

Consumer Financial Services Update



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California Court of Appeal Applies California Finance Lenders Law Despite Choice of Law Clause

In *Brack v. Omni Loan Company, Ltd.* (2008) 164 Cal.App.4th 1312, the California Court of Appeal held that the California Finance Lenders Law is a fundamental policy of the State of California which will be enforced despite a choice of law clause in a loan agreement selecting the law of another state as governing the transaction.

In *Brack*, the Court of Appeal noted the salient facts to be as follows.

In 1996, a finance company known as Pioneer Military Lending, Inc. applied to the Commissioner of Corporations for permission to make loans in California to nonresident members of the military without complying with the requirements of the Finance Lenders Law, Financial Code section 22000, *et seq.* Pioneer asked the

“ . . . the requirements of the Finance Lenders Law are matters of fundamental public policy which cannot be waived by way of agreement between the parties. . . .”

Brack v. Omni Loan Company, Ltd. (2008) 164 Cal.App.4th 1312, 1326

Commissioner for a ruling that its loan program was not subject to the Finance Lenders Law. The Commissioner issued such a ruling, stating that, “it is difficult to discern what the

interest is of the State of California so as to require licensure of Pioneer under [the Finance Lenders Law].” In other words, the Commissioner advised Pioneer its loan program was not finance lending within the meaning of the Finance Lenders Law. 164 Cal.App. 4th at 1317.

In 1997, the Omni Loan Company, Ltd. and the Omni Financial Corporation (“Omni”) determined to establish a similar business in California, lending in California to non-resident military personnel. Omni sought a similar letter from the Commissioner of Corporations to that provided to Pioneer. However, the Commissioner declined to issue one to Omni, stating:

Omni's proposed lending activities are similar to Pioneer's, in that both lenders have represented to the Department that they will only be making loans to military personnel who are not residents of California. However, Omni appears to propose a greater business presence in California than Pioneer proposed to the Department. Pioneer represented to the Department that its loan paperwork would not be processed in California, and that the loans would be funded out-of-state. Thus, Pioneer represented

that it would be making the loans from out-of-state to nonresidents stationed in California, and that its business activities within California would be minimal. Omni appears to propose a main California office to perform all functions related to making loans, and to further propose contracting with one to two independent contractors to facilitate the lending through the California main office. Omni is proposing to engage in more lending activities within the state of California than Pioneer, and is therefore more likely to be engaged in the business of a finance lender in California than Pioneer. In short, Omni has not chosen to structure its California lending activities in a manner identical to the Pioneer structure set forth in [the Pioneer letter].

Id., 164 Cal.App.4th at 1317 – 1318.

Despite this decision, Omni opened two loan offices, one in Oceanside and the other in San Diego. In addition, Omni developed a retail partners program with merchants in California, making loans to non-resident members of the military. (When California members of the military came into Omni's

offices, they were directed to a computer terminal in the office and encouraged to obtain financing through Omni's online affiliate.)

Plaintiff Joshua Brack was a non-resident member of the military stationed at Camp Pendleton. Brack applied for a loan through Omni. He was not told until he was presented with a loan agreement that the interest rate was 34.89 percent per annum. The loan agreement contained a provision that the transaction was governed by the law of the State of Nevada, where Omni was incorporated and had its principle place of business. Brack fully repaid his loan.

Brack then filed a class action lawsuit, alleging that the loan agreement violated the Finance Lenders Law, which violations also allegedly created rights pursuant to the Consumers Legal Remedies Act, Civil Code section 1750, *et seq.*, and the Unfair Competition Law, Business and Professions Code section 17200 *et seq.*

Omni answered the complaint, alleging in part by way of affirmative defense the loan agreements were all governed by Nevada law. Omni also asserted the Commerce Clause of the United States Constitution barred the plaintiff's complaint. Omni stipulated to class certification. The trial court bifurcated the case and

tried the choice of law and the Commerce Clause issues first, to the court.

After trial, the court found that Nevada had a substantial relationship to the loan agreements because Omni was incorporated in Nevada and the loans were approved in Nevada. The court relied upon the Pioneer letter and drew parallels between Pioneer's operation and Omni's program. Finally, the trial court found that the only difference between California law and Nevada law was California's requirement that lenders post signs fully and accurately setting forth loan charges and the method of computing those charges. 164 Cal.App.4th at 1319. (The trial court found against Omni on the Commerce Clause issue, which Omni did not appeal.)

Shortly after the judgment was entered, the Commissioner of Corporations rescinded the Pioneer letter, by stating that the rescission had no effect on loans already made. The plaintiff moved to set aside the judgment entered in favor of Omni on this basis, but the trial court denied the motion.

The plaintiff appealed.

The Court of Appeal noted that choice of law rules provide that California courts will enforce a contractual choice of law if the state whose law was chosen has an

interest in the parties' controversy. However, if application of the chosen law conflicts with a fundamental – i.e. substantial – policy of California, courts must consider the impact application of the law will have on California's interests. If California's interests are materially greater than the interests of the state whose law was chosen by the parties, California will apply its law notwithstanding a choice of law clause.

The Court of Appeal first noted that it agreed with the trial court that Nevada did have an interest in the parties' controversy. 164 Cal.App.4th at 1325. The Court noted that it was therefore necessary to determine whether Nevada's law conflicts with a fundamental policy of California, and, if so, whether California has a materially greater interest in the transaction than Nevada.

The Court of Appeal held that the trial court erred in finding that the laws of Nevada and California did not conflict. The Court noted that “[r]ather than determining whether the application of the chosen state's law violated a fundamental policy of California, it isolated the difference between California's and Nevada's laws controlling finance lenders and then analyzed whether the isolated difference in the

two states' laws – namely signage – was a fundamental policy. This approach led the trial court to consider each portion of the law separately and thereby minimize the impact of any deviation from the requirements of the law. As our analysis discloses, this approach was erroneous because it failed to consider the law as an integral whole, the particular parts of which reinforce each other.” 164 Cal.App.4th at 1325.

The Court then noted that in enacting the Finance Lenders Law, the Legislature directed that it be liberally construed. Financial Code section 22001. The Court went on to explain:

The expressly articulated policies set forth in *section 22001* – assuring an adequate supply of credit to consumers and protection of consumers from unfair practices – are on their face of some consequence. Here, in addition to the Legislature's statement of purposes, the remedies which the Legislature has provided and the enforcement mechanism it has created make it clear not only that the requirements of the Finance Lenders Law are matters of fundamental public policy which cannot be waived by way of agreement between the parties, but that the

provisions of the law must be viewed together.

164 Cal.App.4th at 1326.

The Court then began its analysis by noting that Financial Code section 22324 provides that it is a violation of the Finance Lenders Law to try to evade its reach by making a loan out of state. The Court noted that this was a strong suggestion that the Finance Lenders Law may not be circumvented by a contractual choice-of-law provision.

The Court also noted that the Finance Lenders Law provides that any contracts made in willful violation of its provisions, including licensure provisions, are void. Financial Code section 22750. If the violations are not willful, the lender must nonetheless forfeit any interest and charges on the loan. Financial Code section 22752. The Court noted that willful violations are also punishable by civil and criminal penalties. Financial Code sections 22713 and 22753.

The Court then stated that lenders must be licensed under the Finance Lenders Law. The Court noted that, “[t]here would be little, if any, utility in establishing this thorough licensing scheme and giving the commissioner power over licensees, if the licensing requirements of the law and the power of the department could be waived

by simple agreement between lender and borrower.” 164 Cal.App.4th at 1327.

The Court concluded its analysis of the substantial state policy embodied in the Finance Lenders Law by stating:

In sum, the Legislature, in expressly preventing any attempt to avoid its provisions by making loans outside the state, in voiding contracts made in violation of the Finance Lenders Law and in creating a licensing scheme through which it directly regulates the finance lenders market, has made it clear that the Finance Lenders Law is a matter of significant importance to the state and, like the provisions of Corporate Securities Law of 1968 and the CLRA, is fundamental and may not be waived.

Id.

Having found that the Finance Lenders Law is a fundamental California policy, the Court then determined whether there was a conflict between California and Nevada law. The Court of Appeal held that given the discussion above, the trial court failed to appreciate the significant differences between California and Nevada law. The Court noted that operation of the Finance Lenders Law depends in large measure upon private

enforcement, licensing and the considerable power the Commissioner of Corporations exercises over licensees. The Court noted that the choice-of-law provisions in Omni's loan agreements attempted to immunize Omni's activities from the California regulatory scheme and thereby conflicted with it in a substantial manner. 164 Cal.App.4th at 1328.

Finally, the Court decided that California's interest in enforcing its law is materially greater than Nevada's interest in enforcing its laws. It stated that Omni's 12,000 California loans were made to California consumers, secured with collateral located in California, and provided cash that was likely spent in California. Moreover, Omni's California competitors who are subject to California's regulatory scheme were deprived of the opportunity to make those 12,000 loans. On the other hand, the Court noted that Nevada's interest is limited to the out-of-state activities of one of its corporate citizens. *Id.* The Court also noted that application of Nevada law would deprive a substantial segment of California's borrowing public of the substantive and regulatory protection California affords all of its other consumers. Nevada, on the other hand, has no policy preventing its lenders from subjecting

themselves to the regulatory authority of other states.

On this basis, the Court of Appeal held that despite the fact there was a reasonable basis for selecting Nevada law, its application conflicted with a fundamental policy of California in circumstances in which California has a greater interest than Nevada. Accordingly, the Court found the choice-of-law provisions in the loan agreements were not enforceable. It therefore reversed the judgment of dismissal.

California Courts Determine Song-Beverly Credit Card Act of 1971 Does not Apply to Returns of Merchandise

In *TJX Companies, Inc. v. Superior Court* (2008) 163 Cal.App.4th 80, the Court of Appeal decided that a provision of the Song-Beverly Credit Card Act of 1971, Civil Code section 1747.08, is subject to a one-year statute of limitations, and it did not apply to returns of merchandised purchased with a credit card.

The statute at issue prohibits a retailer from (1) having the cardholder write personal information on a credit card form, (2) having the cardholder furnish personal information for a retailer to write on a credit card form, and (3) using forms containing preprinted spaces for personal information. *Id.*

In *TJX*, the plaintiff Sean Caldwell used a credit card to purchase goods at retail. When she returned the goods on a later date, the retailer asked for Ms. Caldwell to provide certain personal information.

The plaintiff filed a lawsuit on her behalf, and on behalf of a class comprised of all others who used credit cards in connection with the return of merchandise within the previous three years.

The defendant moved to strike portions of the complaint, including an allegation that defined the class as users of credit cards within the last three years. The defendant took the position that the statute in question had a statute of limitations period of only one year. The trial court denied the motion.

The defendant also demurred to the complaint, contending that section 1747.08 does not apply to returns of merchandise. The trial court overruled the demurrer.

The defendant filed an application for a writ of mandate with the Court of Appeal. The Court stayed the matter and issued writs as to both issues.

1. The One-Year Statute of Limitations.

The Court of Appeal stated the issue to be which statute of

limitations applied – the three year statute of limitations set forth in Code of Civil Procedure section 338, subdivision (a), or the one year statute of limitations provided for in Code of Civil Procedure section 340, subdivision (a).

The Court held that the one year statute of limitations set forth in Code of Civil Procedure section 340, subdivision (a) applied. That section applies if a civil penalty provided in a statute is mandatory, rather than discretionary. If the court is required to impose a penalty, then the statute of limitations is one year. If the decision as to whether to impose a penalty is discretionary with the court, then the longer three year penalty would apply, pursuant to Code of Civil Procedure section 338, subdivision (a).

The Court then reviewed the language of the statute. It noted that the language used is mandatory. It provides that violators “shall be subject to . . .” civil penalties. The Court stated that similar language in other statutes has been interpreted as binding the trial court, and therefore mandatory.

The Court noted that in *Linder v. Thrifty Oil* (2000) 23 Cal.4th 429, the California Supreme Court stated that section 1747.08 does not mandate fixed penalties but rather sets maximum penalties. In *TJX*,

the plaintiff argued that this meant that the penalties were not mandatory. The Court of Appeal held that all this language meant is that the amount of the penalties was not mandatory, but the decision to award a penalty was without discretion. Thus, the *TJX* court distinguished the *Linder* holding.

2. Application of the Statute to Returns of Merchandise

The Court then turned to the issue of whether section 1747.08 applies to returns of merchandise. The Court held that it does not. Again, the statute prohibits a retailer from (1) having the cardholder write personal information on a credit card form, (2) having the cardholder furnish personal information for the retailer to write on a credit card form, and (3) using forms containing preprinted spaces for personal information. *Id.*

The Court noted that the first two provisions, i.e. those prohibiting the retailer from having the cardholder write personal information on a credit card form, or having the cardholder furnish personal information for the retailer to write on the form, explicitly referred to using the credit card for “payment.” The Court noted that returning merchandise is not the same as payment for it.

The Court concluded that if the plaintiff were correct,

then, it would only be with respect to the third portion of the statute – i.e. that which prevents the retailer from using forms that contain preprinted spaces for personal information. It stated, “[i]nterpreting *paragraph (3) of subdivision (a) of section 1747.08* so as to prohibit the use of preprinted forms with spaces for personal information to apply to transactions beyond those covered in the first two paragraphs leads to the anomalous conclusion that for return transactions, it is acceptable to request or require cardholders to furnish personal information but they may not be requested or required to do so on forms designed for this purpose.” 163 Cal.App.4th at 88. The Court noted that this would be an absurd result, and so declined the plaintiff’s invitation to read the statute that way.

Finally, the Court noted that the legislative history of the statute was consistent with its determination. The Court noted that once it has the information from the credit card, there is no reason the retailer needs any further personal information. On the other hand, when accepting a return, the retailer has a duty to identify the person who returns the merchandise, which may turn out to have been used, damaged or even stolen. *Id.*, at 89.

Accordingly, the Court issued a writ of mandate directing the trial court to sustain *TJX*’s demurrer without leave to amend, and granting its motion to strike. *Id.*

After *TJX* was decided by the Fourth District, other courts followed suit. See *Absher v. AutoZone, Inc.* (2008) 164 Cal.App.4th 332 (return of gas cap five minutes after purchase) and *Korn v. Polo Ralph Lauren Corp.* (E.D. Cal.) 2008 WL 2225743. See also *Romeo v. Home Depot, U.S.A. Inc.* (S.D. Cal.) 2007 WL 3047105.

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