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SUPREME COURT  
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IN THE SUPREME COURT

FOR THE STATE OF CALIFORNIA

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**EDUARDO DE LA TORRE *et al.*,**

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Deputy

*Plaintiffs, Appellants, and Cross-Appellees,*

vs.

**CASHCALL, INC.,**

*Defendant, Appellee, and Cross-Appellant.*

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**ANSWER BRIEF ON THE MERITS**

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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.<sup>1</sup> 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.”<sup>2</sup> 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.”<sup>3</sup>

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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<sup>1</sup> All undesignated statutory references are to the Financial Code.

<sup>2</sup> Motion for Judicial Notice (MJN) Ex. 2.

<sup>3</sup> 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.<sup>4</sup>) 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.<sup>5</sup> (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 ¶

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<sup>4</sup> “ER” and “SER” refer, respectively, to the Excerpts of Record and Supplemental Excerpts of Record filed in the Ninth Circuit.

<sup>5</sup> 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](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.”<sup>6</sup> (2-ER-195:5-7.)<sup>7</sup> 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

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<sup>6</sup> 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.

<sup>7</sup> 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.<sup>8</sup> (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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<sup>8</sup> 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<sup>9</sup>) but subsequently granted reconsideration (1-ER-1<sup>10</sup>) 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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<sup>9</sup> *De La Torre v. CashCall, Inc.* (N.D. Cal. 2014) 56 F.Supp.3d 1073.

<sup>10</sup> *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).)<sup>11</sup> The FLL does not provide for private enforcement by borrowers, but instead comprehensively provides for licensure, regulation, and enforcement by the Department.<sup>12</sup> (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:<sup>13</sup>

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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<sup>11</sup> 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.

<sup>12</sup> 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).

<sup>13</sup> "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.<sup>14</sup> (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

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<sup>14</sup> “[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

(a)-(d) cannot be deemed unconscionable under Section 22302 because “the more specific provision, section 22303, directly answers whether the Legislature intended to allow a licensee to charge interest at this rate.” (POB p. 10.)

CashCall agrees wholeheartedly with Plaintiffs’ interpretation as far as it goes, but Plaintiffs ignore the fact that Section 22303 is the more specific statute with respect to *all* interest rates. Section 22303 specifically addresses the interest rates on larger loans, by expressly stating that the regulatory rate caps established thereunder do not apply to loans of \$2,500 or more. Thus, Section 22303 directly answers whether the Legislature intended to allow a licensee to charge *any* interest rate.

## **2. Section 22302 Does Not Apply to Interest Rates.**

Nothing in Section 22302 says or implies that it is designed to address interest rates, as opposed to other aspects of a loan that might be alleged to be unconscionable. Section 22302 adds an important consumer protection that has nothing to do with interest rates.

In 1985, the law was well established that the doctrine of unconscionability applied to all contracts.<sup>15</sup> But unconscionability was recognized only as a *defense* to enforcement of a contract, not as an affirmative claim for relief or a basis for regulatory action.<sup>16</sup> By adding Section 22302, the Legislature established that lenders could be subject to disciplinary action by the Department for making unconscionable loans.

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<sup>15</sup> See *A & M Produce Co. v. FMC Corp.*, *supra*, 135 Cal.App.3d at pp. 484-485.

<sup>16</sup> See *Dean Witter Reynolds, Inc. v. Superior Court* (1989) 211 Cal.App.3d 758, 766 (collecting cases showing that Civil Code section 1670.5 does not provide an affirmative cause of action).



Plaintiffs insist that by incorporating Civil Code section 1670.5 into the FLL, the Legislature intended for courts to make determinations of unconscionability. Plaintiffs' interpretation ignores the language in Section 22302, subdivision (b) that unconscionable loans are "subject to the remedies of this division." There is no private right of action to enforce "the remedies of this division"; the *Department*, not classes of borrowers, regulates licensees and enforces the FLL. (See *Graves v. Southwestern & Pac. Specialty Fin.*, *supra*, 2013 WL 5945851, at \*3.)

The Department itself has the authority without resort to the courts to issue desist and refrain orders if it concludes any licensee is "violating any provision of this division."<sup>17</sup> (Fin. Code, § 22712.) The legislation itself states that "[t]his bill would make unconscionable loan contracts of . . . consumer finance lenders a violation of their respective licensure laws." (3-SER-800.) A licensee has the right to contest the Department's order through an administrative hearing. (Fin. Code, § 22718.) In that typical

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<sup>17</sup> The Department exercised that power when it served CashCall with a desist and refrain order based on alleged violations of Section 22251, the provision of the FLL defining how to determine the bona fide principal amount of a loan. In that order, entered without judicial involvement, the Department made clear its position on the question presented here: "[u]nder the provisions of the [FLL], interest rates are only regulated on loans under \$2,500. Accordingly, a [FLL] licensed lender can charge whatever interest rate it chooses on loans of bona fide principal amounts of \$2,500 or more." ([http://www.dbo.ca.gov/ENF/pdf/2014/CFL-CashCall\\_accusationrev\\_redacted.pdf](http://www.dbo.ca.gov/ENF/pdf/2014/CFL-CashCall_accusationrev_redacted.pdf) ¶ 2.) That was not some "off-hand" statement, as Plaintiffs argue. (POB p. 18.) While not included in a formal rulemaking, this statement nonetheless is entitled to deference. (See *Yamaha Corp. of Am. v. State Bd. of Equalization* (1998) 19 Cal.4th 1, 11-12 ["because the agency will often be interpreting a statute within its administrative jurisdiction, it may possess special familiarity with satellite legal and regulatory issues. It is this 'expertise,' expressed as an interpretation (whether in a regulation or less formally . . . ), that is the source of the presumptive value of the agency's views."].)

enforcement scenario, a court would only get involved if asked to review a final administrative order through a petition for writ of mandate. Thus, it is simply not true, as Plaintiffs argue, that incorporation of Civil Code section 1670.5 evidences an intent to allow judicial review of all determinations of unconscionability under the FLL.<sup>18</sup>

**3. The Legislature Did Not Make Rates Governed By Section 22303 Subject to the Unconscionability Section.**

Plaintiffs' theory that Section 22302 was intended to protect consumers from unconscionable interest rates makes no sense as a matter of statutory drafting. For instance, it is illogical that the Legislature would provide in Section 22302 that interest rates on loans of \$2,500 or more may be adjudicated by a court to be unconscionable, but then provide in the very next section that loans of \$2,500 or more have no cap on interest rates.<sup>19</sup>

Moreover, if the Legislature wanted to ensure that Section 22302's unconscionability provision applied to interest rates on loans of \$2,500 or more, while at the same time deregulating rates on those loans in Section 22303, it would have been easy to simply say so in Section 22303 by adding language such as the underlined language here: "Subject to Section 22302, [t]his section does not apply to any loan of a bona fide principal amount of two thousand five hundred dollars (\$2,500) . . . ."

Such cross-referencing of another applicable statute would have been consistent with Section 22303's express reference to Section 22251,

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<sup>18</sup> The Department also has the discretion to file an action in court. (Fin. Code, § 22713.) But it is not required to do so.

<sup>19</sup> See *Carmack*, *supra*, 2 Cal. 5th at pp. 854-855 (declining to adopt an interpretation of a statutory provision that would mean that the Legislature had "undo[ne]" in one provision the "specific and carefully calibrated" limitations imposed in an adjacent provision).

which itself serves as a check on compliance with Section 22303 by ensuring that a lender may not “evad[e]” the stated rate caps by manipulating the loan principal amount.

Or the Legislature could have made clear an intent to subject otherwise unregulated interest rates to the unconscionability doctrine by simply inserting the unconscionability provision directly into Section 22303.<sup>20</sup> It did none of these things.

The statutory text unambiguously establishes that the interest rate on a loan governed by Section 22303 cannot be unconscionable under Section 22302. So does the legislative history.

**B. The Second Step of the Analysis: The Legislative History Confirms That Loans Governed by Section 22303 Cannot Be Unconscionable Under Section 22302.**

The legislative history of the 1985 amendment that deregulated interest rates on loans of \$2,500 or more and added Section 22302 confirms CashCall’s interpretation of how the statutes work in tandem.

**1. The Legislature Intended to Remove Interest Rate Caps on Loans of \$2,500 or More.**

The Legislature did not view Section 22303 as being irrelevant to loans of \$2,500 or more, as Plaintiffs assert, nor did it believe that rates for such loans could be challenged as unconscionable. To the contrary, the legislative history confirms that the entire purpose of the amendment was to remove the interest rate caps on loans of \$2,500 or more. For instance, an

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<sup>20</sup> See *Moradi-Shalal v. Fireman’s Fund Ins. Cos.* (1988) 46 Cal.3d 287, 295 (“one would reasonably have expected that the Legislature simply would have directly imposed such liability in clear, understandable, unmistakable terms, as it has done in numerous other statutes”) (citation omitted).

analysis of Senate Bill No. 447<sup>21</sup> by the Senate Committee on Banking and Commerce explained:

BACKGROUND: Since January 1, 1984, if a . . . consumer finance lender (CFL) makes a loan in excess of \$5,000, various sections of . . . the CFL law do not apply to the loan. With respect to interest rates, . . . *CFLs can charge whatever interest rate they want* on consumer or commercial loans in excess of \$5,000. [¶] . . .

ANALYSIS: This bill would make loans of \$2,500 or more made by . . . consumer finance lenders exempt from the interest rate ceilings of the Financial Code.

(MJN Ex. 3 [italics added; underlining in original].)<sup>22</sup>

An Enrolled Bill Report prepared by the Department of Corporations (the Department's predecessor)<sup>23</sup> shortly after passage of the bill stated that "[t]he effect of lowering the interest rate ceiling is to *eliminate rate regulation as a form of regulation of loans made under these laws. . . . The Department of Corporations will monitor the interest rates on loans above \$2,500 to determine whether these rates are 'competitive' through the mechanism of the annual report required to be filed by licensed lenders.*"<sup>24</sup>

(MJN Ex. 4 [emphasis added].)

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<sup>21</sup> Senate Bill No. 447 was enacted as Stats. 1985, ch. 552.

<sup>22</sup> Legislative committee analyses are relevant to legislative intent. (See, e.g., *Apple Inc. v. Superior Court* (2013) 56 Cal.4th 128, 148.)

<sup>23</sup> This Court has "'routinely found enrolled bill reports, prepared by a responsible agency contemporaneous with passage and before signing, instructive on matters of legislative intent.'" (*In re Conservatorship of Whitley* (2010) 50 Cal.4th 1206, 1218, fn. 3 [citations omitted].)

<sup>24</sup> See *Western Oil & Gas Ass'n v. Monterey Bay Unified Air Pollution Cont. Dist.* (1989) 49 Cal.3d 408, 425 [contemporaneous construction of statute by agency charged with its enforcement entitled to significant weight].) As noted in fn. 17, the Department maintains this interpretation of Section 22303.

And a letter from the author of the 1994 bill that consolidated and renumbered the FLL provisions, which was printed in the Assembly Journal on August 29, 1994, similarly states: “The Legislature believes that it is appropriate and reasonable to *exempt* certain loans in the regulated class of commercial and consumer loans from *any* rate limitations.”<sup>25</sup> (MJN Ex. 8 [emphasis added].)

These materials confirm that Section 22303 affirmatively exempts loans over \$2,500 from regulatory rate caps.

**2. The Legislature Intended to Allow the Free Market to Set Interest Rates on Loans of \$2,500 or More.**

The legislative history demonstrates that the Legislature’s foremost objective was to allow the free market to set interest rates on loans of \$2,500 or more. Plaintiffs’ brief completely ignores this primary and repeatedly stated legislative goal.

Senate Bill No. 447 was not the first bill to remove an interest rate cap. Prior to 1984, Section 22303 set rate caps for loans up to \$10,000; in 1984, the Legislature deregulated rates on loans above \$5,000; and in 1985, Senate Bill No. 447 extended rate deregulation to loans of \$2,500 or more. The legislative history shows that the prior reductions were intended to, and successfully did, encourage competition and increase access to credit. (MJN Ex. 3, 4, 5.)

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<sup>25</sup> The Assembly Journal is a proper subject of judicial notice. (*Kaufman & Broad Communities, Inc. v. Performance Plastering, Inc.* (2005) 133 Cal.App.4th 26, 32.) Statements in letters written by the author of legislation can be relevant to ascertaining legislative intent. (*California Teachers Ass’n v. San Diego Comm. College Dist.* (1981) 28 Cal.3d 692, 710-711 (en banc).)

Legislative history also confirms that the primary goal of the legislation was to allow the rates to be set by the market. The Senate Committee on Banking and Commerce analysis explains: “The sponsor of this bill, the California Financial Services Association, believes that the \$5,000 figure (for the interest rate ceiling exemption) is too high and it should be significantly lowered because *flexible rates would foster competition within the industry. . . .*” (MJN Ex. 3 [italics added; underlining in original].) The Enrolled Bill Report notes that an argument in favor of the bill was that “[t]he effect of this bill is that interest rates for consumer finance loans above \$2,500 will be set by the market place.” (MJN Ex. 4.) The letter from the author of the 1994 consolidation legislation, printed in the Assembly Journal, states: “It is the intent of the Legislature to let the rates charged generally be set by free market competition, *subject to rate limitations deemed necessary by the Legislature.*” (MJN Ex. 8 (emphasis added].) Plaintiffs ignore this history and would have courts impose rates based on their own variable notions of fairness.

### **3. The Legislature Did Not Intend Section 22302 to Allow Courts to Regulate Interest Rates.**

The legislative history shows that the Legislature wanted to ensure that strong consumer protections remained in place as to aspects of loans *other* than interest rates, which it was deregulating. (See MJN Ex. 8 [“The Legislature believes that the Law creates a reasonable balance between regulation and free-market activity, and provides necessary consumer protections.”]; MJN Ex. 4 [“Senate Bill 447 removes *only the rate regulation provision* of the laws regulating lenders while *preserving the consumer protection provisions* of all laws.”] [emphasis added].)

Plaintiffs draw the unsupported conclusion that Section 22302 was added in response to a concern expressed in a June 28, 1985 letter written by the Attorney General’s office regarding lessened consumer protections if the interest rates were deregulated. (POB p. 13.) Plaintiffs merely assume that Section 22302 was added to permit challenges to deregulated interest rates under the unconscionability doctrine. There is no support for that assumption, and “[s]peculation and reasoning as to legislative purpose must give way to expressed legislative purpose.” (*Milligan v. City of Laguna Beach* (1983) 34 Cal.3d 829, 831.)

Further, the fact that the unconscionability provision was added to the legislation after the Attorney General’s letter is at least equally consistent with an inference that the Legislature responded to the Attorney General’s concern by tightening consumer protections on *other* loan terms to balance the fact that interest rates would be deregulated. In fact, it is *more* consistent with such an inference.

Other materials in the legislative history reinforce the conclusion that the Legislature did not intend Section 22302 to allow courts to impose limits on the same interest rates that it was simultaneously deregulating. For instance, the Senate Committee on Banking and Commerce analysis is consistent with an intent to leave interest rates to the market as long as checks are in place to protect consumers with regard to other provisions of loans. The analysis discusses the views of the Department, and states that “[t]he Department will be neutral if the noninterest rate provisions (consumers protection)—which currently apply to loans up to \$5,000—continue to apply to loans up to \$5,000. Hence, *the interest rate provision can be deregulated, but various consumer protection sections would have to be in the bill.*” (MJN Ex. 3 [italics added; underlining in original].) As

discussed above, Section 22302 added an important consumer protection to the FLL by making unconscionable loans subject to regulatory enforcement actions by the Department.

Similarly, the Enrolled Bill Report noted an argument asserted against the bill: that “deregulation has gone too far and an element of consumer protection will be eliminated by lowering the interest rate ceiling from \$5,000 to \$2,500.” (MJN Ex. 4.) But the report noted in response that “other consumer protection elements of the consumer finance lending laws remain intact as well as a new provision added by this bill which would provide that if a loan made under these laws is found to be unconscionable pursuant to Section 1670.5 of the Civil Code, it shall be deemed to be a violation of the consumer finance lender laws and thereby subject to the remedies of these laws.” (*Id.*) In other words, the bill was removing *one consumer protection*—caps on rates for loans of \$2,500 and above—but was keeping in place *other consumer protections*, and indeed was strengthening other consumer protections by including Section 22302.

And the Legislative Counsel’s Digest to Senate Bill No. 447 recognized that general unconscionability law already applied to loan contracts, but “[t]his bill would make unconscionable loan contracts of . . . consumer finance lenders a violation of their respective licensure laws.” (3-SER-800.)

Like the plain statutory text, the legislative history resolves the question posed by the Ninth Circuit in the negative.



**C. The Consequences of Plaintiffs' Interpretation Would Be Contrary to Section 22303 and Would Undermine the Purposes of the FLL.**

The third step of statutory analysis requires the Court to examine the “consequences that will follow from a particular interpretation.” (*Ailanto Properties, Inc. v. City of Half Moon Bay* (2006) 142 Cal.App.4th 572, 583 [citing *Dyna-Med, supra*, 43 Cal.3d at p. 1387].) In *Harris*, this Court, after considering the statutory language, legislative history, and other factors, reached the “consequences” step when analyzing the Unruh Act to determine whether it encompassed a claim for economic discrimination. (*Harris, supra*, 52 Cal.3d at p. 1165-1166.) The *Harris* Court concluded that “significant adverse consequences . . . would likely follow from plaintiffs’ proposed interpretation of the Act” and declined to adopt the plaintiffs’ interpretation of the statute. Those precise “significant adverse consequences” (and others) are present here.

**1. Plaintiffs' Interpretation Would Allow Courts to Re-Impose Interest Rate Caps on Loans of \$2,500 or More, Contrary to the Legislature's Intent to Remove Such Caps.**

Plaintiffs’ interpretation would override the Legislature’s intent in enacting Section 22303, by allowing courts to re-impose interest rate caps that the Legislature chose to remove. Plaintiffs here sought restitution and injunctive relief. Neither remedy could be awarded without the court determining the benchmark rate that CashCall could charge without “cross[ing] the line into unconscionability.” (1-ER-5:28-6:1.) (See *Carboni v. Arrospide* (1991) 2 Cal.App.4th 76, 80, 82 (*Carboni*) [“Although it is a simple matter to say that at some point an interest rate becomes unconscionable, it is more difficult to determine when that point is

reached.”].)

Comparison to a benchmark “not unconscionable” interest rate is the only way to arrive at a “measurable amount” of restitution.<sup>26</sup> The concept of comparison to “the price actually being paid by other similarly situated consumers in a similar transaction” is at the core of the unconscionability analysis.<sup>27</sup> Similarly, no valid injunction could issue without a clear specification of the interest rate that CashCall could not exceed.<sup>28</sup>

In determining the appropriate “not unconscionable” interest rate, a court would be imposing a *de facto* cap on that lender’s future interest rates through an order punishable by contempt. Plaintiffs have argued that a court need not determine the “not unconscionable” interest rate, but could simply declare any rate above 90 percent unconscionable and order CashCall to return all interest collected on the loans.<sup>29</sup> Under Plaintiffs’

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<sup>26</sup> See *In re Vioxx Class Cases* (2009) 180 Cal.App.4th 116, 136 (plaintiffs could not recover restitution for allegedly misrepresented drugs “without first identifying a proper comparator drug, the cost of which would provide the actual value to the patient . . .”).

<sup>27</sup> *Perdue v. Crocker Bank* (1985) 38 Cal.3d 913, 926-927, appeal dismissed (1986) 475 U.S. 1001 (*Perdue*) (citation omitted); see also *Wayne v. Staples, Inc.* (2006) 135 Cal.App.4th 466, 483 (comparing price Staples charged for insurance with amount charged by UPS and other retailers); *Morris v. Redwood Empire Bancorp* (2005) 128 Cal.App.4th 1305, 1323 (complaint failed to state claim for substantive unconscionability because there were no allegations that the bank’s termination fee was “grossly out of line with fees charged by other banks”).

<sup>28</sup> See *Del Webb Communities, Inc. v. Partington* (9th Cir. 2011) 652 F.3d 1145, 1149-1150 (“Rule 65(d) requires an injunction to ‘state its terms specifically’ and ‘describe in reasonable detail . . . the act or acts restrained.’”) (citation and internal quotation marks omitted).

<sup>29</sup> This approach is contrary to the cases on which Plaintiffs themselves rely. (Cf. *Carboni, supra*, 2 Cal.App.4th at pp. 80, 82 [affirming trial court order finding 200 percent interest rate unconscionable and modifying loan to permit interest at 24 percent per annum—the approximate market rate available for a third deed of trust on the property]; *State ex rel. King v.*

approach, the result would be the same—the court would be re-imposing a 90 percent interest rate cap on CashCall’s loans.

Plaintiffs’ interpretation is an invitation to serial litigation challenging interest rates. An order holding that interest rates above 90 percent are unconscionable would amount to a judicially imposed cap on all future loans without informing CashCall or any other lender what lower rate would pass muster. Plaintiffs here challenge rates above 90 percent after originally claiming that a 59 percent interest rate was unconscionable; another plaintiff could claim that 50 percent or some other rate is unconscionable. In each case, the plaintiff would be asking the court to impose a cap on the permissible interest rate.

In sum, Plaintiffs’ interpretation contravenes the Legislature’s deliberate policy decision to remove caps on interest rates and have the rates be set by the market.

**2. Plaintiffs’ Interpretation Would Undermine the Purposes of the FLL—Securing Access to Credit and Fostering Competition Among Lenders.**

Plaintiffs’ interpretation would undermine the purposes of the FLL, which include “ensur[ing] an adequate supply of credit to borrowers in this state” and “foster[ing] competition among finance lenders.” (Fin. Code,

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*B&B Investment Group, Inc.* (N.M. 2014) 329 P.3d 658, 675 (*B&B*) [court declined to compel defendants to repay all interest charged; “[W]e agree with the district court that it would be inequitable to allow borrowers to pay no interest at all. . . .”]; see also *Day v. AT&T Corp.* (1998) 63 Cal.App.4th 325, 338-339 [rejecting argument that defendant should be required to disgorge all money earned from the sale of falsely advertised phone cards: “The fact remains . . . that once the cards were purchased and used, the members of the public received *exactly what they paid for.*”] [emphasis in original].)

§ 22001, subd. (a).) The goals of competition and access to credit are interrelated—competition ensures expanded access to credit.

The inevitable consequence of allowing courts to set interest rate caps on an ad hoc basis is an end to lending to subprime borrowers. CashCall has numerous competitors, and collectively they make loans to tens of thousands of consumers at interest rates Plaintiffs would call unconscionable. Lenders make decisions based on their own costs and the potential risks of making loans. That is how CashCall arrived at its interest rates. (See *supra* Part II.A.)

Requiring lenders to charge no more than court-determined “not unconscionable” interest rates may prevent CashCall and similar lenders from covering their costs, which will prompt them to leave the market entirely. The hundreds of thousands of loans with APRs above 90 percent during the Class period would not have been available to consumers under Plaintiffs’ theory, and there is no evidence that lenders would have made the loans at a lower interest rate. The State Consumer Services Agency noted this precise problem in a 1985 memorandum to the Governor regarding Senate Bill 447: “Limiting interest or cost of credit charges has the effect of benefitting the ‘haves’ (those who can afford to pay) at the expense of the ‘have nots’. The result will be less credit available to higher risk applicants if charges cannot be made to cover the additional risk.” (MJN Ex. 6.)

Further, allowing courts to intervene and set interest rates would interfere with the free market that the Legislature intended to encourage and would “inject an inappropriate level of judicial subjectivity into” the interest rate setting process. (See *Wayne v. Staples, Inc.*, *supra*, 135 Cal.App.4th at p. 483 [“With a concept as nebulous as ‘unconscionability’

it is important that courts not be thrust in the paternalistic role of intervening to change contractual terms that the parties have agreed to merely because the court believes the terms are unreasonable.”] [citation and internal quotation marks omitted].)

There is no way for a lender to know in advance how to set rates that comply with Plaintiffs’ amorphous and variable unconscionability standard for interest rates. Throughout the entire Class period, only a single California case (*Carboni*) provided any guidance on the question of interest rate unconscionability, and held that a 200 percent interest rate on a secured loan (made under unique factual circumstances) was too high. CashCall’s rates (96 percent and 135 percent) were substantially less than the rate that *Carboni* held to be too high yet are now being challenged as unconscionable. After nine years of litigation, CashCall still does not know what rate would pass muster. It might not know until a series of courts have evaluated different interest rates in successive lawsuits—and even then would not have certainty, to the extent that different courts arrive at different permissible rates.

Any ruling in this case would have repercussions throughout the market. Other plaintiffs assuredly would take a finding that a rate above 90 percent is unconscionable and seek to apply that ruling to every other lender charging such rates. Licensed finance lenders currently are subject to a uniform regulatory scheme overseen by the Department. Interest rate regulation through ad hoc judicial unconscionability determinations would be anything but uniform, and would render market forces irrelevant, contrary to the intent of the Legislature. A lender could be enjoined in one court from charging more than a particular amount, but subject to a different injunction, setting a lower or higher “not unconscionable” rate in a

different case, while other competitor lenders are subject only to regulation by the Department or are subject to inconsistent rulings from other courts.

This is not an abstract concern. In the virtually identical case of *Meeks v. CashCall*, Justice (then Judge) Chaney dismissed on demurrer the plaintiff-borrowers' claim that CashCall's interest rates were unconscionable, finding that "[a]llegations that rates are too high do not, standing alone, state substantive unconscionability" and that plaintiffs "do not allege defendant's interest rates are grossly out of line with rates charged by other lenders in similar circumstances."<sup>30</sup>

There is no evidence that there is any current restriction on competition, or that there was at any time during the Class period. To the contrary, many new lenders have entered the market, while some have left it. Any market participant is free to charge lower interest rates if it can make the numbers work. Setting rates through ad hoc judicial unconscionability decisions would create a "lender beware" market where lenders respond to successive court decisions. Judicial regulation would supplant market competition in setting rates. Faced with such uncertainty, lenders may simply exit the market.

There is another way in which Plaintiffs' interpretation would interfere with the consumer lending market. Statutory rate disclosure laws play an important role in credit markets by providing consumers information that permits them to shop among competing alternatives.<sup>31</sup> Statutory disclosure requirements and market competition work together to

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<sup>30</sup> 9-SER-1936-37 ¶¶ 2, 3; 9-SER-1942-57; see also MJN.

<sup>31</sup> One purpose of TILA is to "assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him . . . ." (15 U.S.C. § 1601(a).)

prevent lenders from charging “excessive” rates. As this Court has acknowledged, “it is unlikely that a court would find a price set by a freely competitive market to be unconscionable . . . .” (*Perdue, supra*, 38 Cal.3d at p. 927.) If CashCall’s rates were “excessive” compared to those available in the market for similarly situated borrowers, CashCall would find few borrowers and, in order to compete, would have to lower its rates. That is how the market functions to regulate interest rates, and that is what the Legislature intended when it deregulated interest rates.

### **3. Plaintiffs’ Interpretation Would Force Courts to Engage in Economic Regulation.**

Another consequence of Plaintiffs’ interpretation is that it requires courts to engage in economic regulation by setting interest rate caps. That is the function of the Legislature.

The Court’s analysis in *Harris* is almost precisely applicable here; the question of whether an interest rate that the Legislature has decided not to cap is unconscionable:

would devolve into a battle of economic studies and experts, with each side arguing from statistical and other evidence in support of its favorite criteria. And the outcome would be of little value to the parties (because the various economic factors involved are subject to constant change) or to anyone else (because the fact-specific decision would not allow other [lenders or borrowers] to predict what [interest rate] . . . would pass muster). Indeed, the issue of what [interest rate] could be used by [lenders] could be tried and retried across the state as an issue of fact, with no prospect of certainty or stability in the respective rights and duties of the parties.

(*Harris, supra*, 52 Cal.3d at p. 1166.)

The *Harris* Court held that such judicial regulation was improper “[i]n the absence of clear legislative direction . . . . designed to address particular grievances.” (*Id.* at pp. 1167-1168.) The generic incorporation

of the general unconscionability doctrine into a statutory scheme from which the Legislature simultaneously removed rate regulation hardly constitutes “clear legislative direction.”

*Harris* was not articulating a novel concept. The Court relied on its own prior jurisprudence recognizing the limits of courts engaging in economic regulation.<sup>32</sup> The Court of Appeal has also refused to engage in judicial regulation for the same reasons.<sup>33</sup>

The consistent theme running through these cases is that the proper forum to address concerns over economic policy and price regulation is the Legislature. These economic regulation cases are distinct from cases in which the defendant allegedly engaged in deceptive conduct. In those circumstances, courts do not hesitate to intervene to remedy the deceptive conduct. For example, *Perdue* involved an unconscionability challenge to an ancillary fee that the bank failed to disclose in its signature cards, and disclosed elsewhere “in print so small that many could not read it.” (*Perdue, supra*, 38 Cal.3d at pp. 925-926.) No deception exists here.

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<sup>32</sup> See *Harris, supra*, 52 Cal.3d at p. 1168, fn. 15 (discussing prior cases of this Court recognizing limits of judicial economic regulation).

<sup>33</sup> See, e.g., *California Grocers Ass’n v. Bank of Am.* (1994) 22 Cal.App.4th 205, 218 (claim that bank fee was unconscionable “implicates a question of economic policy. . . . ‘It is primarily a legislative and not a judicial function to determine economic policy’”) (citation omitted); *Wolfe v. State Farm Fire & Cas. Ins.* (1996) 46 Cal.App.4th 554, 567 (“[j]udicial intervention in areas of complex economic policy is inappropriate”); *Korens v. R. W. Zukin Corp.* (1989) 212 Cal.App.3d 1054, 1061 (“Any requirement that interest be paid [on security deposits] should be enacted explicitly by the Legislature, not developed through doctrinal manipulation by the courts.”); *Archer v. United Rentals, Inc.* (2011) 195 Cal.App.4th 807, 822 (“judges are not accredited to supersede [the Legislature] or the appropriate agency by embellishing upon the regulatory scheme”); *Crusader Ins. Co. v. Scottsdale Ins. Co.* (1997) 54 Cal.App.4th 121, 138 (refusing to engage in “court-created regulation” of insurance brokers).



CashCall's loan terms were fully disclosed in accordance with legal requirements, and Plaintiffs' unconscionability claim is premised solely on the amount of the interest rates.<sup>34</sup>

These economic regulation cases also stand in contrast to individual disputes that only impact the parties, such as the dispute in *Carboni*. The *Carboni* court was not engaging in market-wide economic regulation, but was merely analyzing the unique facts of a single loan transaction. (See *Carboni, supra*, 2 Cal.App.4th at p. 83.) Nothing in *Carboni* indicates that the court intended other courts to use its holding as a guidepost for establishing permissible interest rates in other cases against other lenders. Thus, *Carboni* is irrelevant to the question of whether a court can adjudicate the propriety of interest rates under the FLL.

In contrast, permitting unconscionability challenges to interest rates would amount to economic regulation, even in an individual case. The court would have to monitor compliance and enforce any injunction and thus would supplant the Department as CashCall's interest rate regulator.<sup>35</sup>

Decisions regarding interest rate caps clearly implicate economic policy. The legislative history of Section 22303, discussed in detail above, demonstrates the competing views on this economic policy issue. Opponents of the amendment expressed concern that deregulating interest

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<sup>34</sup> Contrast this with the New Mexico lender in *B&B, supra*, 329 P.3d 658, which actively concealed its rates and the true cost of its loans, depriving borrowers of the information needed to make informed decisions. (See Part III.D, *infra*.)

<sup>35</sup> See *Alvarado v. Selma Convalescent Hosp.* (2007) 153 Cal.App.4th 1292, 1306 (refusing to issue injunction directing nursing facilities to comply with statute when agency was better equipped to enforce the statute; "granting the requested injunctive relief would place a tremendous burden on the trial court to undertake a class-wide regulatory function and manage the long-term monitoring process to ensure compliance").

rates would harm consumers by eliminating the protection of rate caps. Proponents extolled the virtues of the market in setting rates. In 1985, the Legislature came down on the side of market regulation.

Legislative action on interest rate regulation continues. In 2013, the Legislature adopted the Pilot Program for Increased Access to Responsible Small Dollar Loans (Pilot Program). (Fin. Code, §§ 22365-22381.) The Legislature did so to address a specific problem: “The Legislature finds and declares that consumer demand for responsible installment loans in principal amounts of at least three hundred dollars (\$300) but less than two thousand five hundred dollars (\$2,500) exceeds the supply of these loans.” (Fin. Code, § 22365, subd. (a).) The Pilot Program establishes a rate structure for loans of less than \$2,500 that lenders can use “[a]s an alternative to the charges authorized by Section 22303 or 22304.” (Fin. Code, § 22370, subd. (b).) In short, lenders can charge marginally higher rates for such loans provided they comply with the Pilot Program’s other restrictions and requirements. (See Fin. Code, § 22370.)<sup>36</sup> Consistent with its earlier decision to exempt loans of \$2,500 or more from rate caps, the Legislature exempted those same loans from the Pilot Program, with the exact same language it used to exclude the loans from rate regulation. (Fin. Code, § 22370, subd. (j) [“This section shall 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.”].)

Plaintiffs argue that CashCall’s interpretation “makes it difficult for

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<sup>36</sup> The 2013 Pilot Program replaced an earlier program, adopted in 2010, that also experimented with interest rates for small consumer loans. The 2010 program was called the Pilot Program for Affordable Credit-Building Opportunities. (Senate Bill No. 1146, Stats. 2010, ch. 640.)

consumers to get any loans below \$2500.” (POB, p. 1.) That’s exactly the issue the Pilot Program and its 2010 predecessor sought to address—a demand for loans below \$2,500 that exceeds the supply. (Fin. Code, § 22365, subd. (a).) The Legislature chose to address that issue by increasing the interest rates that lenders could charge under specified circumstances, not by re-imposing interest rate caps on loans of \$2,500 or more. These pilot programs demonstrate the proper method for regulating interest rates: through a deliberative process in which the Legislature identifies a need and, with input from consumer advocates and lenders, crafts a detailed regulatory structure to address that need.

Courts appear to recognize that they should stay out of regulating interest rates. The *Carboni* court itself acknowledged that it was doing something unusual: “[T]he parties have not cited, and we have not discovered, any case which applies the doctrine of unconscionability to specifically annul or reform a loan which bears a shockingly high rate of interest.” (*Carboni, supra*, 2 Cal.App.4th at p. 81.) *Carboni* was decided more than 25 years ago, but there are virtually no reported decisions following its lead and using unconscionability as a defense to an allegedly too-high interest rate.<sup>37</sup> And no court has extended *Carboni*’s limited

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<sup>37</sup> A federal district court recently relied on *Carboni* when reviewing a bankruptcy court’s finding that an investor’s payment for an equity interest in the debtor’s home was unconscionable. (See *Freeman v. Ow* (N.D. Cal. Nov. 16, 2016) 2016 WL 6778667.) The case involved facts analogous to those in *Carboni*—an individual debtor under economic and personal duress. As the *Freeman* court noted, that case was unlike Plaintiffs’ case here, where “any judicial decision regarding the unconscionability of the challenged interest rates would necessarily ‘intrude in matters of economic policy’ because the California Legislature had expressly decided *not* to cap interest rates on loans exceeding \$2,500. No such legislative determinations are implicated in this case.” (*Id.* at p. \*6 [quoting *De La*

holding to recognize an affirmative claim to challenge the interest rates on thousands of loans made by a regulated lender. Ad hoc regulations through serial litigation in state and federal courts, with different judges imposing their own views of what seems fair in a particular case, is no way to regulate interest rates.<sup>38</sup>

**D. Plaintiffs’ Out-of-State Cases Do Not Resolve the Question of California Statutory Construction Posed by the Ninth Circuit.**

Plaintiffs’ primary support for their statutory construction of Section 22303 is a recent decision of the New Mexico Supreme Court decided under New Mexico law. *B&B, supra*, 329 P.3d 658. The question posed by the Ninth Circuit involves unique provisions of *California* law. In undertaking its analysis of the Ninth Circuit’s question, this Court must determine the intent of the *California* Legislature when it amended the FLL in 1985 to add Sections 22302 and 22303. Decisions of sister state courts interpreting different states’ statutory schemes shed little light on the

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*Torre v. CashCall, Inc.* (N.D. Cal. 2014) 56 F.Supp.3d 1005, 1109-1110] [emphasis in original].)

<sup>38</sup> Plaintiffs and the Ninth Circuit both mention a “safe harbor” argument. CashCall’s argument is more straightforward: based on statutory language and legislative history, Section 22302 simply does not apply to claims based only on the rate of interest on loans of \$2,500 or more. But the safe harbor concept nonetheless lends additional support to CashCall’s position—assuming that the concept, which was developed under the UCL’s “unfair” prong, also applies under the “unlawful” prong. (See *Cel-Tech Commc’ns v. Los Angeles Cellular Tel. Co.* (1999) 20 Cal.4th 163, 182.) As explained in *Cel-Tech*, conduct expressly permitted by law may not be challenged through a UCL claim. (*Ibid.*) Here, Section 22303 expressly permits lenders to charge whatever interest rates they choose on loans of at least \$2,500, which insulates them from UCL claims based on those interest rates.

unique question of California law posed here. The cases also are readily distinguishable.

*First*, most notably, the lawsuit in *B&B* was brought by the Attorney General—not private plaintiffs—under a New Mexico statute that grants the State, through the Attorney General, the right to sue to challenge allegedly unconscionable contract terms, specifically including interest rates. (*B&B*, *supra*, 329 P.3d at p. 662.) *Second*, the facts in *B&B* demonstrate that the defendant’s conduct was affirmatively deceptive. For example, the lender’s employees were expressly instructed to deceive borrowers about the APR and to withhold amortization schedules from them. (*Id.* at p. 667.) *Third*, the defendant had structured its 1000 percent interest rate loans (which an expert testified were “among the most expensive loan products offered in the recorded history of human civilization”) to evade recently imposed limitations on payday loans, and had converted its former payday loans into the new product, which was prohibited under New Mexico law. (*Id.* at p. 674.)

*Drogorub v. Payday Loan Store of WI, Inc.* (Wis. Ct. App. Dec. 18, 2012) 2012 WL 6571696 (*Drogorub*), an unpublished opinion from the Wisconsin Court of Appeal, involved transactions between an individual borrower and a lender, not an attempt to regulate loans more broadly. The Wisconsin statutory scheme at issue there also differs from the FLL. Wisconsin statutes provided that consumer credit transactions “are ‘not subject to any maximum limit on finance charges’” and that “[a]ny charge or practice expressly permitted by [the consumer act] is not in itself unconscionable[.]” (*Id.* at p. \*5 [quoting WIS. STAT. §§ 422.201(2)(bn) and 425.107(4)].) However, another Wisconsin statute provided that ““even though a practice or charge is authorized by [the consumer act], the

totality of a creditor’s conduct may show that such practice or charge is part of an unconscionable course of conduct,” and the *Drogorub* court used that statute as the predicate for finding the interest rate to be part of an unconscionable course of conduct that led to an unconscionable result. (*Drogorub*, *supra*, 2012 WL 6571696, at p. \*5 [quoting WIS. STAT. § 425.107(4)].)

Finally, *James v. National Financial, LLC* (Ct. of Chancery of Del. 2016) 132 A.3d 799, involved an individual plaintiff suing to rescind one loan (after the court denied his class certification motion). As in *B&B*, the lender had devised a loan product to evade recent limitations on payday loans. (*Id.* at pp. 806, 834.) The lender had also deceived the borrower about the interest rate and violated TILA. (*Id.* at pp. 806, 833, 838-839.) The court expressly noted that it was not called upon to issue a decision that would have any broader impact than just the one loan. (*Id.* at p. 812.) And the court expressly rejected the plaintiff’s request for broader relief: “James also asked for a permanent injunction barring National from collecting on similar loans it made to other customers. That relief is too broad to be granted in the current case and would embroil this court in on-going oversight of National’s business.” (*Id.* at p. 838.)

#### **IV. CONCLUSION**

Plaintiffs cannot use Section 22302 to regulate interest rates and reimpose interest rate caps that the Legislature removed. Plaintiffs’ interpretation would contradict the Legislature’s express goal in deregulating interest rates and would undermine the primary purposes of the FLL by restricting access to credit and replacing competition among

lenders with judicial regulation of interest rates. This Court should answer the Ninth Circuit's question in the negative.

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## WORD COUNT CERTIFICATION

Pursuant to California Rules of Court, rule 8.520(c), I certify that this Answering Brief on the Merits contains 10,741 words, not including the table of contents, table of authorities, the caption page or this certification page.

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## PROOF OF SERVICE

I, Brigitte Scoggins, declare as follows:

I am employed in Los Angeles County, Los Angeles, California. I am over the age of eighteen years and not a party to this action. My business address is Manatt, Phelps & Phillips, LLP, 11355 West Olympic Boulevard, Los Angeles, California 90064-1614. On **October 13, 2017**, I served the within: **ANSWER BRIEF ON THE MERITS** on the interested parties in this action addressed as follows:

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I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct and that this declaration was executed on **October 13, 2017**, at Los Angeles, California.

  
BRIGETTE SCOGGINS