

California Business Law PRACTITIONER

Volume 33 / Number 1

Winter 2018



Susan R. Goldfarb is Special Finance Counsel in the Corporate Department of Proskauer Rose LLP in Los Angeles. Her practice focuses on representing lenders and borrowers with regard to personal property secured transactions, structured finance transactions, commercial law transactions, and real estate finance transactions. Ms. Goldfarb

has extensive experience drafting and negotiating financing documents for secured and unsecured loans, receivables financing, syndicated loans, loan modifications, restructuring transactions, equipment finance loan documents, loan assumptions, and lease assumptions. She is the author of the *Loan Financing* chapter of *Financing and Protecting California Businesses* (Cal CEB). Ms. Goldfarb received her undergraduate degree from University of California, Berkeley, her masters in law and diplomacy from the Fletcher School of Law and Diplomacy at Tufts University, and her law degree from Georgia State University College of Law.



Thomas E. McCurnin is a partner with Barton, Klugman & Oetting LLP in Los Angeles, where he practices commercial banking law with an emphasis on payment systems, operations, and secured transactions. He is AV-rated. Mr. McCurnin received his undergraduate degree from the University of Iowa and his law degree from Drake University.

Usury and the California Financing Law

Knowing the Exemptions and Avoiding the Traps

Susan R. Goldfarb
Thomas E. McCurnin

California courts take the usury limitations established by the California Constitution and Civil Code very seriously. California courts have held that compliance with the usury limitations is a fundamental policy of the State of California. This article discusses the elements of usury, who can sue for usury, who can be sued for usury, defenses to usury, and the penalties for violation of the usury limitations. The most common defense to an allegation of usury is that the lender or the transaction is exempt from the usury limitations based on the California Constitution or a statutory provision. This article discusses several exemptions and then focuses on the exemption provided by Fin C §§22000–22780 (the California Financing Law).

—continued on page 3

IN THIS ISSUE

- Usury and the California Financing Law: Knowing the Exemptions and Avoiding the Traps** 1
by Susan R. Goldfarb and Thomas E. McCurnin
- The EU General Data Protection Regulation: An Introduction and Practical Takeaways** 13
by Tanya L. Forsheit and Daniel M. Goldberg
- How to Raise Money Online Under Title II of the Jobs Act** 21
by Richard A. Weintraub and Amber L. Condon

Persons engaged in the business of making loans are required to be licensed under the California Financing Law, unless an exemption from licensing is available. This article discusses when an exemption from licensure may exist, the basic requirements for obtaining a license under the California Financing Law, and some of the more important ongoing duties and obligations of a finance lender, particularly if a lender will be making consumer loans. Once licensed, a lender must be careful and follow all the laws, rules, and regulations of the California Financing Law to avoid suspension or revocation of the license and any civil or criminal penalties for violations of the California Financing Law.

Note

The California Financing Law was known as the California Finance Lenders Law before October 4, 2017. See AB 1284 (2017–2018 Reg Sess).

WHAT IS USURY?

Usury is the exacting, taking, or receiving of a greater rate of interest than is allowed by law, for the use or loan of money without a recognized exemption. *O'Connor v Televideo Sys., Inc.* (1990) 218 CA3d 709, 713. California's usury law is "a curious and confusing blend of the California State Constitution, statutory law, and case law pertaining to both Article XV of the California Constitution and the relevant usury statutes." *Wishnev v Northwestern Mut. Life Ins. Co.* (ND Cal 2016) 162 F Supp 3d 930, 937. There is no single source for the body of usury law. This article seeks to synthesize the various laws and decisions that comprise California's usury law. As noted above, California courts take usury very seriously because it is deemed to be a fundamental policy of the State of California. *Brack v Omni Loan Co., Ltd.* (2008) 164 CA4th 1312, 1326; *Mencor Enters., Inc. v Hets Equities Corp.* (1987) 190 CA3d 432, 441.

While the elements of usury are deceptively simple, the devil is in the details. The essential elements of usury are the following (*Ghirardo v Antonioli* (1994) 8 C4th 791, 798):

- The transaction must be a loan or forbearance;
- The interest to be paid must exceed the statutory maximum;
- The loan and interest must be absolutely repayable by the borrower; and
- The lender must have a willful intent to enter into a usurious transaction.

A transaction is presumed *not* to be usurious. 8 C4th at 798.

Loan or Forbearance of Money

Determining whether a particular transaction is or is not a "loan" can be difficult, especially with complex transactions. The terms "loan" and "forbearance" are not defined by statute, but the concepts have been developed in case law and generally mean that the money is absolutely repayable by the borrower. *Creative Ventures, LLC v Jim Ward & Assocs.* (2011) 195 CA4th 1430, 1449. Therefore, most sale transactions, true leases, equity investments, or joint venture transactions would not be considered loans or forbearances.

Transactions That Are Not "Loans"

There are several factors that distinguish a loan from a joint venture transaction: (1) whether there is an absolute obligation of repayment and (2) whether the investor has no risk of loss, except collectability. See *Atkinson v Wilcken* (1956) 142 CA2d 246, 248. The existence of these factors gives the transaction the characteristics of a loan.

True leases are not loans. *Rochester Capital Leasing Corp. v K & L Litho Corp.* (1970) 13 CA3d 697, 702. Generally, California courts apply Com C §1203, which provides the framework for distinguishing a true lease from a loan secured by a security interest.

Conditional sales agreements also are not loans, due to the doctrine of the time-price differential. *Southwest Concrete Prods. v Gosh Constr. Corp.* (1990) 51 C3d 701, 708. The time-price differential is a concept by which a vendor sells the same product for cash for one price and on credit terms for another price. This type of arrangement is not a loan under California law.

Judgments are not considered loans because the debtor is not a borrower. *Bisno v Kahn* (2014) 225 CA4th 1087, 1105.

Late charges are not considered loans, the rationale being that the borrower could have avoided paying them by not going into default. *Donohue v Quick Collect* (9th Cir 2010) 592 F3d 1027, 1034. Late charges are governed under another statute and must be reasonable. See CC §1671.

Other hybrid transactions are difficult to assess generally and will probably be judged on a case-by-case basis. One developing area is the lending practice of a "merchant's cash advance," a loan that is ostensibly an advance in exchange for the purchase of future receivables. Depending on the nature of the underlying documents, this type of transaction may be construed as a loan, especially if the borrower is obligat-

ed to repay the advance. *Essex Partners Ltd. v Merchant Cash & Capital* (CD Cal, Aug. 1, 2011, No. CV 11-03366 CAS (MRW)) 2011 WL 13123326, *6.

Interest Rate Exceeds Maximum Allowable Rate

The California constitutional maximum rate of interest is found in CC §1916-2 and Cal Const art XV, §1. For written contracts, the maximum interest rate is 10 percent if the loan is for use primarily for personal, family, or household purposes (*i.e.*, a consumer loan). For nonconsumer loans in writing, the maximum interest rate is the higher of (a) 10 percent per annum or (b) 5 percent plus the discount rate charged by the Federal Reserve Bank of San Francisco for advances to member banks and other depository institutions under Federal Reserve Act §§13-13a (12 USC §§347-347c). For contracts not in writing, the maximum interest rate is 7 percent. Of course, if the lender or the transaction is exempt from the usury limitations under one of the many statutory exemptions, the loan is not usurious.

California's usury law is "a curious and confusing blend of the California State Constitution, statutory law, and case law pertaining to both Article XV of the California Constitution and the relevant usury statutes."

What is a "written contract" under the usury law may be subject to debate. One court held that for an agreement to constitute a "writing," the agreement must clearly specify the interest rate and be signed by the borrower. See *Brown v Cardoza* (1944) 67 CA2d 187, 194. This is in accord with CC §1916-2. Another court held that a "written instrument" is an agreement expressed in writing, signed and delivered by one person to another. See *Rich v Ervin* (1948) 86 CA2d 386, 391. Finally, it should be noted that if the contract is ambiguous with respect to the interest rate, parol evidence is allowed to show that the obligation was usurious. See *Miley Petroleum Corp. v Amerada Petroleum Corp.* (1936) 18 CA2d 182, 190.

Borrower Must Pay Illegal Interest

To assert usury, the borrower must make payments in excess of the principal amount. See *Westman v Dye* (1931) 214 C 28, 38. See also *In re Vehm Eng'g Corp.* (9th Cir 1975) 521 F2d 186, 189. Usury is

measured by what the borrower pays, not by the amount the lender receives. *Creative Ventures, LLC v Jim Ward & Assocs.* (2011) 195 CA4th 1430, 1438. The calculation is fairly simple. One simply adds up all the payments made on the loan and then deducts the principal amount. What is left is interest. *Gibbo v Berger* (2004) 123 CA4th 396, 403.

Lender's profits may not be included as interest if (1) the profits are contingent, (2) the creditor had the risk of nonpayment in the transaction, and (3) the creditor is acting in good faith. *Thomassen v Carr* (1967) 250 CA2d 341, 346. This doctrine is often called the "interest contingency rule," whereby a loan with profits that exceed the usury cap is legal if there is risk to the creditor in the transaction that is over and above the normal risk with all loans. The interest payment must be "subject to a contingency so that the lender's profit is wholly or partially put in hazard," provided "the parties are contracting in good faith and without the intent to avoid the statute against usury." *WRI Opportunity Loans II LLC v Cooper* (2007) 154 CA4th 525, 534 (citations omitted).

What Is Payment of Interest?

Sometimes there are issues regarding whether certain kinds of payments by a borrower are interest or can be classified as other forms of payment. For example, fees or charges—such as commitment fees, costs of examining title to property, brokerage commissions, bonuses, and other charges assessed to the borrower in addition to the interest charged on a loan—may be construed as fees and will not be considered interest if they are reasonable in amount and backed up by specific services actually rendered or they confer a real benefit on the borrower. *Charlotte Guyer & Assocs. v Franklin Factors* (1963) 211 CA2d 690, 694.

Variable Interest Rates

If a loan is not usurious at inception but becomes usurious as a result of a variable interest rate, the loan may or may not be usurious, depending on which party controlled the contingency. If the borrower controlled the contingency, then it will likely *not* be usurious. *French v Mortgage Guar. Co.* (1940) 16 C2d 26, 31. A court might be tempted to average the interest rates when neither party has control over the contingency. See *Arneill Ranch v Petit* (1976) 64 CA3d 277, 290, in which the contingency of possible stock dividends was not under the control of either party.

Default Interest

If a note is not usurious but a default rate is included in the note that would make the note usurious on default, is it still usurious? The answer is no. An agreement that is not usurious in its inception cannot become so by reason of the borrower's subsequent default. See *Pacific Fin. Corp. v Crane* (1955) 131 CA2d 399, 406. But default interest rates have their own issues relative to enforcement if they are found to be liquidated damages. See CC §1671.

Compound Interest

Compound interest is interest on interest, and there is a statutory prohibition against compound interest, CC §1916-2. However, the case of *Heald v Friis-Hansen* (1959) 52 C2d 834, 838, stands for the proposition that compound interest is allowed if the loan is in default and the compounding is not done more than once a year. An exemption from the usury limitations will not exempt the lender from this limitation. *Wishnev v Northwestern Mut. Life Ins. Co.* (ND Cal 2016) 162 F Supp 3d 930, 944. A renewal of a court judgment that folds interest into principal is compounding, but it is permissible because a judgment is not a loan. *OCM Principal Opportunities Fund v CIBC World Mkts. Corp.* (2008) 168 CA4th 185, 195.

Willful Intent to Enter Into Usurious Transaction

While "willful" intent is indeed an element of a usury claim, it is easily satisfied by the debtor proving that the creditor cashed the check in payment of usurious interest. *Creative Ventures, LLC v Jim Ward & Assocs.* (2011) 195 CA4th 1430, 1449. "The conscious and voluntary taking of more than the legal rate of interest constitutes usury and the only intent necessary on the part of the lender is to take the amount of interest he receives; if that amount is more than the law allows, the offense is complete." *Ghirardo v Antonoli* (1994) 8 C4th 791, 798, quoting *Thomas v Hunt Mfg. Co.* (1954) 42 C2d 734, 740. The only possible way to establish lack of intent is a scrivener's mistake, such as the use of an unintended form. See *First Am. Title Ins. & Trust Co. v Cook* (1970) 12 CA3d 592, 597. In essence, California's usury law imposes strict liability on lenders. See *In re Dominguez* (9th Cir 1993) 995 F2d 883, 886; *Falconpoint Unlimited, LLC v Senn* (ND Cal, Sept. 4, 2015, No. 14-CV-02342 NC) 2015 US Dist Lexis 118792, *11.

WHO CAN SUE AND BE SUED FOR USURY

Usury is a personal cause of action, and typically only the borrower or those in absolute privity with the borrower may sue. *Domarad v Fisher & Burke, Inc.* (1969) 270 CA2d 543, 561. This would include the borrower, a guarantor, or the executor for either, or a trustee in bankruptcy. See *Smith v Arthur Andersen LLP* (9th Cir 2005) 421 F3d 989, 1002 (trustee); *Barnes v Hartman* (1966) 246 CA2d 215, 219 (administrator of estate). This rule therefore precludes junior lienholders as well as judgment creditors from suing for violations of the usury limitations.

Targets for a usury suit obviously include the original lender. If the obligation is securitized or participated, the investors or participants in the notes would not be able to collect the usurious interest. *Creative Ventures, LLC v Jim Ward & Assocs.* (2011) 195 CA4th 1430, 1449. Officers and directors of the lender may also sometimes be held liable. *Clarke v Horany* (1963) 212 CA2d 307, 311 n3.

WHEN IS USURY MEASURED?

Whether a loan is usurious is measured when the loan is made, not when it is enforced. See *Sharp v Mortgage Sec. Corp.* (1932) 215 C 287, 290; *Strike v Trans-West Discount Corp.* (1979) 92 CA3d 735, 745. Thus, if a loan or a lender is exempt from the usury limitations at the inception of the loan, the loan remains exempt, even if it is assigned to a nonexempt lender. *Montgomery v GCFS, Inc.* (2015) 237 CA4th 724, 732. However, under New York law, the assignee does not automatically enjoy the benefits of the exemption when the original exempt lender retains no interest in the loan. *Madden v Midland Funding, LLC* (2d Cir 2015) 786 F3d 246, 252.

DEFENSES TO USURY

A creditor may defend a usury claim by proving the transaction was not a loan, the repayment obligation was not interest, the borrower has not paid any portion of interest, or the rate did not exceed the constitutional maximum. However, the main defenses to usury center on exemptions from the usury limitations scattered throughout Cal Const art XV, §1, the Financial Code, the Corporations Code, the Insurance Code, the Government Code, and the Civil Code. See the Appendix for a comprehensive list of usury exemptions and the source of law for each exemption.

PENALTIES FOR USURY

The taint of usury in an agreement prevents recovery of *any* interest under the usurious loan agreement. See *Simmons v Patrick* (1962) 211 CA2d 383, 387; *Gibbo v Berger* (2004) 123 CA4th 396, 403. Usury can also be asserted as a setoff when the claim of usury is outside the statute of limitations. *In re Vehm Eng'g Corp.* (9th Cir 1975) 521 F2d 186, 190. For example, since usury clawback claims are limited to a 2-year statute of limitations (*Whittemore Homes, Inc. v Fleishman* (1961) 190 CA2d 554, 561), it is common for a creditor to sue to enforce a usurious note 3 years after the borrower's breach, leaving the borrower without an affirmative remedy. However, the borrower can always claim usury as an offset to any damages that the lender may be entitled to receive following the borrower's breach of the note. See *Simmons*, 211 CA2d at 390. Thus, usury can always be used as a shield, but it may only be used as a sword by a borrower within 2 years of making illegal interest payments.

In addition, any illegal interest paid by the borrower is subject to prejudgment interest against the lender as well. *Charlotte Guyer & Assocs. v Franklin Factors* (1963) 211 CA2d 690, 696. A court may also allow the borrower to recover treble damages for the amount of interest paid for the year preceding the filing of the lawsuit. CC §1916-3(a). The "may" language in the statute signifies that the award is discretionary. See *Gibbo*, 123 CA4th at 404. Further, a court may award punitive damages in certain circumstances. See *Harris v Gallant* (1960) 183 CA2d 94, 100 (court found fraud and intent to evade usury statute).

USURY CLAIMS CANNOT BE WAIVED OR RELEASED

A settlement agreement with a broad form release of an unknown claim for usury is ineffective. *Hardwick v Wilcox* (2017) 11 CA5th 975, 988. In *Hardwick*, the loan obligation was potentially usurious, and the parties entered into a forbearance agreement with a full release. The borrower paid the sums required under the forbearance agreement but later made a claim for usury. The court held that the prior release was ineffective for future payments because exempting a lender from the consequences of usury violates public policy. Counsel drafting forbearance agreements should be mindful that any potential usury claims will not be released. As discussed above, California courts take usury very seriously because it is deemed to be a fundamental policy of the State of California. Therefore, lenders that intend to make

loans at interest rates above the California usury limitation should ensure that either (1) they are exempt on the basis of a class-wide exemption or (2) the transactions themselves are exempt.

EXEMPTIONS FROM USURY LIMITATIONS

There are multiple exemptions from the usury limitations. The exemptions are either transaction-based or class-wide. Most exemptions are class-wide exemptions based on the California Constitution or authorized by statute. Examples of the most well-known class-wide exemptions are those for (1) California and federal banks, savings and loan associations, and credit unions (Cal Const art XV, §1); (2) federal and state savings and loan associations and their holding companies and subsidiaries (Fin C §7675); (3) trust companies and state and national banks acting in a fiduciary capacity (Fin C §1504); and (4) finance lenders and brokers (Fin C §22002). Frequently relied-on transaction-based exemptions are conditional sales (discussed above), loans arranged by a real estate broker secured directly or indirectly by real property (Cal Const art XV, §1; CC §1916.1), and certain commercial loans to sophisticated persons (Corp C §25118). See the Appendix for the comprehensive list of usury exemptions. Below is a discussion of two important transactional exemptions for loans to entities.

Transactional Exemption: Loans to "Sophisticated" Persons

Under Corp C §25118, there are two transactional exemptions from usury for certain commercial loans, one based on the borrower's assets and the second based on the total loan amount. *Raceway Props., LLC v LSOF Carlsbad Land L.P.* (9th Cir 2005) 157 Fed Appx 959. Corporations Code §25118(a) provides that loans to an entity that has total assets of at least \$2 million according to its then most recent financial statements prepared either in accordance with GAAP or in accordance with the rules and requirements of the Securities and Exchange Commission and that meet certain additional criteria set forth in §25118 and described below are exempt from California usury laws. The exemption also applies to loans that are guaranteed by an entity (not an individual) that is an affiliate of the borrower that satisfies the foregoing test. Under Corp C §25118(b), loans aggregating at least \$300,000 in original face amount at the time of issuance and loans issued in accordance with a written commitment for the lending of at least \$300,000 are also exempt from the California usury laws, provided

such loans meet the additional criteria set forth in §25118.

Under Corp C §25118(e)(1), neither exemption applies to loans made or guaranteed by individuals, a revocable trust having one or more individuals as trustors, or partnerships in which, at the time of issuance, one or more individuals are general partners. See *Development Acquisition Group, LLC v eaConsulting, Inc.* (ED Cal 2011) 776 F Supp 2d 1161 (individual shareholder's pledge of stock to secure loan to corporation was equivalent to personal guaranty; therefore, loan transaction was not exempt from usury laws). In addition, the §25118 exemptions do not apply unless (1) the lender and borrower (or guarantor) have a "preexisting personal or business relationship" or (2) the lender and borrower (or guarantor), by reason of their own business and financial experience or that of their professional advisers, can reasonably be assumed to have the capacity to protect their own interests in connection with the loan transactions. Corp C §25118(f). Corporations Code §25118(g) defines the terms "preexisting personal or business relationship" and "capacity to protect their own interests in connection with the transaction" by reference to Corp C §25102(f)(2) and its implementing regulations. Lastly, Corp C §25118(h) provides that the exemptions from usury provided by §25118 do not exempt any person from the application of the California Financing Law if such person is required to be licensed under that law.

CALIFORNIA FINANCING LAW

The California Financing Law provides a class-wide exemption from usury for licensed finance lenders (persons engaged in the business of making consumer loans or commercial loans) and licensed brokers (persons engaged in the business of negotiating or performing any acts as brokers in connection with loans made by a finance lender). The remainder of this article focuses on finance lenders and discusses certain exemptions from licensing, the basic requirements for obtaining a license under the California Financing Law, the ongoing duties of a licensed finance lender, and penalties for failure to be licensed or to follow the laws, rules, and regulations under the California Financing Law.

Exemptions From Licensing Under the California Financing Law

In general, California law requires all persons engaged in the business of a finance lender or broker to obtain a license from the Commissioner of Business Oversight (Commissioner). Fin C §22100(a). Li-

censed finance lenders and brokers are regulated by the Commissioner under 10 Cal Code Regs §§1400–1618. However, there are several exemptions from the licensing requirement for persons that are otherwise regulated under other federal or California statutes, such as those described above and listed in the Appendix. See Fin C §22050(a). In addition, there is a "de minimus" exemption for persons that make five or fewer commercial loans in a 12-month period, provided that the loans are "incidental to the business of the person relying on the exemption." Fin C §22050(e). No definition is provided in the California Financing Law for the meaning of "incidental," and to date, there is no case law on point. Therefore, a person that intends to become licensed as a finance lender should not rely on the "de minimus" exemption because any commercial loan made by such a person is unlikely to be "incidental" to their proposed business. However, until January 1, 2022, there is an additional exemption from licensing for persons who make one commercial loan in a 12-month period. See Fin C §22050.5. Therefore, if a person makes a single consumer loan, more than one commercial loan in a 12-month period (until January 1, 2022), or more than five commercial loans that are incidental to a person's business in a 12-month period, a license is required. See *Raceway Props., LLC v LSOB Carlsbad Land L.P.* (9th Cir 2005) 157 Fed Appx 959 (decided when exemption under Fin C §22050(e) was one commercial loan in 12-month period).

[C]ompound interest is allowed if the loan is in default and the compounding is not done more than once a year. An exemption from the usury limitations will not exempt the lender from this limitation.

The "de minimus" exemption applies *only* for licensing purposes and does not provide an exemption from the usury limitations. Unless another exemption from the usury limitations applies, only licensed persons that originate loans are exempt from the usury limitations. See *West Pico Furniture Co. v Pacific Fin. Loans* (1970) 2 C3d 594 (court concluded that lender, a licensed personal property broker, was making loans to plaintiff; therefore, loans were not subject to usury limitations). However, in *Montgomery v GCFS, Inc.* (2015) 237 CA4th 724, the court of appeal held that licensed finance lenders are permitted to sell or assign loans to *nonlicensed persons* as well as to institutional investors or licensed finance lenders as expressly provided in the California Financing

Law. Therefore, although the original lender must be licensed for the usury exemption to apply, the assignee does not need to be similarly licensed for the usury exemption to continue to apply to the loan. See also *Estante v Mountain Lion Acquisitions, Inc.* (Dec. 2, 2016, No. C076826) 2016 Cal App Unpub Lexis 8611; *Deaguero v Mountain Lion Acquisitions, Inc.* (Dec. 2, 2016, No. C077123) 2016 Cal App Unpub Lexis 8615.

Exemption for Banks and Other Regulated Entities?

Although Fin C §22050(a) is clear that federal and California banks, trust companies, and savings and loan associations are not required to be licensed under the California Financing Law, there has been some uncertainty concerning whether wholly owned subsidiaries of such institutions were also exempt from licensure. Many of those institutions took the position that a wholly owned subsidiary was not required to be licensed. The statute does not say that expressly, but that position was consistent with previous opinions of the Commissioner of Corporations (predecessor to the Commissioner of Business Oversight). See *Op. Comm'r, Cal. Dept. of Corps.* (Aug. 5, 1999, No. OP 6738 CFLL) 1999 Cal Sec Lexis 1 (exempting subsidiary of federally chartered savings association); *Op. Comm'r, Cal. Dept. of Corps.* (Nov. 5, 1996, No. OP 6595 CFLL) 1996 Cal Sec Lexis 9 (exempting subsidiary of federally chartered savings association); *Op. Comm'r, Cal. Dept. of Corps.* (Oct. 11, 1995, No. OP 6531 RMLA) 1995 Cal Sec Lexis 3 (exempting subsidiaries of federal savings bank); *Op. Comm'r, Cal. Dept. of Corps.* (Dec. 1, 1988, No. OP 5792CM) 1988 Cal Sec Lexis 11 (exempting subsidiary of bank holding company).

However, in the context of consumer lending, the Department of Business Oversight (DBO) has recently taken action to limit the types of entities exempt from the California Financing Law by narrowing the licensing exemption for *nondepository* subsidiaries, affiliates, and agents of banks and bank holding companies that engage in *consumer* lending. Title 10 Cal Code Regs §1422.3(a), operative September 28, 2016, provides that (emphasis added)

[a] nondepository lender or broker that engages in the business of making or brokering consumer loans in this state is *not exempt* from licensure under subdivision (a) of section 22050 of the Financial Code *unless* that nondepository lender or broker is a bank, trust company, savings and loan association

The DBO also adopted a regulation under the California Residential Mortgage Lending Act similarly

limiting an exemption from licensure for nondepository subsidiaries, affiliates, and agents of banks and bank holding companies making or servicing residential mortgage loans. The purpose of the new regulation is to protect California consumer borrowers by “promoting the uniform oversight over nondepository consumer lending in California.” See Notice of Rule-making Action: Title 10. California Department of Business Oversight (Oct. 16, 2014), available at http://www.dbo.ca.gov/Licensees/Residential_Mortgage/pdf/03-13_ANotice_CM_OALRevised_10-16.pdf.

Application of California Financing Law to Out-of-State Lenders and Brokers

Whether the California Financing Law will apply to out-of-state lenders or brokers making loans to California borrowers will depend on whether there are sufficient contacts with the State of California and whether a fundamental policy of California is at issue. The court will engage in a fact-based analysis to make this determination. In *Brack v Omni Loan Co., Ltd.* (2008) 164 CA4th 1312, the court held that a Nevada lender making consumer loans in California to nonresident military personnel was required to be licensed under the California Financing Law because licensing is a fundamental policy of California and therefore the Nevada choice of law provision in its loan documents was not enforceable. The Nevada lender was making 30 percent interest payday loans to nonresident military personnel in offices located near California military bases. But see *Op. Comm'r, Cal. Dept. Corps.*, (Apr. 2, 1997, No. OP 6629CFLL) 1997 Cal Sec Lexis 2 (Commissioner of Corporations did not require out-of-state lender making loans in form of fuel charge cards to government agencies, including California government agencies, to be licensed when lender’s “contacts with California are minimal”). The authors believe that courts are more likely to find sufficient contacts or a fundamental policy at issue when consumer borrowers are involved.

Obtaining a License Under the California Financing Law

If a company or individual determines that it is required to be licensed as a finance lender or broker under the California Financing Law, it must submit the application with the investigation and filing fees (currently \$300) plus any fingerprint processing fees. Fin C §22103. The applicant must maintain a minimum net worth of \$25,000 and submit financial statements prepared in accordance with GAAP demonstrating satisfaction with such requirement. Fin C §22104(a). An applicant that intends to make or broker loans se-

cured by residential real property is subject to a higher minimum net worth requirement (\$250,000) and is required to obtain its license through the Nationwide Mortgage Licensing System and Registry. Fin C §§22104(b), 22015.1.

Counsel drafting forbearance agreements should be mindful that any potential usury claims will not be released.

A Statement of Identity and Questionnaire (SIQ) must be filed by each of the following persons, as applicable: (1) the sole proprietor applicant; (2) each general partner, officer, or director of the finance lender or broker; (3) each person who will be in charge of the place of business of the finance lender or broker; (4) each person with direct involvement in or responsibility for finance lender's or broker's proposed activities under the license; and (5) each person that owns or controls, directly or indirectly, 10 percent more of the finance lender or broker. An organizational chart also must be submitted if the applicant is owned by another entity or individual or has subsidiaries or affiliated entities. If an entity owns or controls 10 percent or more of a finance lender or broker, a SIQ must be submitted for each officer, director, general partner, or managing member, as applicable, of such other entity. The DBO may waive this requirement if it determines that further investigation is not necessary for public protection. For example, if the entity that owns 10 percent or more of the applicant is a passive investor, SIQs may not be required. Further, a licensee must maintain a surety bond payable to the Commissioner in the sum of \$25,000. Fin C §22112. The DBO will notify the applicant whether the application is complete within 45 days of its receipt of the application. 10 Cal Code Regs §1421. Often, the DBO requests additional information or clarification.

Ongoing Duties of a Finance Lender

Licensed finance lenders have multiple ongoing duties and requirements. For example, licensed persons must

- Post their license in a conspicuous place (Fin C §22151);
- Maintain books, records, and accounts at the approved license location (10 Cal Code Regs §1425);

- File annual reports on or before March 15 for the preceding year (Fin C §22159; 10 Cal Code Regs §1430.5);
- Not issue any false, misleading, or deceptive statements or advertising (Fin C §22161);
- Not advertise in California without disclosing the license under which the loan is to be made (Fin C §22162);
- Retain advertising copy for 2 years from the date of its use (Fin C §22166; 10 Cal Code Regs §1552);
- Notify the DBO of any changes in the officers, directors, or other persons named in the original license application within 30 days of the change (10 Cal Code Regs §1409);
- Immediately report the filing of any criminal action (not just a felony conviction) against the licensed company, directors, officers, or management (10 Cal Code Regs §1411);
- Not predate or postdate any documents (10 Cal Code Regs §1450);
- Immediately deliver to the borrower copies of all executed documents or the pertinent provisions thereof (10 Cal Code Regs §1449);
- Not receive any charge from a borrower after the making of the loan *unless* authorized by law and specifically provided for in the original contract (all charges must be clearly substantiated in the record and set forth in a detailed statement) (10 Cal Code Regs §1445); and
- Not require or permit a borrower to waive any statutory provisions of the California Financing Law, including any provision of general law that requires notice to be given to the borrower (10 Cal Code Regs §1408).

The foregoing examples are representative of the ongoing duties and obligations of licensed persons, but they are not exhaustive.

Additional Rules and Regulations Applicable to Consumer Loans

Lenders making consumer loans and counsel advising those lenders should pay careful attention to the disclosure requirements, limitations on interest rates and payment terms, and similar provisions in Fin C §§22200–22470 (consumer loans) and the multiple additional regulations in the California Code of Regulations that apply to consumer loans. “Consumer loan” is defined as a loan intended by the borrower for use *primarily for personal, family, or household purposes* (Fin C §22203, emphasis added). However, there is an additional definition that includes (a) loans *under \$5,000* if the borrower intends to use the pro-

ceeds primarily for *other than* personal, family, or household purposes (*i.e.*, business purposes) and (b) consumer loans under Fin C §22204 if they are secured by a lien on income arising from the operation of a business by a borrower such as accounts or chattel paper (Fin C §22204(a)–(b)). In *Wertheim, LLC v Currency Corp.* (May 22, 2012, No. B218547) 2012 Cal App Unpub Lexis 3839 (unpublished), the court held that when the lender made discretionary loans under \$5,000 that were not revolving loans or credit lines, those loans are consumer loans subject to the rate limitations of Fin C §§22303 and 22304 and Regulation Z (Truth-in-Lending) (12 CFR pt 1026), administered by the Consumer Financial Protection Bureau. Consumer loans that are less than \$5,000 are subject to maximum regulation on the theory that borrowers of smaller amounts are more likely to need additional protections from unscrupulous lenders. Consumer loans in excess of \$10,000 are therefore exempt from many of the consumer loan provisions of the California Financing Law and the California Code of Regulations (Fin C §22250(a); 10 Cal Code Regs §1570(a)), and consumer loans in excess of \$5,000 are exempt from an additional part of the consumer loan provisions of the California Financing Law and California Code of Regulations (Fin C §22250(b); 10 Cal Code Regs §1570(b)). However, Regulation Z is likely to continue to be applicable to lenders making consumer loans. Under current regulations, Regulation Z does not apply to consumer loans (not secured by a dwelling) that are in excess of \$54,600. Determining exactly when compliance with Regulation Z is required is complicated, and lenders making consumer loans must be vigilant to ensure compliance.

Revocation and Penalties Under the California Financing Law

The Commissioner can impose multiple penalties for failure to be licensed under the California Financing Law or for failure to follow the California Financing Law or its related rules and regulations. The Commissioner may censure, suspend, or bar a licensee or an employee of a licensee for violations of the California Financing Law. Fin C §22169.

The Commissioner may also recommend criminal prosecution. Fin C §22708. The Commissioner has the power to investigate and examine the loans and business of a licensee by examining and taking possession of the books, accounts, records, and files of the licensee. Fin Code §§22701, 22702. The Commissioner's powers of investigation and examination are not terminated by the surrender, suspension, or revocation of a license (Fin C §22704), and the Commissioner has those powers regardless of whether a license was ever issued (Fin C §22705). The Commissioner also has the power to subpoena records from third parties, to depose witnesses, and to recover the costs of the investigations from the licensee. Fin C §§22706, 22707. The Commissioner can assess administrative fines of up to \$2,500 per violation of the California Financing Law, and the citation may also include an order to correct the violations identified by the Commissioner. Fin C §22707.5. Civil penalties of \$2,500 per violation can also be assessed in connection with any civil action brought in the name of the people of California. Fin C §22713.

Any person who willfully violates any provision of the California Financing Law, or who willfully violates any rule or order adopted under the California Financing Law, will, on conviction, be punished by a fine of not more than \$10,000 and by imprisonment in a county jail for not more than 1 year, or both. Fin C §§22753, 22780.

CONCLUSION

The usury limitations and the licensing requirements under the California Financing Law are fundamental policies of the State of California. In addition to the numerous class-wide and transaction-based exemptions from the usury limitations, a lender can avoid the usury limitations by obtaining a finance lenders license in accordance with the California Financing Law. Once licensed, a lender must be careful and follow all the requirements of the California Financing Law itself and the regulations under it to avoid suspension or revocation of the license and any civil or criminal penalties for violation.

**APPENDIX
CALIFORNIA USURY EXEMPTIONS**

Exemption	Source		Exemption	Source
California banks; savings and loan associations; credit unions; nonprofit agricultural, horticultural or dairy cooperative associations and certain other agricultural corporations; pawnbrokers; industrial loan companies; national banks; any successor-interest to any loan or forbearance	Cal Const art XV, §1		Loans made by college-level educational institutions to students (specified interest caps) and faculty or staff (secured by residential dwellings)	Fin C §28000
Loans made or arranged by a licensed real estate broker and secured by liens on real property	Cal Const art XV, §1; CC §1916.1		Admitted, incorporated insurers	Ins C §1100.1
Federal and state savings and loan associations or savings banks and their subsidiaries and holding companies	Fin C §7675		Physicians' cooperative indemnity corporations	Ins C §1280.7(a)(4)
State banks; licensed foreign banks and foreign banks with assets greater than \$100 million	Fin C §1716		Qualified evidence of indebtedness	Corp C §25116
Trust companies and state and national banks acting in fiduciary capacities	Fin C §1504		Investment grade evidence of indebtedness	Corp C §25117
Bank holding companies and subsidiaries	Fin C §3707		Affiliate lending: (a) written loans of \$300,000 and (b) loans to an entity with total assets of \$2 million	Corp C §25118
Licensed brokers and industrial development corporations	Fin C §31410		Transactions conducted by licensed broker-dealers	Corp C §25211.5

continued on next page

APPENDIX
CALIFORNIA USURY EXEMPTIONS *(continued)*

Exemption	Source		Exemption	Source
California Finance Lenders	Fin C §22000.2		Out-of-state public pension systems	CC §1916.2
Residential Mortgage Lenders	Fin C §50000.1		Pension funds/retirement systems subject to ERISA	CC §1917.220
Certain public bond issues	Govt C §5906		Shared appreciation loans	CC §1917.005
California state and local public retirement systems	Govt C §7509		Shared appreciation loans to seniors	CC §1917.616
National banks	12 USC §85		Real property development associations	CC §1366(d)
Federal savings and loans	12 USC §1463(g)(l)		Bottomry contracts	Harb & N C §455
Federally related, first lien, residential real property loans	12 USC §1735(f)-7a		Veterans' Administration loans	38 USC §1828
Small business investment companies	15 USC §1687		Small Business Administration development company debentures	15 USC §697
Federal credit unions	12 USC §1757(5)(A)(vi)		Solar energy and energy conservation bank	12 USC §§1723g, 1723h