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THE USURY EXEMPTION: SHOULD IT APPLY TO REAL ESTATE BROKERS MAKING LOANS?

I. Introduction

The California Legislature recently enacted Civil Code section 1916.1 in order to clarify confusing language in article XV, section 1 of the California Constitution which exempts licensed real estate brokers from the Usury Law. Civil Code section 1916.1 declares that a real estate broker is exempt from the Usury Law whether or not the broker is acting within his licensed capacity. In other words, a real estate broker may lawfully negotiate and lend money from his own pocket and may charge interest rates far in excess of the statutory maximum without incurring any liability whatsoever. The po-

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2. Cal. Const. art. XV, § 1 reads in relevant part: “However, none of the above [usury] restrictions shall apply . . . [to] any loans, made or arranged by any person licensed as a real estate broker by the State of California, and secured in whole or in part by liens on real property . . . .”


The restrictions upon rates of interest contained in section 1 of Article XV of the California Constitution shall not apply to any loan or forbearance made or arranged by any person licensed as a real estate broker by the State of California, and secured, directly or collaterally, in whole or in part by liens on real property . . . . The term “made or arranged” includes any loan made by a person licensed as a real estate broker as a principal or as an agent for others, and whether or not the person is acting within the course and scope of such license.

Id.

4. In general, a real estate broker acts within his capacity as a broker when he “arranges” a loan and works within his license when the following conditions are met: 1) he must be acting on behalf of someone else, and 2) he must be working for compensation. Froid v. Fox, 132 Cal. App. 3d 832, 839, 183 Cal. Rptr. 461, 465 (1982). See also Cal. Civ. Code § 1916.1 (Deering Supp. 1986). In Froid, the court held that the real estate broker’s activity did not require a real estate broker’s license because the broker was acting as a principal rather than for others in certain real estate transactions. The court concluded that because unlicensed activity was involved, the investors could not recover from the Real Estate Education, Research and Recovery Fund despite the fact that they had obtained a fraud judgment against the broker. The court relied on Cal. Bus. & Prof. Code § 10133(a) (Deering Supp. 1986). At that time, the statute excluded anyone dealing with his own property from the real estate broker
tentially harsh results of Civil Code section 1916.1 became clear in a recent California appellate court decision which upheld a real estate broker’s loan transaction involving an interest rate in excess of 250 percent. Although the court appeared reluctant to reach such an inequitable result, the majority felt compelled to follow the legislative interpretation of the real estate broker exemption codified by Civil Code section 1916.1.

This comment examines the serious problems which arise if real estate brokers acting as principals are exempt from the Usury Law. Section II presents the history of California usury laws and focuses on the current real estate broker exemption. Section III reviews the legislative history and voter intent behind the real estate broker exemption. Section IV demonstrates that exempting a real estate broker’s unlicensed activity violates federal and state equal protection provisions. Finally, the comment proposes that Civil Code section 1916.1 either be struck down by the California Supreme Court on equal protection grounds or be significantly amended by the California Legislature. This will ensure that the usury exemption only applies when a broker is acting within his capacity as a real estate broker and “arranges” a loan rather than when he acts as a personal lender and “makes” a loan. Alternatively, the comment proposes that if real estate brokers are exempt from the Usury Law when making loans, then such lending activity should be independently regulated by the Legislature. Such action will protect consumers from being

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When a broker “makes” a loan he is a “principal” or a “lender,” and he is acting for himself rather than others. See Merrifield v. Edmonds, 146 Cal. App. 3d 336, 342-43, 194 Cal. Rptr. 104, 108 (1983). He is thus not performing services within the scope of his license.

In limited circumstances, however, a broker’s activity requires a license even though he is acting as a principal. For instance, a broker acts within his license when he is in the business of buying or selling real property sales contracts or promissory notes secured by liens on real property. See Cal. Bus. & Prof. Code § 10131.1 (Deering 1984).

For purposes of this comment, when a broker acts as a lender, he acts “outside of his license.” See infra note 96 and accompanying text for the statutory definition of a real estate broker.

5. Garcia v. Wetzel, 159 Cal. App. 3d 1093, 1098, 206 Cal. Rptr. 251, 254 (1984) (holding that a real estate broker who charged a high interest rate on a loan transaction was not liable under the Usury Law because of the real estate broker exemption).

6. The Garcia court stated that “We are constrained to note, however, that the interest rate charged here is over 250 percent per annum. By permitting such a transaction, the legislature may have gone too far. . . .” Id. at 1097-98, 206 Cal. Rptr. at 254.

7. This comment does not dispute the constitutionality of exempting loans “arranged” by brokers. Less risk of abuse exists when a broker “arranges” a loan made by another lender because the real estate broker is acting within his license and is subject to statutory regulations. See infra notes 60-62 and accompanying text.
charged unconscionable interest rates on loans.

II. CALIFORNIA USURY EXEMPTION FOR REAL ESTATE BROKERS

A. History of California Usury Exemptions

Usury is defined as the charging of an interest rate on a loan transaction which is above the maximum amount permitted by statute. Common law usury does not exist; usury is exclusively the creature of legislation. Although interest rates have been restricted since early civilization, California has recognized the evils of usury for less than a century.

In 1918, the Legislature presented an initiative measure to California voters which proposed a twelve percent limit on interest rates for all loan transactions. The electorate ratified the initiative measure, and California thereby regulated interest rates for the first time in the state's history.

The Usury Law was enacted to protect borrowers from being charged unconscionable interest rates on loans. The 1918 regulations applied a blanket twelve percent interest rate limit on all lenders. The regulations effectively protected the California consumer from potential abuse; however, the Usury Law created other problems because it overlooked the heterogeneous nature of the lending industry.

Consequently, the Legislature amended the California Usury

10. For example, the laws of ancient Babylon limited the amount of interest that could be charged on loans of corn or silver. Comment, California's Model Approach to Usury, 18 Stan. L. Rev. 1381, 1381-83 (1966) [hereinafter cited as Model Approach]; see also Comprehensive View, supra note 9, at 168-69 (stating that references to usury can be found in the legal and religious annals of the last 2,500 years).
11. The 1918 initiative measure was contained in CAL. CIV. CODE §§ 1916-1 to 1916-5 (Deering 1981). These provisions are reported in Deering's Uncodified Initiative Measures because the initiative was superseded by a constitutional provision.
12. Id.
14. Some commentators have suggested that because the lending industry is heterogeneous, the interest rate charged on a loan should vary according to the type of loan and the lender. Factors such as the cost of money to the lender and the risk of default with a particular type of loan should be considered when determining a reasonable interest rate limit rather than a blanket approach. See Comprehensive View, supra note 9, at 169-71; Model Approach, supra note 10, at 1383-84.
Law in 1934. The 1934 amendment exempted certain classes of lenders from the Usury Law and empowered the Legislature to regulate such exempted lenders. The lenders who became exempt under the 1934 amendment were singled out because their lending activities were already regulated in some manner. Such exemptions added flexibility to the Usury Law, which remained unchanged for more than forty years.

The economic climate of the last decade led to the most recent change in the Usury Law. As interest rates escalated in the 1970's many lenders were unwilling to lend money at the low rates required by the Usury Law. The prevailing high interest rates meant that very little money was readily available for mortgage lending. This, in turn, crippled the consumer who was then unable to borrow money. The Legislature reacted by presenting Proposition 2 to the California voters, a measure which the electorate adopted on November 6, 1979. Proposition 2 purported to make more money availa-

15. The Usury Law is now contained in Cal. Const. art. XV, § 1 (formerly art. 22, § 20). Article XV was adopted on June 8, 1976.
16. These classes included: 1) savings and loan associations, 2) industrial loan companies, 3) credit unions, 4) pawnbrokers, 5) personal property brokers, 6) state and national banks, and 7) nonprofit agricultural lenders. These lenders continue to be exempt under Cal. Const. art. XV, § 1. The question of whether these classes of lenders should be exempt from the Usury Law is beyond the scope of this comment.
17. Cal. Const. art. XV, § 1 reads in relevant part:

The Legislature may from time to time prescribe the maximum rate per annum of, or provide for the supervision, or the filing of a schedule of, or in any manner fix, regulate or limit, the fees, bonuses, commissions, discounts or other compensation which all or any of the said exempted classes of persons may charge or receive from a borrower in connection with any loan or forbearance of any money, goods or things in action . . . .

Id.
18. For instance, credit unions and industrial loan companies were subject to strict statutory regulation. See Cal. Fin. Code §§ 14000-14959 and §§ 18000-18705 (Deering 1978 & Supp. 1986). Many of the statutes which presently exist were enacted prior to 1934.
19. After 1934, the Usury Law was not amended until 1979 when an initiative measure was passed by the California electorate. See infra note 21 and accompanying text. Prior to 1979, the California Legislature proposed several amendments to the Usury Law, including one in 1970 and two in 1976. All the proposals, however, were rejected by the California voters. See Preble & Herskowitz, Recent Changes in California and Federal Usury Law: New Opportunities for Real Estate and Commercial Loans?, 13 Loy. L.A.L. Rev. 1, 2 n.6 (1980).
20. During this period, the California Usury Law was among the most restrictive in the nation, and some institutional lenders were forced to do business outside of California in order to charge economically feasible interest rates. Id. at 2-3.
21. Proposition 2 was presented to the voters pursuant to California Constitutional Amendment No. 52 (1979 Cal. Stats. ch. res. 49). Because the California Usury Law is contained in an article of the California Constitution, it can only be amended by popular vote. Carter v. Seaboard Finance Co., 33 Cal. 2d 564, 579, 203 P.2d 758, 768 (1949). However, Proposition 2 also expressly granted the Legislature the power to determine additional classes
ble for mortgage lending by extending the list of exempt loans.\footnote{22} Loans made by licensed real estate brokers were included in this expanded list.\footnote{23}

**B. Current State of the Usury Law**

Proposition 2 is now contained in article XV, section 1 of the California Constitution. Article XV, section 1 exempts loans which are “made or arranged” by licensed real estate brokers and which are secured by liens on real property.\footnote{24} The term “made or arranged” has sparked recent controversy as courts have considered the issue of whether a real estate broker’s loan is exempt when the broker is acting outside of his license.\footnote{25} In 1983, however, the Legislature enacted Civil Code section 1916.1.\footnote{26} Civil Code section 1916.1 expressly clarifies the meaning of the term “made or arranged” as used to define the parameters of the real estate broker exemption.

Civil Code section 1916.1 reads in relevant part: “The term ‘made or arranged’ includes any loan made by a person licensed as a of exempt lenders. Consequently, exempt classes must no longer be designated by the electorate through the initiative process.

22. The rationale was that if the list of exempt loans were expanded, there would be more lenders willing to lend money to consumers. See California Ballot Pamphlet, Special Statewide Election 10, 12 (Nov. 6, 1979).

23. Proposition 2 created two other exemptions: 1) successors in interest to exempt loans or forbearances, and 2) obligations of exempt lenders. These exemptions are beyond the scope of this comment, however, for a summary of these exemptions, see Bosco & Larmore, Practice Under the New California Usury Law, 55 Cal. St. B.J. 58 (1980).

24. See supra note 2 for the applicable text of art. XV, § 1. See Dana & Harroch, The Real Estate Broker Exemption From the California Usury Law, 4 CEB Real Prop. L. Rep. 137 for a discussion of 80 Op. Att’y Gen. 122 (April 29, 1980) which was published soon after Proposition 2 passed and which concluded that real estate brokers acting on their own account should not receive the broker exemption. The Attorney General’s Opinion was later withdrawn without further consideration. The Dana & Harroch article also examines several of the issues pertaining to the real estate broker exemption discussed in this comment.

25. See In re Lara, 731 F.2d 1455 (9th Cir. 1984); Garcia v. Wetzel, 159 Cal. App. 3d 1093, 206 Cal. Rptr. 251 (1984). These are the only two courts to address the issue of whether a real estate broker is exempt from the Usury Law when he “makes” a loan and is acting outside of his license. Both courts held that such broker activity falls within the usury exemption. See also infra note 26 and accompanying text.

real estate broker as a principal or as an agent for others, and whether or not the person is acting within the scope or course of such license.\textsuperscript{27} An appendix to Civil Code section 1916.1 explains that real estate brokers are exempt because they are both licensed by the state on the basis of education and also regulated by the state.\textsuperscript{28} The explicit language of the statute and its accompanying appendix make it quite clear that the Legislature intends to exempt real estate brokers who act outside their licenses. Two recent California appellate court decisions have applied Civil Code section 1916.1 to hold that a real estate broker acting as a principal is not liable for charging an interest rate above the statutory maximum.\textsuperscript{29}

1. Recent Cases

In Garcia v. Wetzel,\textsuperscript{30} a California appellate court upheld a loan made by a real estate broker to a couple who was facing imminent foreclosure of their home. The broker lent the sum required to redeem the couple’s home from foreclosure. The Garcias executed a grant deed on the property in favor of the broker, and the broker assumed the Garcias’ existing mortgage payments. The agreement also provided that the Garcias had the option to repurchase their property within thirty days. The Garcias exercised the option to repurchase their property and then sued the broker. The Garcias claimed that the interest rate on the broker’s loan was 250 percent per annum and thus constituted a usurious loan.

The court’s analysis was inconsistent. First, the court characterized the transaction as an unsecured loan,\textsuperscript{31} but then nevertheless applied the real estate broker exemption. The court’s reasoning was illogical because Civil Code section 1916.1 requires that a real estate broker make a loan which is secured in whole or in part by liens on real property in order to be exempt.\textsuperscript{32}

Despite this ambiguous analysis, the court found that the real estate broker exemption applied and upheld the transaction based on

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{28} Id.; see also infra note 81.
\item \textsuperscript{29} See In re Lara, 731 F.2d at 1462; Garcia v. Wetzel, 159 Cal. App. 3d at 1098, 206 Cal. Rptr. at 254.
\item \textsuperscript{30} 159 Cal. App. 3d 1093, 206 Cal. Rptr. 251 (1984).
\item \textsuperscript{31} The Garcia court stated: “Respondent baldly asserts that the transaction was ‘secured’ by the grant deed of the property. However, no deed of trust, mortgage, promissory note, or other security document was ever executed.” Id. at 1096 n.3, 206 Cal. Rptr. at 253 n. 3.
\end{enumerate}
\end{footnotesize}
Civil Code section 1916.1. The court stated, however, that it was reluctant to follow Civil Code section 1916.1 because such a high rate of interest had been charged on the loan.

Similarly, in the recent case of *In re Lara*, the Ninth Circuit Court of Appeals applied Civil Code section 1916.1 to uphold a loan made by a real estate broker who charged an interest rate of approximately forty-three percent. In that case, a real estate broker structured a loan transaction so that the broker contributed a portion of the loan proceeds and other individuals provided the balance. Thus, the broker was both “making” and “arranging” a loan. The court held that the loan was legal under Civil Code section 1916.1 and concluded that both the portion of the loan made by the real estate broker and the portion arranged by the broker, were exempt. However, the court questioned the wisdom of exempting real estate brokers when they make loans. The court stated that “regardless of our view concerning the desirability of the statute, we must defer to the state government.”

In both the *Garcia* and *Lara* cases, the defendant real estate brokers lent the money to the plaintiffs prior to the enactment of Civil Code section 1916.1. Both courts, however, relied on *Chapman v. Farr* and held Civil Code section 1916.1 to be retroactive in effect. The courts concluded that both of the loans were legal despite the fact that the money was lent before the real estate broker

33. The court conceded that the broker was acting outside his license by stating that “the taking of personal loans [is] ... an activity that does not require a real estate license.” *Garcia v. Wetzel*, 159 Cal. App. 3d at 1097, 206 Cal. Rptr. at 253. However, the court concluded that CAL. CIV. CODE section 1916.1 effectively exempts loans made by a broker from the Usury Law. *Id.* at 1097-98, 206 Cal. Rptr. at 254.

34. *Id.* at 1098, 206 Cal. Rptr. at 254. See supra note 6.

35. 731 F.2d 1455 (9th Cir. 1984).

36. *Id.* at 1462.

37. The loan made by the real estate broker was made in part by the broker and in part by another individual. The court held that the portion of the loan made by the individual was usurious because it was not made or arranged by a real estate broker. *Id.* at 1464.

38. *Id.* at 1460.

39. 132 Cal. App. 3d 1021, 183 Cal. Rptr. 606 (1982) (upholding a loan with an allegedly usurious interest rate because a real estate broker “arranged” the loan, and that subsequently such lending activity became exempt under CAL. CONST. art. XV, § 1).

40. The *Chapman* court cited Orden v. Crawshaw Mortgage & Investment Co., 109 Cal. App. 3d 141, 167 Cal. Rptr. 62 (1980) in holding that usury laws should be retrospective in effect. In Orden, the court upheld a loan with an interest rate in excess of the legal rate because a mortgage investment company which was also licensed as a real estate broker made the loan. The Orden court only discussed the real estate broker exemption in terms of whether the changes made by Proposition 2 were retroactive in effect. The court concluded that a penalty imposed under a usury statute terminates upon the repeal or modification of the statute. *Id.* at 144, 167 Cal. Rptr. at 63-64.
exemption was enacted.\textsuperscript{41}

2. \textit{Problems with Civil Code Section 1916.1}

The cases cited in the preceding section indicate that the courts have been ambivalent about completely exempting real estate brokers from the Usury Law. Such ambivalence is not surprising because \textit{Garcia} and \textit{Lara} illustrate the potential negative effects that Civil Code section 1916.1 can have on consumer loans.

However, other reasons exist for the judicial ambivalence toward applying Civil Code section 1916.1 to real estate brokers acting outside their licenses. First, the legislative intent of the statute is unclear. Second, the text of Proposition 2 did not indicate that real estate brokers would be exempt when "making" loans. Consequently, the background of the real estate broker exemption must be traced in order to determine the voters' intent in adopting Proposition 2.

III. BACKGROUND OF THE CURRENT REAL ESTATE BROKER EXEMPTION

A. Legislative History

A review of the legislative history surrounding article XV, section 1 suggests that at the time of the initial proposal, the Legislature's sole intention was to exempt a real estate broker's licensed activity.\textsuperscript{42} Proposition 2 was enacted pursuant to Assembly Constitutional Amendment No. 52 and originally exempted "loans arranged by a duly licensed real estate broker."\textsuperscript{43} Subsequently, the wording was changed to exempt loans "made or arranged" by a real estate broker, but the change was not discussed.\textsuperscript{44}

The addition of the word "made" into the language of the proposition indicates a legislative intent to exempt brokers who act as principals. However, further inquiry into the legislative deliberations show that this was not the Legislature's intent.\textsuperscript{45} The Senate Com-

\textsuperscript{41} In \textit{Garcia}, the loan transaction was completed on May 8, 1979, which was prior to the time that Cal. Civ. Code § 1916.1 was enacted in 1983. 159 Cal. App. 3d at 1096, 206 Cal. Rptr. at 252. In \textit{Lara}, it is not apparent exactly when the loan was made, however, the lower court entered a final judgment before Cal. Civ. Code § 1916.1 was even enacted. See \textit{In re Lara}, 731 F.2d at 1459.

\textsuperscript{42} See Assembly Constitutional Amendment No. 52, Reg. Sess. 1979, ch. 49, 4860-62 [hereinafter referred to as ACA 52].

\textsuperscript{43} \textit{Id.}

\textsuperscript{44} \textit{Id.}

\textsuperscript{45} See Senate Committee on Insurance and Financial Institutions, Analy-
committee on Insurance and Financial Institutions (Committee) analyzed the proposed amendment subsequent to the amendment of the word "made" to the language defining the real estate broker exemption. The Committee produced a report, however, which implied that the exemption would still only apply when a broker "arranges" a loan and is thus acting within his license. 48

The Committee discussed the following hypothetical situation: "[U]nder ACA 52, if a borrower and a lender become involved in a second mortgage via a real estate broker, the interest rate may be substantially higher than 10% . . . ." 47 The Committee focused on the circumstances in which a real estate broker is acting as an intermediary, and is "arranging" a loan, and did not discuss the situation in which a broker is acting as a principal. In fact, nowhere in the report does the Committee consider the consequences of real estate brokers making loans. Of course, one may argue that the report was not intended to be a complete discussion of when the real estate broker exemption applies. Yet the Committee, in the same report, also questioned why a private citizen must go to a real estate broker, mortgage banker, or mortgage loan broker to escape the ten percent interest rate. 48 Thus, the legislators seemed to believe that exempt loans would have to be made through an intermediary.

Although some confusion existed when the Legislature considered Proposition 2, it seems that the legislators only intended to exempt brokers when they act within their licenses to "arrange" loans. However, legislative history is not conclusive, and a later interpretation by the Legislature is presumed to be valid. 49 Thus, Civil Code section 1916.1 rests on solid ground in light of the Legislature's subsequent declaration. 50

Despite the legislative intent as declared in Civil Code section 1916.1, the legislative confusion which preceded the statute's passage is relevant to a discussion of the voters' intent in adopting Proposi-

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46. Id. at 4.
47. Id.
48. The questions presented were: "1) Why should private citizens who wish to transact a second mortgage loan between themselves be restricted to the 10% ceiling?, and 2) Why should they have to go through a real estate broker, mortgage banker, or mortgage loan broker to get around the 10% rate?" Id.
50. CAL. CIV. CODE § 1916.1 (Deering Supp. 1986). In this section, the Legislature essentially "declared its intent" regarding the language of Proposition 2 and article XV, section 1 of the California Constitution.
tion 2. If the legislators themselves were unclear as to the meaning of the amendment, it is quite likely that the voters did not understand that real estate brokers acting outside their licenses would be exempt from the Usury Law.

B. Voter Intent Regarding Proposition 2

To determine the voter intent with regard to Proposition 2, it is helpful to consider the arguments that were presented in the voters' handbook. The argument expressed in the handbook for expanding the list of exempted lenders noted that the then-existing Usury Law contributed to the shortage of available money in the lending industry. This shortage curtailed "the building of new homes, apartments, stores and factories [which would] provide needed jobs." Thus, Proposition 2 was presented to the voters as a tool to stimulate the lending industry. By allowing higher interest rates to be charged, the lenders would thereby be encouraged to make more money available to the borrowing public.

The ballot handbook assured the voters that Proposition 2 would deal with the money shortage problem in "controlled circumstances." A rational construction of such language means that real estate brokers would only be exempt from the Usury Law when acting within their licensed capacity; that is, when their activity is subject to state regulation.

One could argue that real estate brokers acting outside their licenses are effectively regulated. For instance, the court in In re Lara found that real estate brokers acting outside their licenses are adequately regulated by the state through such sanctions as license

51. **California Ballot Pamphlet, Special Statewide Election 10** (Nov. 6, 1979). As a general rule of statutory construction, courts will interpret a measure voted on by the public in a manner which gives effect to the intent of the electorate. See Carter v. Seaboard Finance Co., 33 Cal. 2d 564, 203 P.2d 758 (1949) (court considered arguments regarding a proposed constitutional amendment set forth in campaign literature and pamphlets which were sent out with the sample ballots); Kaiser v. Hopkins, 6 Cal. 2d 537, 538, 58 P.2d 1278, 1279 (1936) (court looked to the intent of the voters to determine the meaning of a constitutional amendment which exempted World War I veterans from tax laws).

52. See supra note 20.

53. **California Ballot Pamphlet, Special Statewide Election 10, 12** (Nov. 6, 1979).

54. Id. (emphasis in original).

55. 731 F.2d 1455 (9th Cir. 1984). The Lara court used an equal protection analysis instead of the voter intent argument discussed herein. Id. at 1460. However, a proponent of the real estate broker exemption could argue that such regulations represent the "controlled circumstances" mentioned in the voters' literature.
suspension or license revocation. While this may be true, it does not address the issue of what the term "controlled circumstances" meant to the voting public. The adjective "controlled" used to modify the noun "circumstances" seems to indicate that circumstances (i.e., the lending of money from the lender to the borrower) would be effectively "controlled" or regulated from the time the loan originates and until the debt is paid off.

The Lara court discussed the regulation of real estate brokers acting outside their licenses only in terms of sanctioning them for performing illegal acts. For instance, the Lara court cited examples when a broker's license is properly revoked. In one example a court revoked a broker's license because a realtor offered to sell property as a principal without indicating its dilapidated condition, and in another case, a licensee pled guilty to possession of marijuana.

Although the Lara court correctly indicated that real estate brokers acting outside their licenses are subject to some regulation, the examples cited did not represent situations in which a loan transaction was subject to some sort of regulation or "controlled circumstances." The term "controlled circumstances" implies regulation of a loan transaction rather than regulations or sanctions which may be imposed on the real estate broker after-the-fact for acting illegally.

In fact, a real estate broker acting outside his license is not subject to the statutory regulations or "controlled circumstances" of a licensee who acts within his license to structure a loan transaction. For instance, a broker acting within his license is required to disclose the costs involved in the transaction to the borrower before the loan is completed. The maximum amount of expenses, charges and in-

56. Id. at 1462. But see Garcia v. Wetzel, 159 Cal. App. 3d at 1100, 206 Cal. Rptr. at 255 (White, P.J., dissenting) ("[T]he rarely invoked sanction of license revocation [e.g. Golde v. Fox (1979), 98 Cal. App. 3d 167, 177, 159 Cal. Rptr. 864] does not provide sufficient protection for consumer transactions like the instant one.") Id.

57. The Lara court stated that a real estate broker will be regulated if he engages in fraudulent or dishonest dealings or commits a crime involving moral turpitude. 731 F.2d at 1462.

58. Id. at 1462 n.11 (citing Katz v. Department of Real Estate, 96 Cal. App. 3d 895, 158 Cal. Rptr. 766 (1979), and Golde v. Fox, 98 Cal. App. 3d 167, 159 Cal. Rptr. 804 (1979)).

59. See supra notes 55-57 and accompanying text.

60. CAL. BUS. & PROF. CODE § 10240 (Deering 1984). The statute provides in relevant part:

Every real estate broker . . . who negotiates a loan to be secured directly or collaterally by a lien on real property shall, before the borrower becomes obligated to complete the loan, cause to be delivered to the borrower a statement in
interest paid by the borrower is limited, and the broker must present the borrower with a statement regarding the total of brokerage fees to be paid by the borrower.

The preceding statutory requirements constitute only some of the regulations that a real estate broker must adhere to when acting within his license. A real estate broker is subject to strict regulation when he "arranges" a loan. However, under the new broker exemption, it appears that the broker is not required to follow such regulations when he "makes" a loan because he is then acting outside his license. Arguably, the regulations that brokers must follow when

writing, containing all the information required by Section 10241.

Id.

61. Cal. Bus. & Prof. Code § 10242 (Deering 1984). Section 10242 provides in relevant part:

The maximum amount of expenses, charges and interest to be paid by a borrower with respect to any loan subject to the provisions of this article shall be as follows: (a) The maximum amount of all costs and expenses referred to in subdivision (a) of Section 10241, exclusive of actual title charges and recording fees, shall not exceed five percent (5%) of the principal amount of the loan or one hundred ninety-five dollars ($195), whichever is greater but in no event to exceed three hundred fifty dollars ($350), provided that in no event shall said maximum amount exceed actual costs and expenses paid, incurred or reasonably earned.

Id.

62. Cal. Bus. & Prof. Code § 10241(b) (Deering 1984). This section provides that the statement required in § 10240 must include:

The total of the brokerage or commissions contracted for or to be received by the real estate broker for services performed as an agent in negotiating, procuring or arranging the loan or the total of loan origination fees, points, bonuses and other charges in lieu of interest to be received by the broker if he or she elects to act as a lender rather than an agent in the transaction.

Id.

63. A broker is also subject to such "controlled circumstances" if he "arranges" a loan using broker-controlled funds. Cal. Bus. & Prof. Code § 10240(b) provides that a real estate broker is regulated:

[1] If he or she solicits borrowers, or causes borrowers to be solicited, through express or implied representations that the broker will act as an agent in arranging a loan, but in fact makes the loan to the borrower from funds belonging to the broker.

Id.

In such a situation, the broker must provide a statement to the borrower indicating that broker-controlled funds will be used, and setting forth the amount of origination fees, points and other bonuses to be charged. See Cal. Bus. & Prof. Code § § 10241(b), 10241.2 (Deering 1984). Also, a limited amount of expenses, interest and other charges can be added to the loan principal. See Cal. Bus. & Prof. Code § 10242 (Deering 1984). However, if the real estate broker informs the borrower that he is lending personal funds and thus makes a personal loan, the statutory provisions do not apply. Section 10240 prescribes that the provisions of the broker regulation article are only applicable when broker activity falls within the statutory definition of real estate brokers under Cal. Bus. & Prof. Code § 10131(d). See infra note 96 for the applicable text of this statute. In other words, the regulations only apply when
"arranging" loans are the ones that the voters presumed to define "controlled circumstances" when they cast their ballots for Proposition 2.64

The voters' handbook also contained the legislative analysis of Proposition 2 which recites in part:

1. Under existing law, loans made or arranged by any person licensed as a real estate broker are subject to the 10% interest rate ceiling. Such loans commonly are made by mortgage brokers and mortgage bankers. Under this measure such loans would be exempt from the constitutional limitations on interest rates that may be charged.65

Such analysis implies that Proposition 2 was presented to the voters as a means of encouraging loans made or arranged by real estate licensees acting within their licenses. The emphasis on mortgage brokers and bankers emphasizes that only licensed activity was intended to be exempt from the Usury Law. Additionally, the voters' handbook indicated that brokers and bankers would be exempt from the Usury Law if they fall within the category of "any person licensed as a real estate broker."66

In California, a mortgage broker usually acts as a borrower's agent to negotiate loans.67 Consequently, any person who acts as a mortgage broker in California is required to obtain a real estate license.68 Mortgage banking, on the other hand, entails making mortgage banking loans.69 Mortgage bankers are independently regulated the broker solicits borrowers or lenders or when he represents that the broker will arrange the loan, but in fact the broker makes the loan. See Cal. Bus. & Prof. Code § 10240 (Deering 1984). There is no indication that the requirements apply when a broker makes a personal loan.

64. Real estate brokers acting within their licenses are also subject to standards of care set forth by the courts. In Wyatt v. Union Mortgage Co., 24 Cal. 3d 773, 598 P.2d 45, 157 Cal. Rptr. 392 (1979), the California Supreme Court upheld an award of punitive damages against a real estate licensee who misrepresented the terms of a loan to plaintiff borrower. The court stated that a broker must "act always in the utmost good faith toward their principals," and "a real estate licensee is 'charged with the duty of fullest disclosure of all material facts concerning the transaction.'" Id. at 782, 598 P.2d at 50, 157 Cal. Rptr. at 397 (quoting Rattray v. Scudder, 28 Cal. 2d 214, 223, 169 P.2d 371, 376 (1946)).

65. California Ballot Pamphlet, Special Statewide Election 10 (Nov. 6, 1979) (emphasis added).

66. Id.


68. Id.

by statute. However, the voters' handbook indicated that a mortgage banker would be exempt if he was also a real estate licensee.

Thus, it appears that possession of a real estate license is the essence of the exemption. The text of the voters' handbook did not mention loans made by real estate brokers acting outside their licenses, and, furthermore, the handbook only considered the exemptions to apply to loans made under the restrictions of a license. Accordingly, voters probably interpreted the pamphlet to mean that the exemption would apply to real estate licensees acting within their licenses.

C. Summary of Legislative History and Voter Intent

The court in In re Lara dismissed the voter intent issue and concluded that those arguments were inconclusive. This dismissal is partially based on the principle that Civil Code section 1916.1 is presumed to be valid, and that the party challenging the interpretation bears the burden of proving that the Legislature's decision conflicts with voter intent. The Garcia majority agreed with the Lara decision, and more specifically, found the federal court's discussion of voter intent to be persuasive.

The Legislature responded to the judicial interpretation of article XV, section 1, by enacting Civil Code section 1916.1. The Legislature interpreted Proposition 2 to mean that real estate brokers are exempt even when they are acting outside their licenses. After considering the legislative history and the voters' handbook, however, two reasons exist why the legislative codification of article XV, section 1 (Civil Code section 1916.1), published four years after the people of California voted on Proposition 2, is unreasonable.

First, the recent controversy surrounding the phrase "made or arranged" probably would not have arisen if the Legislature had truly intended real estate brokers to be exempt from the Usury Law at the time that Proposition 2 was enacted. If the Legislature had so intended, it would have utilized unambiguous language in Proposi-

71. California Ballot Pamphlet, Special Statewide Election 10 (Nov. 6, 1979).
72. 731 F.2d at 1461.
74. 731 F.2d at 1461 n.10.
75. 159 Cal. App. 3d at 1097, 206 Cal. Rptr. at 254.
76. Proposition 2 was passed by the electorate on November 6, 1979; Cal. Civ. Code § 1916.1 was enacted on July 18, 1983 and became effective on January 1, 1984.
USURY EXEMPTION

tion 2 to explain the exemption.77

Second, there is no indication that at the time the voters passed Proposition 2, that either the Legislature or the California electorate intended the usury exemption to apply to real estate brokers acting as principals. Justice White, who dissented from the Garcia decision, articulated this view by arguing that the article XV, section 1 exemption is only applicable to a real estate licensee who acts within that license.78 Accordingly, the court should strike down Civil Code section 1916.1 because it is an unreasonable interpretation of the voters' intent in passing Proposition 2.

Moreover, as described in the subsequent section of the comment, an analysis of the constitutional implications of Civil Code section 1916.1 indicates that exempting brokers from the Usury Law when "making" loans violates provisions of both the federal and state constitutions. The real estate broker exemption is unreasonable because it applies to a broker's unlicensed activity.

IV. THE REAL ESTATE BROKER EXEMPTION VIOLATES FEDERAL AND STATE EQUAL PROTECTION

A. Federal Equal Protection

The exemption from the Usury Law for real estate brokers acting outside their licenses violates the equal protection clause of the United States Constitution79 because it confers a benefit to a particular class of individuals based on irrational grounds.80 The legislative explanation for exempting real estate brokers was that such individuals are licensed by the California Real Estate Board, and real estate brokers are effectively regulated through those licensing sanctions.81

77. For example, Proposition 2 could have contained explicit language of the type utilized in Cal. Civ. Code § 1916.1, which reads: "The term 'made or arranged' includes any loan made by a person licensed as a real estate broker as a principal or as an agent for others, and whether or not the person is acting within the course and scope of such license." Id.
78. 159 Cal. App. 3d at 1099, 206 Cal. Rptr. at 254-55 (White, P.J., dissenting).
79. U.S. Const. amend. XIV, § 1. The equal protection clause regulates state action by commanding that: "[N]o state shall ... deny any person ... equal protection of the laws." Id. at 587-88, 203 P.2d at 254.
80. In Carter v. Seaboard Finance Co., 33 Cal. 2d 564, 203 P.2d 758 (1949), the court, in determining whether a legislative classification in the California Constitution violated federal equal protection, stated that "it must be ... neither unwarranted nor arbitrary, but on the contrary, ... based on sound and reasonable grounds." Id. at 587-88, 203 P.2d at 773.
Yet, the exemption creates a class of individuals (i.e., real estate brokers) who can make personal loans at usurious rates with literally no limitation. The perplexing aspect of the exemption is that it singles out real estate brokers to charge unlimited interest rates despite the fact that lending money is not a statutorily recognized function of such brokers.

Usury exemptions are constitutionally suspect unless the classification is based on rational grounds. The United States Supreme Court has upheld the constitutionality of usury exemptions in general. In *Griffith v. Connecticut*, the court held that equal protection was not violated unless the classification of persons exempt from the Usury Law was arbitrary. Accordingly, the general constitutionality of article XV, section 1 is not now being challenged. Instead, this comment contends that the specific real estate broker exemption does violate equal protection.

The constitutionality of certain California usury exemptions has been challenged in several instances, but the leading California

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[1] Real estate brokers are exempt from the Usury Law because:

> Real estate brokers are qualified by the state on the basis of education, experience, and examination, and that the licenses of real estate brokers can be revoked or suspended if real estate brokers perform acts involving dishonesty, fraud, or deceit with intent to substantially benefit themselves or others, or to substantially injure others.

*Id.*

82. Until the Legislature uses its power to regulate an exempted class, loans made by such persons are subject to no restrictions whatsoever under the Usury Law. 33 Cal. 2d at 582, 203 P.2d at 770. At the present time, the Legislature does not regulate real estate brokers as an exempted class, and thus, according to the *Carter* decision, there are no limits on the interest rates that such brokers may charge. *Id.*

83. See infra note 96 and accompanying text.

84. In Hays v. Wood, 25 Cal. 3d 772, 603 P.2d 19, 160 Cal. Rptr. 102 (1979), the California Supreme Court held that “[t]he constitutional bedrock upon which all equal protection analysis rests is composed of the insistence upon a rational relationship between selected legislative ends and the means chosen to further or achieve them.” *Id.* at 786, 603 P.2d at 26, 160 Cal. Rptr. at 109.

85. See *Griffith v. Connecticut*, 218 U.S. 563 (1910) (the fixing of maximum interest rates held to be within the police power of the state, and the classification of persons exempt from the maximum interest rate was permissible if reasonably within legislative discretion); see also *Mutual Loan Co. v. Martell*, 222 U.S. 225 (1911) (holding that it is within the state's police power to impose regulations limiting interest rates).

86. 218 U.S. 563 (1910).

87. *Id.* at 569.

case is *Carter v. Seaboard Finance Co.* In *Carter*, the California Supreme Court upheld the personal property broker exemption contained in the California Constitution against a claim that it violated the fourteenth amendment to the United States Constitution. The state supreme court reasoned that the Legislature could rationally distinguish personal property brokers from other classes of individuals because unique problems are involved in loans made by such individuals. The *Carter* court quoted a 1935 report of the Assembly Interim Committee which found that:

In the sense that personal property is used as security, it is distinguishable from real property by being movable, destructible, difficult to record as to property rights therein, susceptible of abuse as to rights of third persons, and not subject to a period of redemption after foreclosure . . . . This type of security . . . present[s] problems of regulation peculiar to the class.

Thus, the court found that a rational reason existed for exempting personal property brokers who were in the business of lending money because these brokers took unique risks with this money.

In reviewing the reasons set forth by the California Legislature for excluding real estate brokers from the usury restrictions, it is clear that to extend the exemption to unlicensed activity is irrational. The principal purpose of Proposition 2 was to encourage investments by relieving certain lenders of the restrictions imposed by the Usury Law. The rationale for specifically exempting real estate brokers was that they are licensed on the basis of education, experience, and examination and are effectively regulated through the sanctions of license revocation and suspension.

Exempting real estate brokers from the Usury Law because they are licensed on the basis of their education is irrational because direct lending is not the primary function of such brokers. The California Business and Professions Code provides that a real estate broker is a person, who, for compensation, solicits borrowers and lenders, or who negotiates loans or performs services for borrowers and

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89. 33 Cal. 2d 564, 203 P.2d 758 (1949).
90. Id. at 587-88, 203 P.2d at 773.
91. Id. at 587, 203 P.2d at 772-73.
92. Id.
93. The exemption is rational when applied to a real estate broker's licensed activity because brokers are in the business of "arranging loans," and they are extensively regulated when they are acting within their broker capacity. See supra notes 60-62 and accompanying text.
94. See supra notes 20-22 and accompanying text.
95. See supra note 81.
lenders. The broker definition does not indicate that lending money is a function of a licensed real estate broker. Thus, the fact that a real estate broker is educated and experienced in the area of "arranging" loans is irrelevant to the "making" of loans by brokers. Lending money is not a statutorily authorized function of a licensed real estate broker. Because the education and experience behind the broker's license is a purported reason for extending the usury exemption to real estate brokers, the exemption arguably must be limited to the boundaries of the license. If the license is relied upon to formulate the exemption, permitting the real estate broker to deal outside the license and still be exempt makes no sense.

The real estate broker class differs from the other exemptions in article XV, section 1 because the other exempted classes consist of individuals and organizations which are in the business of lending money. Exemptions for building and loan associations, pawnbrokers, and personal property brokers are clearly reasonable because these lenders are traditional sources of financing, and their activities are extensively regulated. However, this is not the case with real estate brokers who make personal loans.

The second legislative explanation for exempting real estate brokers is based on the presumption that real estate brokers are adequately regulated through sanctions such as license revocation and license suspension. Yet a review of the relevant statutory provi-


[A] person who, for a compensation or in expectation of a compensation, regardless of the form or time of payment, does or negotiates to do one or more of the following acts for another or others: (d) Solicits borrowers or lenders for or negotiates loans or collects payments or performs services for borrowers or lenders or note owners in connection with loans secured directly or collaterally by liens on real property or on a business opportunity.

*Id.*

97. *Id.*

98. See *Cal. Const.* art. XV, § 1. The California Constitution lists the currently exempted classes of lenders as: building and loan associations, industrial loan companies, credit unions, duly licensed pawnbrokers or personal property brokers, licensed real estate brokers, any bank defined or operating under the “Bank Act,” and certain nonprofit agricultural loan companies. *Id.*

99. Unlike real estate brokers, a statutorily recognized function of a pawnbroker is to lend money. *Cal. Fin. Code* § 21000 (Deering 1978) defines a pawnbroker as “[e]very person engaged in the business of receiving goods in pledge as security for a loan.” *Id.*

100. Personal property brokers are in the business of lending money. *Cal. Fin. Code* § 22009 (Deering 1978) defines a personal property broker as “all who are engaged in the business of lending money and taking . . . as security for such loan, any . . . rights in or to personal property.” *Id.*

101. See supra note 81.
sions reveals that most of the grounds for such sanctions relate to a broker's licensed activity, and a broker's unlicensed activity is only regulated in rare instances.

The California Business and Professions Code provides that the real estate broker may have his license revoked or suspended if the broker enters a plea of guilty or is found guilty of a felony or a crime involving moral turpitude. A real estate broker acting outside his broker's license may also have his license revoked for fraudulent or dishonest dealing. Although the Legislature considered such provisions to be adequate regulation of a broker's unlicensed activity, they are inadequate when compared to the sanctioning provisions which apply to licensed activity.

For instance, a real estate broker acting within his license can be subject to license sanctions merely by a showing that the broker

102. CAL. BUS. & PROF. CODE § 10176 (Deering 1984). This section sets forth potential grounds for the revocation or suspension of real estate broker licenses. However, this section does not regulate a broker's unlicensed activity. The statute provides in relevant part that:

The commissioner may . . . investigate the actions of any person engaged in the business or acting in the capacity of a real estate licensee within this state, and he may temporarily suspend or permanently revoke a real estate license at any time while the licensee, while a real estate licensee, is performing or attempting to perform any of the acts within the scope of this chapter . . .

Id.

A broker must be acting within his capacity as a real estate broker in order for the statute to apply.

103. CAL. BUS. & PROF. CODE § 10177 (Deering 1984). Under this statute, a real estate broker can be subject to sanctions even when he acts outside his license. The statute provides in relevant part that "[t]he commissioner may suspend or revoke the license of any real estate licensee, or may deny the issuance of a license to an applicant who has done any of the following . . ." Id. See infra notes 104-05 for a discussion of when a broker's unlicensed activity is regulated by statute.

104. CAL. BUS. & PROF. CODE § 10177(b) provides that the real estate commissioner may investigate and impose sanctions upon a real estate broker who has:

Entered a plea of guilty or nolo contendere to, or been found guilty of, or been convicted of, a felony or a crime involving moral turpitude, and the time for appeal has elapsed or the judgment of conviction has been affirmed on appeal, irrespective of an order granting probation following such conviction, suspending the imposition of sentence, or of a subsequent order under the provision of Section 1203.4 of the Penal Code allowing such licensee to withdraw his plea of guilty and to enter a plea of not guilty, or dismissing the accusation or information.

Id.

See also supra notes 55-59 and accompanying text.

105. CAL. BUS. & PROF. CODE § 10177(j) (Deering 1984). This section provides that a real estate broker may be investigated for "any other conduct, whether of the same or a different character than specified in this section, which constitutes fraud or dishonest dealing." See also supra notes 55-59 and accompanying text.
was negligent or incompetent in performing broker duties. Also, a real estate broker performing his statutory duties may be sanctioned for willfully disregarding or violating any of the provisions of the real estate law. Thus, it appears that a broker's licensed activity is extensively regulated.

In an appendix to Civil Code section 1916.1, the Legislature claimed that a real estate broker's unlicensed activity is adequately regulated because license sanctions can be invoked against a broker who engages in acts involving dishonesty, fraud, or deceit with the intent to substantially benefit himself or to injure others, regardless of whether the broker was acting within his licensed capacity. However, such sanctions do not effectively regulate a real estate broker's unlicensed activity because, in many instances, it is unnecessary to resort to fraud or deceit in order to impose an unconscionable interest rate upon a desperate borrower. Under the current real estate broker exemption, consumers are inadequately protected from exorbitant interest rates.

The Usury Law was enacted "to prevent lenders [from] taking advantage of unwary and necessitous borrowers" and was focused upon protecting the consumer. The desire to eliminate usurious contracts in California is so strong that a lender may be held liable

106. CAL. BUS. & PROF. CODE § 10177(f) (Deering 1984). This section provides that a real estate licensee can be sanctioned for "[d]emonstrated negligence or incompetence in performing any act for which he is required to hold a license."

107. CAL. BUS. & PROF. CODE § 10177(d) (Deering 1984). This section provides that a real estate broker can be sanctioned if he:

Willfully disregarded or violated any of the provisions of the Real Estate Law (commencing with Section 10000 of this code) or of Chapter 1 (commencing with Section 11000) of Part 2 of this division or of the rules and regulations of the commissioner for the administration and enforcement of the Real Estate Law and Chapter 1 of Part 2 of this division.

Id.

This provision does not apply to a real estate broker's unlicensed activity because the Real Estate Law does not apply to such activity. See supra note 63. In other words, a real estate broker acting outside his license cannot violate the Real Estate Law because he is not subject to it.


110. For instance, in Garcia the borrowers were in need of money because their home was to be sold at a foreclosure sale. Despite the fact that no fraud or deceit was involved, the high interest rate that was charged was unconscionable because the lender was able to take advantage of the borrowers' desperate situation. 159 Cal. App. 3d at 1096, 206 Cal. Rptr. at 252.


under the Usury Law despite the fact that he was ignorant of the law at the time of the loan transaction, and thereby lacked intent. With the current real estate broker exemption, however, a rather high degree of culpability is necessary before license sanctions will be invoked. The real estate broker acting outside his license will only be regulated when a loan transaction and the resulting high interest rate was the product of fraud or deceit. Thus, the consumer is left without the protection of the Usury Law.

When a plaintiff goes to court to sue for a violation of the Usury Law, the borrower usually has the burden of proving a usurious agreement. However, the borrower need only establish that there was a loan and that a usurious rate was charged on the loan transaction. With a loan made by a real estate broker acting outside his license, however, the borrower is only protected from dishonest and fraudulent acts. The borrower is at the mercy of the lender's greater bargaining power and has no apparent redress from unconscionable rates.

This injustice is exemplified by the outcome of the Garcia case, in which the lender charged an exorbitant interest rate, and the court upheld it under Civil Code section 1916.1. The Garcia dissent, however, aptly pointed out the inequities which result when real estate brokers acting outside their license are exempt from Usury Law. Justice White noted that in Garcia, the borrowers knew that the broker was involved in the loan transaction for speculative purposes. Thus, it would be difficult for the plaintiff to prove that dishonesty, fraud or deceit was involved. The dissent also questioned the frequency in which the sanction of license revocation is imposed and concluded that it "does not provide sufficient protection for consumer

113. See Burr v. Capital Reserve Corp., 71 Cal. 2d 983, 458 P.2d 185, 80 Cal. Rptr. 345 (1969). In Burr, the majority stated that the borrower in a usury case need only establish a voluntary or conscious taking of money above the legal interest rate in order to prove liability. Id. at 989, 458 P.2d at 189, 80 Cal. Rptr. at 349.

114. See supra note 81.

115. The elements of a usurious transaction are: 1) a loan or forbearance of money; 2) a loan which must be absolutely repayable; 3) payment of a rate of interest in excess of the statutory maximum; and 4) willful intent to exact a usurious rate. See Comprehensive View, supra note 9, at 174.

116. See Burr, 71 Cal. 2d 983, 458 P.2d 185, 80 Cal. Rptr. 345 (1969). See also Comprehensive View, supra note 9, at 176-77 (stating that when a loan is usurious on its face, the lender's intent to violate the Usury Law is conclusively presumed).


118. Id. at 1098-1100, 206 Cal. Rptr. at 254-56 (White, P.J., dissenting).

119. Id. at 1099, 206 Cal.Rptr. at 255.
transactions like the instant one." In essence, the license sanctions are not effective in controlling real estate brokers from making loans with unconscionable interest rates because the real estate commissioner must find that fraud or deceit was involved in a transaction before the sanctions will even be invoked.

For the above reasons, the real estate broker exemption clearly violates the equal protection clause of the federal Constitution as it applies to a broker's unlicensed activity. Although such an exemption may have a slight impact on making more money available for the borrowing public, any group that the Legislature might choose would hypothetically provide more sources of money for loans.

Because the Legislature's reasons for exempting real estate brokers are irrational, the exemption for such brokers, as opposed to the general population, is arbitrary. Accordingly, the exemption in article XV, section 1 should either be deemed unconstitutional by the California Supreme Court or amended by the California Legislature on the basis that it violates federal equal protection.

B. Civil Code Section 1916.1 Violates California Equal Protection

Civil Code section 1916.1 also violates the equal protection provisions of the California Constitution because it allows real estate brokers as a designated class to make personal loans at usurious rates for no rational reason. Generally, the court construes the California equal protection provisions to be "substantially the equivalent" of the equal protection clause of the fourteenth amendment and, consequently, if a provision violates federal equal protection, the California equal protection provisions are also violated. Accordingly, based on the arguments contained in the preceding section, Civil Code section 1916.1 violates California equal protection.

However, even if the real estate broker exemption does not violate federal equal protection, the exemption may still violate the Cal-

120. Id.
124. Id.
125. See supra notes 79-120 and accompanying text.
California Constitution. In Serrano v. Priest,126 the California Supreme Court explained that state constitutional equal protection principles are independent from the guarantees contained in the fourteenth amendment, and that California equal protection provisions may require a different analysis.127 Under California law, the court reviewing an equal protection argument must conduct a "serious and genuine inquiry into the correspondence between the classification and the legislative goals."128 This approach is stricter than the method of determining whether federal equal protection has been violated.129

A serious and genuine inquiry into the classification of real estate brokers reveals it is unreasonable to exempt them from the Usury Law under the guise of making more money available for the lending industry. Any group that the Legislature might choose to exempt would potentially make more money available to the public. Furthermore, the legislative reasons for exempting real estate brokers are irrational when they are applied to a real estate broker's unlicensed activity. Accordingly, the California Supreme Court should strike down Civil Code section 1916.1 because it violates California equal protection.

V. PROPOSAL FOR CHANGE

Civil Code section 1916.1 violates the equal protection provisions of both the federal and state constitutions. Yet, the Lara and Garcia courts upheld the real estate broker exemption against equal protection claims.130 Both courts, however, felt compelled to uphold the broker exemption because the Legislature's reasons for exempting certain groups of lenders from the Usury Law are presumed to be valid, and a heavy burden is involved in uprooting this legislative presumption.

Despite judicial reluctance to disregard the legislative presumption, little disagreement exists that the real estate broker's exemption from the Usury Law for unlicensed activity is unfair. Borrowers faced with unconscionable interest rates have found that there is literally no redress from such circumstances. The Usury Law was en-

126. 18 Cal. 3d 728, 557 P.2d 929, 135 Cal. Rptr. 345 (1976).
127. Id. at 764, 557 P.2d at 950, 135 Cal. Rptr. at 366.
128. Id.
129. Under the federal approach, as long as it is "at least debatable" that a legislative interpretation is a possible meaning of a constitutional amendment, a court will not substitute its own judgment. See In re Lara, 731 F.2d at 1461 n.9.
130. See In re Lara, 731 F.2d 1455 (9th Cir. 1984); Garcia, 159 Cal. App. 3d 1093, 206 Cal. Rptr. 251 (1984).
acted to prevent these unjust situations. Lord Mansfield defined the purpose of the Usury Law to be:

[T]o protect needy and necessitous persons from the oppression of usurious and monied men who are eager to take advantage of the distress of others, whilst they on the other hand, from the pressure of their distress, are ready to come into any terms and, with their eyes open, not only break the law, but complete their ruin.131

The proposed solution is an appeal to the Legislature. If the real estate broker is to be exempt when acting outside his license, such unlicensed activity must be adequately regulated in order to protect California borrowers. Under the enabling provision in article XV, section 1, the Legislature has the power to regulate the classes of lenders which are exempt from the Usury Law.132 Consumers should be assured the same standard of protection that they have when a broker "makes" a loan as when a broker "arranges" a loan. Similarly, when consumers borrow money from real estate brokers they should be protected with safeguards equivalent to those that a borrower has who borrows money from a member of one of the other exempted classes.133 If this were the case, a borrower would have some redress against brokers who charge unconscionable interest rates without being required to prove that fraud or deceit was involved in the transaction. Not only is the proposed solution an equitable one, but it is also reasonable because it gives Californians the "controlled circumstances" that they were promised by Proposition 2.134

132. See supra note 17.
133. For instance, under California law, the lending activity of personal property brokers is extensively regulated. The California Financial Code provides that a personal property broker is subject to the following regulations when lending money: 1) broker cannot charge interest unless a loan is made; 2) a maximum permissible interest rate may only be charged; 3) payment of charges in advance is forbidden: licensee must deliver the face value amount of loan; 4) broker cannot require borrower to purchase anything in connection with the loan; 5) escrow fee limitations; and, 6) a requirement that the schedule of charges be displayed prominently, etc. See, e.g., CAL. FIN. CODE §§ 22450-22475 (Deering 1978 & Supp. 1986). Likewise, the lending activity of pawnbrokers is extensively regulated. See CAL. FIN. CODE §§ 21200-21209 (Deering 1978 & Supp. 1986). A personal property broker is subject to sanctions for violating any of these provisions. The Commissioner of Corporations is responsible for revoking licenses or imposing penalties for violation of the statutes. See CAL. FIN. CODE §§ 22006, 22600-22653 (Deering 1978 & Supp. 1986).
134. Consumers could also be provided with causes of action against those real estate brokers who exact high interest rates from borrowers because the borrower is in need of money. Such actions could be brought if the loan transaction were made under conditions amounting to undue influence, duress or compulsion. The plaintiffs in Garcia argued that the
VI. CONCLUSION

Civil Code section 1916.1 and the express extension of the real estate broker usury exemption to a broker's unlicensed activity present many problems. An analysis of the legislative history and the relevant voter information for Proposition 2 reveals that the California electorate was evidently unaware at election time that real estate brokers acting outside their licenses would be exempt from the Usury Law. Thus, Civil Code section 1916.1 is an unreasonable interpretation of the voter intent in passing Proposition 2.

Questions also remain regarding the constitutionality of the real estate broker exemption. Real estate brokers are singled out to legally make usurious personal loans, and the Legislature has not provided a rational justification for this selection. Accordingly, the legislative interpretation of the real estate broker exemption violates the federal and California equal protection provisions and thus is unconstitutional.

In addition, extending the exemption to a broker's unlicensed activity is detrimental to California's important policy of consumer protection. Real estate brokers acting outside their licenses are not subject to the extensive regulation which, if implemented, could ensure that consumers would be protected from unconscionable interest rates. Such regulation is imperative. Currently, the unfortunate consumer has literally no redress against brokers who charge exorbitant interest rates unless fraud or deceit is involved in the loan transaction. Thus, the proposed solution to this problem is to urge the Legislature to regulate real estate brokers who act outside their licenses so that borrowers will have some protection against real estate brokers who make loans at unconscionable interest rates.

Elisa W. Smith

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1 loan was procured in just such circumstances, but the causes of action were dismissed on a technicality. 159 Cal. App. 3d at 1095 n.1, 206 Cal. Rptr. at 252 n.1.