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Agreed, Not Unauthorized and yet Unenforceable

Students in the USA are taught that we have three branches of government; executive, legislative and judicial. Young students are taught that the legislature makes laws, the executive enforces laws and the judicial branch of government interprets laws. Lawyers know the system is not that simple.

Each branch of government has ways of prohibiting activities that it believes should not be permitted. Take for example, the world of consumer lending laws: (i) the legislature passes laws to prohibit certain procedural activities and substantive agreement provisions – such as consumer protection laws and usury statutes; (ii) the executive branch promulgates regulations requiring certain disclosures and revocation periods; and (iii) courts can also act to declare contract provisions unenforceable.

When a court wants to prohibit some act or enforcement of a contract provision, it declares the objectionable activity or agreement “unconscionable.”^[1] Like many others, Ohio common law includes the concept of an “unconscionable” contract or, as a noun, “unconscionability.” Unconscionability is the claim made by contract litigation defendants as they seek to avoid the bargain they once accepted. In Ohio, we recognize both procedural unconscionability and substantive unconscionability. Citing and quoting Ohio Supreme Court cases, one court recently stated:

The concept of procedural unconscionability implicates the circumstances in which an agreement is negotiated, including factors such as the parties’ business experience and intelligence, . . . The concept of substantive unconscionability ‘involves consideration of the terms of the agreement and whether they are commercially reasonable.’ [citations omitted]. *Booher v. Brace Quest Corps.*, 107 N.E.3d 1286 (Montgomery Cty. App. 2018).

When the legislature acts in a substantive area, we must always wonder if any other lesser legislature (e.g. state legislatures when congress acted) or a court-made rule that varies from the primary legislative enactment can be created or if the entire field has been

occupied by the legislative action. See, for example, the discussion of “field preemption” in Ohio Consumer Law (Sept. 2018 update) Section 22.82 titled Preemption of State Law which includes this:

Implied preemption occurs either where Congress covered the entire field, leaving no room for state law (field preemption), or where compliance with both federal law and state law is impossible, or state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress (conflict preemption). And see, 16 O. Jur.3d Constitutional Law, Section 140 titled Sources of Preemption of State Law.

The question I want to consider now is: If the legislature acts to declare certain substantive provisions unenforceable, has it implicitly declared related but not prohibited provisions enforceable? Asked in reverse – can a court use the doctrine of unconscionability to make unenforceable a provision that is not one that the legislature declared unenforceable? Given what civics teaches about legislative determinations and the role of the judiciary, one might think that if the legislature has addressed an issue and declared that certain provisions are substantively unenforceable (as with usury) then other interest rate terms are enforceable. That thought may be wrong.

In *De La Torre v. CashCall, Inc.*, 5 Cal. 5th 966, 972 (Cal. 2018) the Supreme Court of California considered the interest rate on a loan that was not regulated by California’s usury statute which did regulate the permissible interest rate on other loans. Even though the legislature decided not to regulate the applicable interest rate on the loans at issue, the court decided to act. The California court addressed this issue directly saying:

What the Ninth Circuit asks us to resolve in this case is a more specific version of that question: Can the interest rate on consumer loans of \$2,500 or more render the loans unconscionable under [section 22302 of the Financial Code](#)? The answer is yes. An interest rate on a loan is the price of that loan, and “it is clear that the price term, like any other term in a contract, may be unconscionable.”

Although California sets interest rate caps only on consumer loans less than \$2,500, we do not glean from the statute setting those

rates—section [22303 of the Financial Code](#)—the implication that a court may never declare unconscionable an interest rate on a loan of \$2,500 or more. Nothing in our unconscionability doctrine, in [section 22303](#), its neighboring [section 22302](#), or anything else shedding light on the purpose of the relevant statutes supports such a reading. Indeed, when read together, [sections 22302 and 22303](#) tend to show how the Legislature’s purpose in enacting these provisions was to free larger-denominated debts from the rigid regulation of usury rates, without rendering irrelevant to those transactions the flexible standard of unconscionability long rooted in both statutes and California common law. (citations omitted, California has unconscionability provisions in both the statutory provisions referenced herein and in common law). *Id.*, 5 Cal. 5th at 972.

CashCall’s loan product under attack in *De La Torre* was an unsecured loan in the amount of \$2,600 to “consumers with low credit scores,” living “under financial stress.” It seems clear that this product was designed to avoid the usury rules of the California legislature. At first, it seemed like that design worked. As described by the Supreme Court of California, the federal district court hearing the litigation granted relief to CashCall:

But the [federal district] court changed its mind when CashCall made a motion for reconsideration. The court now agreed with CashCall that “the UCL [California Unfair Consumer Competition Law] cannot be used as a basis for Plaintiffs’ Unconscionability Claim because ruling on that claim would impermissibly require the Court to regulate economic policy.” (*De La Torre v. CashCall, Inc. (N.D.Cal. 2014) 56 F.Supp.3d 1105, 1107.*) In reaching this conclusion, the court reasoned it could not fashion a remedy under the UCL “without deciding the point at which CashCall’s interest rates crossed the line into unconscionability.” (*Id. at pp. 1109–1110.*) The court emphasized that, in enacting [section 22303](#), “[t]he California Legislature long ago made the policy decision not to cap interest rates on loans exceeding \$2,500.” (*Id. at p. 1109.*) To decide the point at which “CashCall’s interest rates crossed the line into unconscionability,” said the court, would be to “second-guess” the Legislature and “impermissibly intrud[e] upon [its] province” to forge economic policy through legislation. . . . The [federal district]

court therefore granted CashCall's motion for summary judgment *Id.*, 5 Cal. 5th at 974–5. The federal district court was following what you probably learned in high school civics class: the legislature makes law and when a topic has been decided by the democratically elected people's representatives, courts are to interpret statutes not alter the duly enacted laws.

Plaintiff/borrowers appealed the district court's decision. The Ninth Circuit Court of Appeals then certified the above-discussed question to the Supreme Court of California. The first sign of trouble for CashCall is found in the California Supreme Court's definition of unconscionability:

Unconscionability is a flexible standard in which the court looks not only at the complained-of term but also at the process by which the contractual parties arrived at the agreement and the larger context surrounding the contract, including its "commercial setting, purpose, and effect." . . . "An evaluation of unconscionability is highly dependent on context. . . . The ultimate issue in every case is whether the terms of the contract are sufficiently unfair, *in view of all relevant circumstances, that a court should withhold enforcement.*" . . . So we conclude plaintiffs have indeed stated a cause of action in this litigation by bringing an unfair competition claim that alleges a violation of [section 22302](#) due to an unconscionably high interest rate. (italics original, bold added, citations omitted). *Id.*, 5 Cal. 5th at 976.

As is so often true, this case was determined by the above-stated definitions used by the court. The Supreme Court of California chose a definition of "unconscionability" that gave that same court the right to make the determination. This should not be a surprise to litigation counsel. Unconscionable contract terms are colloquially described as those that shock the court's conscious. See, for example, 21 Tenn. Prac. Contract Law and Practice § 6:54 titled "*Unconscionability—Procedural/substantive aspects*" and Bagby and Souza in 29 J. Contemporary Health Law & Policy 183 (Spring 2013) which includes this "Courts often apply a 'shocks the conscious' test, finding contracts substantively unconscionable if they are so unfair as to shock the conscience." In other words, declaring something unconscionable and hence unenforceable in reliance on

the common law power to act is a court created power that courts' reserve for their own use, sometimes even if the legislature has already acted to the contrary.

I suspect that the Supreme Court of California's decision was a surprise to CashCall since in 1985 the California legislature had specifically reduced the usury statute application threshold from loans \$5,000 to the current \$2,500. This would seem to evidence an intent not to regulate the interest rate on CashCall's \$2,600 loan much as the federal district court determined. The California court, however, did not agree that by regulating interest rates on loans under \$2,500 the legislature intended for interest rates on larger loans to be unregulated. In response to this assertion by CashCall, the California court said this:

By removing interest rate caps on loans of at least \$2,500, the Legislature allowed the market to set the rates on those loans. . . . But the Legislature did not preclude the possibility that courts would step in to protect consumers if interest rates—within the particular context of a given transaction—are shown to be unconscionable. (citations omitted). *Id.*, 5 Cal. 5th at 985–6.

A diligent but not exhaustive search did not locate any directly analogous decisions from a jurisdiction's highest court holding that the doctrine of unconscionability may apply to make unenforceable contract terms that a legislature has directly chosen not to invalidate. Still, litigators fashioning claims should consider attacking provisions as unconscionable even if the legislature did not outlaw same.

Outside of litigation, counsel who author opinion letters on the enforceability of contracts must consider the danger of the doctrine of unconscionability even if the legislature has apparently authorized precisely the contract clause under examination because unconscionability is for the court to determine.

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[\[1\]](#) Legislatures have adopted the word “unconscionable” when declaring certain activities unenforceable due to perceived unfairness. See, O.R.C. Section 1345.03 titled Unconscionable Consumer Sales Act or Practices.

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