



Financial Services & Products ADVISORY ■

MARCH 20, 2019

California Consumer Loans Exempt from Usury May Be Deemed “Unconscionable”

by [Stephen Ornstein](#)

In a little-noticed development with significant ramifications, the California Supreme Court ruled in *De La Torre v. CashCall Inc.*, S. Cal. 5th 966 (2018), that the interest rate on consumer loans of \$2,500 or more may render the loans “unconscionable” under the California Financial Code—even though the loan is not usurious under California law. The financial product that is subject to the litigation is an unsecured \$2,600 loan, payable over a 42-month term, with an annual percentage rate of up to 135%, which is typically made to subprime borrowers.

The product is not subject to California’s interest rate caps that apply only to consumer loans of less than \$2,500. Nevertheless, the plaintiffs contended that CashCall violated California’s Unfair Competition Law, Cal. Bus. & Prof. Code 17200, because the loans are “unconscionable.” The Northern District of California certified the plaintiffs’ lawsuit as a class action and then granted CashCall’s motion for summary judgment. On appeal, the Ninth Circuit certified to the California Supreme Court the question of whether the interest rate on consumer loans of \$2,500 or more can render the loans “unconscionable” under California law. In this significant ruling, the California Supreme Court responded to the Ninth Circuit’s question in the affirmative.

In rendering this decision, the California Supreme Court did not reach the merits of whether the particular loan product in question—or its interest rate—is itself “unconscionable,” but it set forth criteria that a court should evaluate in ultimately determining whether such a financial product—or a particular provision in the contract—is “unconscionable.”

As a threshold matter, the court asserted that a loan that is not subject to the California usury cap is not shielded from an “unconscionability” determination. The court noted that the unconscionability doctrine predates the California statutory interest rate limits and is concerned with “unreasonably and unexpectedly harsh terms having to do with price and other central aspects of the transaction.” The court, in reviewing the statutory codification of the unconscionability doctrine, observed that a court may find unconscionable “the contract or any clause of the contract and so refuse enforcement.”

According to the California Supreme Court, “unconscionability is a flexible doctrine ... meant to ensure that in circumstances indicating an absence of meaningful choice, contracts do not specify terms that are ‘overly harsh,’ ‘unduly oppressive,’ or ‘so one-sided as to shock the conscience.’” The court added that unconscionability “requires oppression or surprise ... along with ... overly harsh or one-sided results,” noting that “unconscionability has both a ‘procedural’ and a ‘substantive element,’ the former focusing on ‘oppression’ or ‘surprise’ due to unequal bargaining power, the latter on ‘overly harsh’ or ‘one-sided’ results,” both of which must be present for a court to “exercise its discretion to refuse to enforce a contract or clause under the doctrine.”

This alert is published by Alston & Bird LLP to provide a summary of significant developments to our clients and friends. It is intended to be informational and does not constitute legal advice regarding any specific situation. This material may also be considered attorney advertising under court rules of certain jurisdictions.

The court observed that in assessing the presence of substantive unconscionability, a court may need to consider context. For example, “when a price term is alleged to be substantively unconscionable ... it is not sufficient for a court to consider only whether ‘the price exceeds cost or fair value,’ ... the court must also ‘look to the basis and justification for the price.’” Interestingly, the court noted that “when a contract term is salient to purchasers, the market can be trusted to provide an efficient version of the term and price is probably salient to nearly all buyers. If, for example, the interest rate [of a financial product] is high because the borrowers of the loan are credit-impaired or default-prone,” a finding of substantive unconscionability is less likely.

Alston & Bird Observations

Again, the court did not decide whether CashCall’s loans in question are unconscionable, but it dismissed the notion that an unconscionability claim cannot be asserted merely because a loan product technically is not subject to a rate cap in California. Nonetheless, it is our observation that given the factors that a California court must consider in order to render a contract—or certain provisions of the contract—“unconscionable,” there must be extreme circumstances taking into account the bargaining process of the parties and prevailing market conditions. The court emphasized that a particular term in question must be “overly harsh,” “unduly oppressive,” or “so one-sided as to shock the conscience.”

In light of these guideposts, the actual rate of interest for the financial product may not attract scrutiny by itself, especially for a subprime consumer loan, but certain terms that the borrower may not be able to bargain for, such as high up-front fees that are financed by the lender, higher delinquency-related fees imposed upon the borrower (i.e., exorbitant default interest rates that accrue on the outstanding principle balance), and mandatory arbitration clauses that unduly favor the lender or holder, may, under certain circumstances, warrant a finding of “unconscionability.” In light of this California Supreme Court decision, providers of financial consumer products in California would be well advised to review their contracts to eliminate unduly harsh provisions that could give rise to the assertion of an unconscionability claim.

You can subscribe to future *Financial Services & Products* advisories and other Alston & Bird publications by completing our [publications subscription form](#).

If you have any questions or would like additional information, please contact your Alston & Bird attorney or any member of our [Financial Services & Products Group](#).

Stephen Ornstein
202.239.3844
stephen.ornstein@alston.com

Lisa Lanham
212.210.9527
lisa.lanham@alston.com

Nanci Weissgold
202.239.3189
nanci.weissgold@alston.com

Anoush Garakani
202.239.3091
anoush.garakani@alston.com

Morey Barnes Yost
202.239.3674
morey.barnesyost@alston.com

Melissa Sanchez Malpass
202.239.3731
melissa.malpass@alston.com

Rinaldo Martinez
202.239.3205
rinaldo.martinez@alston.com

ALSTON & BIRD

WWW.ALSTON.COM

© ALSTON & BIRD LLP 2019

ATLANTA: One Atlantic Center ■ 1201 West Peachtree Street ■ Atlanta, Georgia, USA, 30309-3424 ■ 404.881.7000 ■ Fax: 404.881.7777
 BEIJING: Hanwei Plaza West Wing ■ Suite 21B2 ■ No. 7 Guanghua Road ■ Chaoyang District ■ Beijing, 100004 CN ■ +86 10 8592 7500
 BRUSSELS: Level 20 Bastion Tower ■ Place du Champ de Mars ■ B-1050 Brussels, BE ■ +32 2 550 3700 ■ Fax: +32 2 550 3719
 CHARLOTTE: Bank of America Plaza ■ 101 South Tryon Street ■ Suite 4000 ■ Charlotte, North Carolina, USA, 28280-4000 ■ 704.444.1000 ■ Fax: 704.444.1111
 DALLAS: Chase Tower ■ 2200 Ross Ave. ■ Suite 2300 ■ Dallas, Texas, USA, 75201 ■ 214.922.3400 ■ Fax: 214.922.3899
 LOS ANGELES: 333 South Hope Street ■ 16th Floor ■ Los Angeles, California, USA, 90071-3004 ■ 213.576.1000 ■ Fax: 213.576.1100
 NEW YORK: 90 Park Avenue ■ 15th Floor ■ New York, New York, USA, 10016-1387 ■ 212.210.9400 ■ Fax: 212.210.9444
 RALEIGH: 555 Fayetteville Street ■ Suite 600 ■ Raleigh, NC 27601-3034 ■ 919.862.2200 ■ Fax: 919.862-2200
 SAN FRANCISCO: 560 Mission Street ■ Suite 2100 ■ San Francisco, California, USA, 94105-0912 ■ 415.243.1000 ■ Fax: 415.243.1001
 SILICON VALLEY: 1950 University Avenue ■ 5th Floor ■ East Palo Alto, California, USA, 94303-2282 ■ 650-838-2000 ■ Fax: 650.838.2001
 WASHINGTON, DC: The Atlantic Building ■ 950 F Street, NW ■ Washington, DC, USA, 20004-1404 ■ 202.239.3300 ■ Fax: 202.239.3333