,981) defaulted. (6-SER-1264 ¶ 21.) Approximately a quarter (33,315) of the Class repaid less than $2,600 (*i.e.*, less than they borrowed from CashCall), and 5,401 borrowers defaulted without making a single payment. (*Id.*; 4-SER-1064 ¶ 25.)

Borrowers are not "trapped into loans . . . for three years or more," as Plaintiffs argue. (POB p. 4.) Class members who repaid their loans heeded CashCall's advice to do so early. Of the 135,288 Class loans, 58,857 (43.5 percent) were repaid prior to the due date—5,651 within one month, and 23,728 within six months. Only 8,858 loans were repaid after going to full maturity. (6-ER-1261 ¶ 4.)

CashCall only allows borrowers to take one loan at a time, so a borrower cannot use one CashCall loan to repay another (unlike payday loans). (*Id.*) A total of 29,039 Class members (21.5 percent) took out multiple CashCall loans during the Class period. (6-SER-1261-62 ¶ 5.) The CashCall loans apparently were not "poor financial decisions" for these

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[8] A FICO score is a numerical grade of a borrower's credit history. (4-SER-931 ¶ 14.) A FICO score of less than 660 is generally considered subprime. (*Id.*)

repeat customers.

E. Procedural History.

Plaintiffs filed suit in federal court in the Northern District of California on July 1, 2008. (2-ER-242.) The operative fourth amended complaint was filed on February 25, 2010. (2-ER-222.)

On November 15, 2011, the district court certified a class for Plaintiffs' claim that the interest rates standing alone were "unlawful" under Business & Profession Code section 17200 et seq. (the UCL). (2-ER-186-91.) The court declined to certify the claim that the same loans were "unfair" under the UCL based on other loan terms. (*Id.* at p. 192.)

On July 30, 2014, the court denied CashCall's motion for summary judgment (1-ER-7[9]) but subsequently granted reconsideration (1-ER-1[10]) and entered judgment in CashCall's favor on the unconscionability claim. (2-ER-46.) Plaintiffs appealed to the Ninth Circuit Court of Appeals, and CashCall filed a cross-appeal challenging the order certifying the Class.

Following briefing and argument, the Ninth Circuit issued an order requesting that this Court decide a question of state law under California Rules of Court, rule 8.548(a):

> The central issue in this case is whether the interest rates on consumer loans of $2500 or more that are governed by California Financ[ial] Code § 22303, which provides no interest rate limitations on such loans, can be deemed unconscionable under California Financ[ial] Code § 22302 and thus be the predicate for a private cause of action under the California Unfair Competition Law ("UCL"). The answer to this question could determine the outcome of this matter and there is no controlling precedent.

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[9] *De La Torre v. CashCall, Inc.* (N.D. Cal. 2014) 56 F.Supp.3d 1073.
[10] *De La Torre v. CashCall, Inc.* (N.D. Cal. 2014) 56 F.Supp.3d 1105.

(*De La Torre v. CashCall, Inc.* (9th Cir. 2017) 854 F.3d 1082, 1083.) This Court granted the request on June 14, 2017.

III. THE DEREGULATED INTEREST RATES ON LOANS GOVERNED BY SECTION 22303 ARE NOT SUBJECT TO CHALLENGE AS UNCONSCIONABLE UNDER SECTION 22302.

CashCall and Plaintiffs agree that the question posed by the Ninth Circuit requires an exercise in statutory construction. The Court's task is to "'ascertain the intent of the lawmakers so as to effectuate the purpose of the statute.'" (*Carmack v. Reynolds* (2017) 2 Cal.5th 844, 849 (*Carmack*) [citation omitted].)

The Court "begin[s], as always, by examining the text of the statute, as 'the statutory language is generally the most reliable indicator' of legislative intent." (*Scher v. Burke* (2017) 3 Cal.5th 136, 143 [citation omitted].) This requires considering the context of a statutory provision, giving meaning to every word, and avoiding rendering any part surplusage. (*Carmack*, *supra*, 2 Cal.5th at pp. 849-850.)

Next, "[i]f the statutory language is not clear, a court may resort to extrinsic sources, like legislative history." (*926 N. Ardmore Ave., LLC v. County of Los Angeles* (2017) 3 Cal.5th 319, 328.) Other considerations include the "'wider historical circumstances of [the statute's] enactment'" (*Carmack*, *supra*, 2 Cal.5th at p. 850 [citation omitted]), as well as "the ostensible objects to be achieved, the evils to be remedied, . . . public policy, contemporaneous administrative construction, and the statutory scheme of which the statute is a part.'" (*DiCampli-Mintz v. County of Santa Clara* (2012) 55 Cal.4th 983, 992 [citation omitted].)

If this Court deems the text and legislative history ambiguous, the Court must reach a third interpretive step: "consideration should be given to the consequences that will flow from a particular interpretation.'" (*People v. Zambia* (2011) 51 Cal.4th 965, 977 [quoting *Dyna-Med, Inc. v. Fair Employment & Housing Comm'n* (1987) 43 Cal.3d 1379, 1387]; *Harris*, *supra*, 52 Cal.3d at pp. 1165-1166 [same]; *People v. Valencia* (2017) 3 Cal.5th 347, 358 [same].)

This statutory analysis confirms that Section 22302 does not support an action based on allegedly unconscionable interest rates.

A. The Statutory Text and Context Establish That the Interest Rate on Loans Governed by Section 22303 Cannot Be Unconscionable Under Section 22302.

The Court first must examine the relevant statutes' plain text, in the context of the statutory framework as a whole, to determine the intent of the statute and to harmonize the scheme of which the statutes are a part. (See *People v. Valencia*, *supra*, 3 Cal.5th at pp. 357-358.)

Sections 22302 and 22303 are part of the FLL, the stated purposes of which are:

> (1) To ensure an adequate supply of credit to borrowers in this state. (2) To simplify, clarify, and modernize the law governing loans made by finance lenders. (3) To foster competition among finance lenders. (4) To protect borrowers against unfair practices by some lenders, having due regard for the interests of legitimate and scrupulous lenders. (5) To permit and encourage the development of fair and economically sound lending practices. (6) To encourage and foster a sound economic climate in this state.

(Fin. Code, § 22001, subd. (a).)[11] The FLL does not provide for private enforcement by borrowers, but instead comprehensively provides for licensure, regulation, and enforcement by the Department.[12] (Fin. Code, §§ 22100-22172, 22300-22347, 22700-22780.)

Loans made under the FLL are exempt from California's usury laws. Fin. Code, § 22002. Section 22303, entitled "Maximum rate of charges," specifically addresses the permissible interest rates for FLL-regulated loans and sets specific "regulatory ceiling provisions" for certain loans:[13]

> Every licensee who lends any sum of money may contract for and receive charges at a rate not exceeding the sum of the following:
>
> (a) Two and one-half percent per month on that part of the unpaid principal balance of any loan up to, including, but not in excess of two hundred twenty-five dollars ($225).
>
> (b) Two percent per month on that portion of the unpaid principal balance in excess of two hundred twenty-five dollars ($225) up to, including, but not in excess of nine hundred dollars ($900).
>
> (c) One and one-half percent per month on that part of the unpaid principal balance in excess of nine hundred dollars ($900) up to, including, but not in excess of one thousand six hundred fifty dollars ($1,650).

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[11] In 1994, the provisions of the FLL were renumbered and combined with other statutes. The current numbering is used herein. Section 22302 was formerly 22450.5 and Section 22303 was formerly 22451.

[12] See *Graves v. Southwestern & Pac. Specialty Fin., Inc.* (N.D. Cal. Nov. 4, 2013) 2013 WL 5945851, at *3 (noting that the FLL only provides for government enforcement).

[13] "Regulatory ceiling provision" is "a statement in a section or subdivision [of the FLL] that specifies an original bona fide principal loan amount at or above which that section or subdivision does not apply to a loan." (Fin. Code, § 22011.)

> (d) One percent per month on any remainder of such unpaid balance in excess of one thousand six hundred fifty dollars ($1,650).

The last sentence of Section 22303 affirmatively deregulates interest rates on loans of $2,500 or more: "*This section does not apply to any loan of a bona fide principal amount of two thousand five hundred dollars ($2,500) or more as determined in accordance with Section 22251.*" (Fin. Code, § 22303 [emphasis added].)

The other provision at issue is Section 22302, which provides:

> (a) Section 1670.5 of the Civil Code applies to the provisions of a loan contract that is subject to this division.
>
> (b) A loan found to be unconscionable pursuant to Section 1670.5 of the Civil Code shall be deemed to be in violation of this division and subject to *the remedies specified in this division*.

(Fin. Code, § 22303 [emphasis added].) The "remedies specified in this division" are available only to the Commissioner of the Department.[14] (See Fin. Code, § 22700 et seq.)

The plain language of these statutes confirms that Section 22302 does not override Section 22303's deregulation of interest rates for loans of $2,500 or more.

1. Section 22303, Which Expressly Governs Permissible Interest Rates, Controls Over the More General Unconscionability Statute.

A more specific statute on a subject controls over a more general one. (*State Dep't of Public Health v. Superior Court* (2015) 60 Cal.4th

[14] "[T]his division" is Division 9 of the Financial Code, entitled "California Finance Lenders Law."

940, 960-961.) Section 22303 is the more specific statute here: it expressly considers loans of $2,500 or more and declares that they are not subject to any rate cap. Section 22302, which applies to the entire FLL and to any unconscionable loan terms, is more general. That is underscored by the fact that Section 22302 merely incorporates the even more general Civil Code section 1670.5, which applies to all contracts. (See *A & M Produce Co. v. FMC Corp.* (1982) 135 Cal.App.3d 473, 484-485.)

Plaintiffs argue that the last sentence of Section 22303, stating that "[t]his section does not apply" to loans over $2,500, makes Section 22303 totally irrelevant to loans over $2,500. (POB p. 16.) Plaintiffs' argument is pure sophistry, designed to evade the rule that a specific statute governs over a general one—a rule they implicitly concede would end their case if applied here. In Section 22303, the Legislature specifically addressed loans of $2,500 or more by expressly providing that such loans are not subject to regulatory rate caps.

Prior to 1985, Section 22303 included a rate cap for loans from $2,500 to $5,000. (MJN Ex. 2.) Had the Legislature wanted to make Section 22303 irrelevant to loans over $2,500, it would simply have deleted any reference to such loans. But the additional sentence instead emphasizes that loans over $2,500 are subject to *no* rate cap. It shows the specific nature of Section 22303 and the general nature of Section 22302. Section 22303 addresses the regulation of interest rates, and specifies that some rates are capped while others—those at issue here—are not.

Plaintiffs concede that Section 22303 is the more specific statute as to interest rates, but they attempt to confine the statute's specificity to loans under $2,500. Plaintiffs argue that a loan of less than $2,500 with an interest rate below the rates permitted under Section 22303, subdivisions