Case No. S246541

IN THE SUPREME COURT OF THE STATE OF CALIFORNIA

THE NORTHWESTERN MUTUAL LIFE INSURANCE COMPANY,
Defendant-Petitioner,

v.

SANFORD J. WISHNEV,
Plaintiff-Respondent.

After Order Certifying Question, U.S. Court of Appeals, Ninth Circuit, No. 16-16037; On Appeal from U.S. District Court, Northern District of California, Hon. Edward M. Chen, No. 3:15-cv-03797-EMC

Service on California Attorney General and Contra Costa County District Attorney Required by Business & Professions Code § 17209

PETITIONER'S OPENING BRIEF

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I.

STATEMENT OF ISSUES TO BE DECIDED

On January 18, 2018, the U.S. Court of Appeals for the Ninth Circuit issued an Order, pursuant to California Rule of Court 8.548, requesting that this Court answer two questions of California law (the "Certified Questions"). (See *Wishnev v. The Northwestern Mutual Life Insurance Company* (9th Cir. 2018) 880 F.3d 493, 495.) By Order dated March 14, 2018, this Court granted the Ninth Circuit's request. The two questions of state law certified by the Ninth Circuit (and the correct answers) are as follows:

> 1. Are the lenders identified in Article XV of the California Constitution, *see* Cal. Const. art. XV, § 1, as being exempt from the restrictions otherwise imposed by that article, nevertheless subject to the requirement in section 1916-2 of the California Civil Code that a lender may not compound interest "unless an agreement to that effect is clearly expressed in writing and signed by the party to be charged therewith"?
>
> [Answer: No.]
>
> 2. Does an agreement meet the requirement of section 1916-2 if it is comprised of: (1) an application for insurance signed by the borrower, and (2) a policy of insurance containing an agreement for compound interest that is subsequently attached to the application, thus constituting the entire contract between the parties pursuant to section 10113 of the California Insurance Code?
>
> [Answer: Yes.]

(*Wishnev, supra*, 880 F.3d at p. 495.) A "no" answer to the first question would be dispositive and would not require any answer to the second question. However, if this Court answers both questions in favor of

Plaintiff-Respondent Sanford J. Wishnev, a third question would arise: If this Court decides that the compound interest restriction applies, and/or that an agreement comprised of an insurance policy disclosing compound interest and an attached, signed application does not satisfy this requirement, should this Court's decision apply prospectively only? [Answer: Yes.]

II.

INTRODUCTION

Plaintiff-Respondent Sanford J. Wishnev ("Wishnev") contends that Defendant-Petitioner The Northwestern Mutual Life Insurance Company's ("Northwestern Mutual") charging of compound interest on his life insurance policy loans violates a century-old usury initiative requiring that "interest shall not be compounded . . . unless an agreement to that effect is clearly expressed in writing and signed by the party to be charged therewith." (Cal. Civ. Code, § 1916-2 (hereafter, "section 2 of the 1918 usury initiative").) Well-established California precedent defeats Wishnev's argument, for two main reasons.

First, insurance policy loans are not subject to the compound interest restriction of section 2 of the 1918 usury initiative because the restriction was superseded as to exempt lenders such as Northwestern Mutual by the 1934 amendment to Section 1 of Article XV of the California Constitution. The 1934 amendment vests in the Legislature the exclusive authority to set maximum rates and "in any manner fix, regulate or limit, the fees, bonuses, commissions, discounts or other compensation" that exempt lenders may collect from borrowers, and supersedes all conflicting provisions of law. (Cal. Const., art. XV, § 1(1)-(2).) In 1979, Section 1 of Article XV was further amended to give the Legislature the power to expand the class of exempt lenders by statute. And in 1981, the Legislature exercised that authority by establishing Northwestern Mutual and other admitted insurers as exempt lenders by enacting Insurance Code section 1100.1, which provides, "This section creates and authorizes incorporated admitted insurers as an exempt class of persons pursuant to Section 1 of Article XV of the Constitution." This Court has repeatedly held that the exemption

created by the 1934 amendment superseded the usury law—which includes the 1918 usury initiative—as to exempt lenders.

Second, there is no violation of the compound interest restriction of section 2 of the 1918 usury initiative in any event, because Wishnev signed an agreement that interest on policy loans would be compounded—the life insurance contract, which under well-settled California law consists of both the signed application and the attached insurance policy. (See Ins. Code, § 10113.) Indeed, signing the application is the manner by which Wishnev agreed to *all* provisions of the life insurance contract, including the right to take a policy loan subject to the charging of compound interest if the loan interest was not repaid. Further, Wishnev, like other policy owners, had the signed agreement with the compound interest disclosure in his possession prior to the taking of any policy loans.

For these and other reasons set forth herein, this Court should hold that Northwestern Mutual is exempt from the compound interest restriction in section 2 of the 1918 usury initiative, or, at a minimum, that Northwestern Mutual complied with the statute.

If this Court were to reach a contrary conclusion, such a decision should apply prospectively only, as Northwestern Mutual and other life insurers have reasonably relied on decades of settled law, including Insurance Code section 10113, and established business practices to reach binding agreements with policyholders, including the charging of compound interest.

III.

STATEMENT OF THE CASE

Northwestern Mutual has been an incorporated insurer admitted in California since 1868. (*Wishnev, supra*, 880 F.3d at p. 499.)[1] Its life insurance policy forms must be filed with the California Department of Insurance, and must fully comply with the California Insurance Code. (See Ins. Code, § 10163.35.)

Northwestern Mutual's whole life insurance policies permit the policyholder to borrow up to the amount of the accumulated cash value of the policy. (*Wishnev, supra*, 880 F.3d at p. 499.) Because policy loans are secured by the accumulated cash value, the policies must be in force for a period of time before a policy owner may take a loan so that the cash value has time to accumulate through the payment of premiums and the potential issuance of dividends from the insurer. (*Ibid.*)

Policy loans may be used to pay outstanding premiums or may be paid to policyholders in cash. (See 8 Appleman on Insurance (2015) § 88.04.) They are further advantageous to borrowers because they do not require a credit check and do not need to be paid back, in whole or in part, while the policy is in force. (*Ibid.*) When policy loans are used to pay premiums, they prevent a policy from lapsing for nonpayment, thus providing an additional benefit to the policy owner as well as the beneficiaries. (*Ibid.*)

Wishnev commenced this action on July 14, 2015, filing a putative class action Complaint in Contra Costa County Superior Court. His counsel asserted similar claims in three other nearly identical putative class actions in California, filed over a six-month period, against other admitted

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[1] "Admitted" in this context means "entitled to transact insurance business" in California. (Ins. Code, § 24.)

insurers that do business in the state: Prudential (*Washburn v. Prudential Insurance Company of America*, No. 15-CV-04009-SI (N.D.Cal., Illston, J.) ("*Washburn*")), MetLife (*Martin v. Metropolitan Life Insurance Company*, No. 3:16-cv-00484-RS (N.D.Cal., Seeborg, J.) ("*Martin*")), and New York Life (*Lujan v. New York Life Insurance Company*, No. 4:16-cv-00913-JSW (N.D.Cal., White, J.) ("*Lujan*")). Each action was premised on an alleged violation of the compound interest restriction of section 2 of the 1918 usury initiative.

Northwestern Mutual removed this action to the U.S. District Court for the Northern District of California. Wishnev filed a First Amended Complaint in that court on September 3, 2015, alleging that he is the holder of four life insurance policies issued by Northwestern Mutual. (*Wishnev, supra*, 880 F.3d at p. 499.)

In obtaining each policy, Wishnev executed an application, and then an insurance policy was issued and delivered to him with the signed application attached. (*Wishnev, supra*, 880 F.3d at pp. 495, 499.) Each policy provides that the policy and the application together constitute the entire contract between Wishnev and Northwestern Mutual: "This policy and the application, a copy of which is attached when issued, constitute the entire contract." (*Id.* at p. 499.) This is consistent with the mandate of Insurance Code section 10113: "Every policy of life . . . insurance delivered within this State on or after the first day of January, 1936, by any insurer doing such business within this State shall contain and be deemed to constitute the entire contract between the parties and nothing shall be incorporated therein by reference to any constitution, by-laws, rules, application or other writings, of either of the parties thereto or of any other person, unless the same are indorsed upon or attached to the policy."

Each of Wishnev's policies expressly provides that interest on policy loans shall be compounded. (*Wishnev, supra*, 880 F.3d at p. 499 [policies

state "Unpaid interest shall be added to and become part of the loan and shall bear interest on the same terms."].)

Years after he received the insurance contracts, Wishnev took out policy loans against each of them. (*Wishnev, supra*, 880 F.3d at p. 499.) Even though he had signed the applications (which were part of the insurance contracts delivered to him before he took any loans), accepted the delivered insurance policies subject to all the terms and conditions contained therein, and exercised his contractual right to obtain loans under the policy loan provisions of the policies, Wishnev now claims that he should not be charged compound interest because he never signed any agreement authorizing Northwestern Mutual to charge him compound interest on his policy loans.

Northwestern Mutual filed a motion to dismiss Wishnev's First Amended Complaint on the two grounds explained above. The District Court (Chen, J.) denied the motion, holding that while exempt lenders such as admitted insurers ***are*** exempt from the usury law's "maximum interest rate provisions," they are ***not*** exempt from the compound interest restriction of section 2. (*Wishnev v. Northwestern Mutual Life Insurance Company* (N.D.Cal. 2016) 162 F.Supp.3d 930, 940.) In addition, the District Court concluded that Wishnev had not signed a written agreement to be charged compound interest, despite his signature on the policy applications, the policy provisions, and decades of case law that instruct that the applications and policies operate as an integrated contract. (*Id.* at p. 949.)

The District Court's decision is the only one to read the law this way; three other federal judges in the Northern District of California examined the same issues and reached the opposite conclusions. In *Washburn*, *Martin*, and *Lujan*, each district judge concluded that admitted insurers ***are*** exempt from the compound interest restriction of section 2 of

the 1918 usury initiative, and on that basis granted the insurers' motions to dismiss. (See *Washburn v. Prudential Insurance Company of America* (N.D.Cal. 2015) 158 F.Supp.3d 888, 896; *Martin v. Metropolitan Life Insurance Company* (N.D.Cal. 2016) 179 F.Supp.3d 948, 956; *Lujan v. New York Life Insurance Company* (N.D.Cal., Aug. 9, 2016, No. 4:16-cv-00913-JSW) 2016 WL 4483870, at *6.)

The *Martin* and *Lujan* courts also found that the practice of delivering the signed insurance contract with the compound interest disclosure in the policy prior to the taking of any policy loans complied with the compound interest restriction. (See *Martin, supra*, 179 F.Supp.3d at p. 957; *Lujan, supra*, 2016 WL 4483870, at *7.)[2]

In this case, the U.S. Court of Appeals for the Ninth Circuit granted permission for Northwestern Mutual to appeal the order denying its motion to dismiss. On January 18, 2018, after briefing and argument, the Ninth Circuit panel certified the following questions of California law to this Court:

> 1. Are the lenders identified in Article XV of the California Constitution, *see* Cal. Const. art. XV, § 1, as being exempt from the restrictions otherwise imposed by that article, nevertheless subject to the requirement in section 1916-2 of the California Civil Code that a lender may not compound interest "unless an agreement to that effect is clearly expressed in writing and signed by the party to be charged therewith"?
>
> 2. Does an agreement meet the requirement of section 1916-2 if it is comprised of: (1) an application for insurance signed by the borrower, and (2) a policy of insurance containing an agreement for compound interest that is subsequently attached to the application,

[2] The *Washburn* court did not reach this issue.

thus constituting the entire contract between the parties pursuant to section 10113 of the California Insurance Code?

(*Wishnev, supra*, 880 F.3d at p. 495.)

By Order dated March 14, 2018, this Court granted the Ninth Circuit's request to decide the Certified Questions and designated Northwestern Mutual the Petitioner.[3]

IV.

ARGUMENT

A. Exempt Classes of Persons Pursuant to Section 1 of Article XV of the California Constitution Are Exempt from the Compound Interest Restriction of Section 2 of the 1918 Usury Initiative.

Well-settled California law dictates that, pursuant to Article XV of the state Constitution, the Legislature has the sole power to set interest rates and to regulate "in any manner" the compensation that exempt classes of persons, including admitted insurers such as Northwestern Mutual, receive in connection with loans. The compound interest restriction of section 2 of the 1918 usury initiative, like all restrictions of the usury law, is therefore superseded and does not apply as to exempt classes of persons such as admitted insurers. We briefly provide an overview of the 1918 usury initiative and the relevant constitutional amendments that have superseded it as to exempt classes of lenders.

[3] Plaintiffs in *Martin* and *Lujan* also appealed the orders granting the motions to dismiss filed by the insurers in those cases. Those appeals have been stayed by the Ninth Circuit pending this Court's decision on the Certified Questions. (See *Martin*, No. 16-15690; *Lujan*, No. 16-16401.) The plaintiff in *Washburn* did not appeal the order granting the motion to dismiss filed by the insurer in that case, and that order is final.

1. The 1918 Usury Initiative

California's "usury law is based upon article XV, section 1 of the California Constitution as well as an initiative measure adopted in 1918." (*Bisno v. Kahn* (2014) 225 Cal.App.4th 1087, 1098 (citations omitted).)[4]

Section 1 of the 1918 usury initiative, characterized as a "rate setting provision," provides that the rate of interest upon a loan shall be seven percent per year, but that parties may contract for a greater rate of interest not exceeding 12 percent per annum. (Civ. Code, § 1916–1; see also *Bisno, supra*, 225 Cal.App.4th at p. 1099.)

Section 2 of the 1918 usury initiative provides, inter alia, that no person shall directly or indirectly receive any compensation, in money or otherwise, in excess of the 12 percent rate; that interest shall not be compounded, unless an agreement to that effect is clearly expressed in writing and signed; and that any agreement in conflict with the provisions of section 2 shall be null and void as to any agreement therein to pay interest. The full text of section 2 of the 1918 usury initiative is as follows:

> No person, company, association or corporation shall directly or indirectly take or receive in money, goods or things in action, or in any manner whatsoever, any greater sum or any greater value for the loan or forbearance of money, goods or things in action than at the rate of twelve dollars upon one hundred dollars for one year; **and in the computation of interest upon any bond, note, or other instrument or agreement, interest shall not be compounded, nor shall the interest thereon be construed to**

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[4] The 1918 usury initiative specifies that it "may be designated simply as the 'usury law.'" (Civ. Code, § 1916-5.) Consistent with the California state courts, Northwestern Mutual refers herein "to the constitutional and initiative provisions collectively as the 'usury law.'" (*Bisno, supra*, 225 Cal.App.4th at p. 1098.) Where necessary to distinguish between the two provisions, Northwestern Mutual refers to the "constitutional usury provisions" or the "1918 usury initiative." (See *ibid.*)

> **bear interest unless an agreement to that effect is clearly expressed in writing and signed by the party to be charged therewith.** Any agreement or contract of any nature in conflict with the provisions of this section shall be null and void as to any agreement or stipulation therein contained to pay interest and no action at law to recover interest in any sum shall be maintained and the debt cannot be declared due until the full period of time it was contracted for has elapsed.

(Civ. Code, § 1916-2 (emphasis added).) Wishnev argues the above-emphasized phrase alone survives as to exempt lenders such as admitted insurers, but two constitutional amendments, in 1934 and 1979, implementing legislation, and interpretive case law demonstrate otherwise.

2. The 1934 Amendment

"The first modification to the 1918 usury initiative took the form of [the 1934 amendment]." (*Bisno, supra*, 225 Cal.App.4th at p. 1099 (citing *Penziner v. W. Am. Finance Co.* (1937) 10 Cal.2d 160, 170, 177–78).) The 1934 amendment accomplished several things. ***First***, it reduced the maximum permissible interest rate from 12 percent to 10 percent. (Cal. Const., art. XV, § 1(1).) ***Second***, the second paragraph of the amendment provided that no person could charge any other "fee, bonus, commission, discount or other compensation" that resulted in the borrower paying more than the maximum 10 percent per annum interest rate. (*Id.* § 1(2).) This language is substantially similar to the first phrase of section 2 of the 1918 usury initiative, except for the rate reduction. (See *Penziner, supra*, 10 Cal.2d at p. 172 ["Except as to the reduction of interest from 12 per cent to 10 per cent per annum this paragraph is substantially similar to the first part of section 2 of the usury law."].) ***Third***, and most important for purposes of this appeal, the third paragraph of the amendment exempted certain enumerated classes of lenders (including those classes of lenders whose

predominant business was the lending of money, such as banks and credit unions) from the requirements of the usury law, and granted the Legislature the following authority:

> [T]he 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, bonus, 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.

(Cal. Const., art. XV, § 1(2).) ***Finally***, the amendment stated that "[t]he provisions of this section shall supersede all provisions of this Constitution and laws enacted thereunder in conflict therewith." (*Ibid.*)

This Court has repeatedly recognized that the exemption created by the 1934 amendment superseded the usury law insofar as it applied to exempt lenders, and re-vested in the Legislature the power to regulate the interest and charges of exempt lenders in all respects. For example, in *Penziner*, this Court stated: "Of course, the placing in the hands of the legislature the control of the charges to be made by the exempted groups is inconsistent with the usury law over which the legislature has no power." (*Penziner, supra*, 10 Cal.2d at p. 177.) Similarly, in *Wolf v. Pacific Southwest Discount Corp.* (1937) 10 Cal.2d 183, 184, issued the same day as *Penziner*, this Court stated that the exemption paragraph of the 1934 amendment "designated certain organizations and individuals which are exempt from the general provisions of the usury law."

In *Carter v. Seaboard Finance Co.* (1949) 33 Cal.2d 564, 579, this Court explained that "the objective of the [1934] amendment was to abolish the inflexible, inadequate and unworkable provisions of the usury law and

to reestablish in the Legislature the power to enact laws affecting the business of lending money in this state." This Court further observed:

> [T]he purpose of the constitutional amendment of 1934 [was] to free the Legislature from the restraints imposed by inflexible usury provisions so that interest and charges more appropriate to business conditions peculiar to each of the exempted classes could be established. Those who voted for the 1934 amendment had reason to expect that the exempt classes would not remain unregulated indefinitely. **But until the Legislature exercises the power granted to it by the amendment to regulate the business of lenders in a manner appropriate to each exempted class, the class not so governed by legislation is subject to no restriction on interest rates or charges.**

(33 Cal.2d at p. 582 (emphasis added).) The 1934 amendment therefore left "supervisory control of all of the exempted classes [to] the vigilant attention of the Legislature." (*Ibid.*)

In *Heald v. Friis-Hansen* (1959) 52 Cal.2d 834, 838, this Court explained that "[t]he *Penziner* decision is in accord with cases holding that [the 1934 amendment], by exempting from its restrictions certain enumerated classes of persons . . . operates to exempt those classes from the restrictions in the Usury Law."

This Court's most recent direct pronouncement on this issue came in *West Pico Furniture Co. v. Pacific Finance Loans* (1970) 2 Cal.3d 594, where this Court stated:

> **It has been for some time the settled law of this state, as set forth in a number of decisions of this court, that [the 1934 amendment] by exempting from its restrictions certain enumerated classes of persons . . . "operates to exempt those classes from the restrictions in the Usury Law."** . . . .

> It must necessarily follow that the exemption of the enumerated classes from the restrictions of the Usury Law has at the same time made them immune to actions grounded upon common law remedies existing prior to the Usury Law. **Any other result would frustrate the constitutional amendment which was designed to place in the hands of the Legislature the control of the charges to be made by the exempted groups.**

(*Id.* at pp. 614–15 (emphasis added) (citing *Penziner, supra*, 10 Cal.2d at p. 177).)

Finally, both *McConnell v. Merrill Lynch, Pierce, Fenner & Smith, Inc.* (1983) 33 Cal.3d 816, 821 ("*McConnell II*"), as well as its predecessor decision *McConnell v. Merrill Lynch, Pierce, Fenner & Smith, Inc.* (1978) 21 Cal.3d 365, 370 ("*McConnell I*"), involved allegations that the defendant had violated the compound interest restriction of section 2 of the 1918 usury initiative. Significantly, on their face, both of these cases speak only to a class of plaintiffs (margin account customers) who maintained margin accounts prior to the date the defendant broker firm obtained constitutionally exempt status. Thus, *McConnell I* and *II* at least impliedly refute Wishnev's theory that section 2 of the 1918 usury initiative applies to constitutionally exempt lenders, and these two cases are consistent with all of this Court's prior pronouncements on the issue.[5]

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[5] In *McConnell I,* "[p]laintiffs filed suit individually and on behalf of a class of all California customers who maintained margin accounts with defendant from November 26, 1971, to September 26, 1973, and who were charged unlawful interest." (21 Cal.3d at p. 370.) After quoting a portion of Article XV, this Court commented: "[Article XV] went on to provide that 'However, none of the above restrictions shall apply' to corporations licensed under various laws, including corporations licensed as personal property brokers. Defendant first obtained such a license on September 26, 1973." (*McConnell I, supra*, 21 Cal.3d at p. 369 n.1.) Similarly, in *McConnell II,* this Court reiterated: "Plaintiffs filed suit individually and on behalf of a class of customers in California who maintained margin

3. The 1979 Amendment and Subsequent Insurance Code Provisions

In 1979, the exemption paragraph of the 1934 amendment was further amended to enable the Legislature to create additional classes of lenders that would be exempt from the usury law's restrictions and instead subject to regulation by the Legislature, by adding "or any other class of persons authorized by statute." (Cal. Const., art. XV, § 1(2).)

In 1981, the Legislature amended Insurance Code section 1100.1 to add admitted insurers as a class of exempt lenders pursuant to Section 1 of Article XV of the Constitution:

> Pursuant to the authority contained in Section 1 of Article XV of the State Constitution, the restrictions upon rates of interest contained in Section 1 of Article XV of the California Constitution shall not apply to any obligation of, loans made by, or forbearances of, any incorporated admitted insurer.
>
> **This section creates and authorizes incorporated admitted insurers as an exempt class of persons pursuant to Section 1 of Article XV of the Constitution.**

(Ins. Code, § 1100.1 (emphasis added); see also *In re Lara* (9th Cir. 1984) 731 F.2d 1455, 1458, fn. 2 ["[The 1979 constitutional amendment] also amended Article XV to permit the legislature to exempt other classes of lenders from the usury prohibitions. Pursuant to this authority, the legislature has created exemptions for corporate insurance companies, see Cal. Ins. Code § 1100.1 . . . ."].)

In the following year, 1982, the Legislature filled the regulatory vacuum created by the exemption of admitted life insurers from the usury

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accounts with defendant between November 26, 1971, and September 26, 1973." (33 Cal.3d at p. 818.)

law by enacting a comprehensive regulatory scheme under article 5.5 of the Insurance Code, entitled "Life Insurance Policy Loans." (See Ins. Code, § 1230 et seq.) Insurance Code section 1230 et seq. sets forth detailed requirements for life insurance policy loans in California, establishing requirements not just for maximum interest rates, but also for disclosures that must be made to policyholders regarding rate calculations, policy cash values and dividends, and other charges. (See, e.g., Ins. Code, § 1232(a) [maximum interest rates applicable to policy loans]; §§ 1232(c), 1237 [written pricing and dividend policies, and disclosures relating thereto]; § 1233 [written disclosures to policyholders regarding the frequency of rate determinations for variable interest rates]; § 1235 [notice requirements for initial rate charged as well as any increases]; § 1236 [fixing the loan value as the cash surrender value of the policy].) Further, Insurance Code section 1239 provides that "[n]o other provision of law shall apply to policy loan interest rates unless made specifically applicable to these rates."

The Legislature's broad regulation of policy loans and interest charges by admitted insurers in response to the 1979 amendment and statutory exemption thus further demonstrates that admitted insurers had become exempt from the requirements of the usury law, and that the Legislature understood it had plenary power to "in any manner fix, regulate or limit" the interest charged by insurers in connection with life insurance policy loans.

4. Wishnev's Exemption Argument Is Foreclosed by Both Well-Established Precedent and Common Sense.

Against this backdrop, Wishnev's argument that exempt lenders are exempt from every provision in the usury law ***except*** the one phrase he relies on in this lawsuit—the compound interest restriction of section 2 of the 1918 usury initiative—is foreclosed for at least five separate reasons.

a. The Exemption Created by the 1934 Amendment Applies to All Provisions in the Usury Law.

As detailed above, this Court has repeatedly recognized that the exemption created by the 1934 amendment superseded the usury law insofar as it applied to exempt lenders, and re-vested in the Legislature the power to regulate the interest and charges of exempt lenders. And indeed, except for the District Court's decision denying Northwestern Mutual's motion to dismiss in this case, no California state or federal court has ever concluded that the exemption created by the 1934 amendment applies only to the "maximum interest rate" requirements and not to the other provisions of the usury law. Indeed, three separate federal district judges concluded to the contrary, in *Martin*, *Lujan*, and *Washburn*.

Wishnev has argued that his position is supported by *Penziner*, but that case is fully consistent with the multiple pronouncements by this Court that the exemption authorized by the 1934 amendment applied universally to all provisions of the usury law. In *Penziner*, the plaintiff-borrower claimed that the amount of interest charged by the defendant-lender violated the 1918 usury initiative. The defendant asserted that the 1918 usury initiative had been repealed by the 1934 amendment—but the defendant was ***not*** an exempt lender. This Court held that, ***as to nonexempt lenders such as the defendant***, the 1934 amendment modified, but did not repeal in toto, the 1918 usury initiative. This Court specifically drew a crucial distinction between exempt lenders (such as Northwestern Mutual) and nonexempt lenders (such as the *Penziner* defendant):

> **[T]he power granted to the legislature by the constitutional amendment [of 1934] is expressly limited in its scope to the regulation and control of the charges of the exempted classes of lenders. As to the nonexempt classes of lenders, the legislature possesses no such power.** The usury law

> applied to all lenders. That has been changed to permit the legislature to regulate the charges made by certain lenders, but except as to reduction of the maximum interest rate, there is nothing to indicate that the constitutional amendment was intended to affect **the nonexempt lenders** at all . . . . From what has been said, it follows that in our opinion, at least **as to the nonexempt classes of lenders** (of which group defendant is a member) the usury law was not repealed by the adoption of the constitutional provision . . . .

(10 Cal.2d at pp. 177–78 (emphasis added).) Thus, *Penziner* is in accord with all decisions of this Court that have held that the usury law's restrictions do not apply to exempt lenders. (See, e.g., *West Pico Furniture Co., supra*, 2 Cal.3d at pp. 614–15; *Heald, supra*, 52 Cal.2d at p. 838; *Carter, supra*, 33 Cal.2d at p. 582.) In denying Northwestern Mutual's motion to dismiss, the District Court essentially ignored the critical distinction drawn in *Penziner* between exempt and nonexempt lenders. In contrast, in all three of the nearly identical putative class actions filed by Wishnev's counsel (*Martin*, *Lujan*, and *Washburn*), the district courts fully recognized this distinction and rejected plaintiffs' interpretation of *Penziner*. (See *Lujan, supra*, 2016 WL 4483870, at *5 ["[I]n *Penziner*, the Court did not seek to extend its findings to exempt classes of lenders and explicitly qualified its holding to non-exempt classes of lenders . . . . Accordingly the Court finds Plaintiffs' reliance on *Penziner* to be unpersuasive."]; *Martin, supra,* 179 F.Supp.3d at p. 953 [rejecting plaintiff's reliance on *Penziner*]; *Washburn, supra,* 158 F.Supp.3d at pp. 894–95 [same].)

Wishnev also relies on dicta in *Penziner* that the constitutional amendment "exempt[s] certain enumerated classes of lenders from certain of its provisions" (*Penziner*, 10 Cal. 2d at 177), but he ignores the

immediately following language, that "***Of course, the placing in the hands of the legislature the control of the charges to be made by the exempted groups is inconsistent with the [1918 usury initiative] over which the legislature has no power.***" (*Ibid.* (emphasis added).) Thus, *Penziner*—like all subsequent decisions of this Court—unequivocally recognizes that the 1918 usury initiative conflicts with the 1934 amendment's grant of complete authority to the Legislature over exempt classes. (See also, e.g., *Martin, supra*, 179 F.Supp.3d at p. 953 ["*Penziner* also recognized 'the placing in the hands of the Legislature the control of the charges to be made by the exempted groups is inconsistent with the [1918 initiative],' thereby suggesting exempt lenders had been freed in greater measure from the obligations articulated in the initiative."]; *Washburn, supra*, 158 F.Supp.3d at pp. 894–95 ["the exemption from 'certain provisions' [phrase in *Penziner*] should be read to mean exemption from provisions that conflict with the California Constitution," which includes the compound interest restriction of section 2 of the 1918 usury initiative].)

b. The Compound Interest Restriction of Section 2 of the 1918 Usury Initiative Is in Conflict with the Legislature's Power to "In any Manner . . . Regulate" Compound Interest Charged by Exempt Lenders.

There is a patent conflict between (i) Article XV's grant to the Legislature of the power to "in any manner fix, regulate or limit, the fees, bonuses, commissions, discounts or other compensation" that exempt lenders may charge in connection with a loan, and (ii) the 1918 usury initiative's regulation of the charging of compound interest. For this reason alone, the compound interest restriction of section 2 of the 1918 usury initiative is necessarily superseded by virtue of the 1934 amendment, which states that Article XV's provisions "shall supersede all provisions of this constitution and laws enacted thereunder in conflict therewith." Indeed, in all three of the nearly identical putative class actions filed by Wishnev's

counsel, the district courts correctly applied controlling precedents and ruled that admitted insurers are indeed exempt from the compound interest restriction of section 2 of the 1918 usury initiative. (See *Washburn, supra*, 158 F.Supp.3d at p. 896; *Martin, supra*, 179 F.Supp.3d at p. 956; *Lujan, supra*, 2016 WL 4483870, at *6.)

To argue otherwise, Wishnev must contend that compound interest is somehow not part of the interest, charges or "other compensation" charged by a lender in connection with a loan.[6] If compound interest ***is*** part of the interest, charges, or other compensation charged by a lender, then pursuant to Article XV the Legislature has the sole power to "in any manner fix, regulate or limit" it. The Legislature's authority over interest or other compensation necessarily conflicts with the continued application of the compound interest restriction of section 2 as to exempt lenders, and is therefore superseded by operation of the fourth paragraph of the 1934 amendment.

This conclusion follows from the commonsense notion that compound interest is additional interest—interest upon interest—charged to the borrower, and actual compensation paid to a lender, to compensate for the lost use of funds and risk of nonrepayment. A simple example will illustrate:

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[6] In addition to constituting part of the interest and overall compensation paid to a lender in connection with a loan, compound interest is also a "charge," another term squarely included within the scope of the 1934 amendment. (See *Carter, supra*, 33 Cal. 2d at p. 583 ["The regulation of the business of [exempt entities], including their interest *and charges*, is entirely within the control of the legislature." (emphasis added)]; *Lujan, supra*, 2016 WL 4483870, at *5–6 ["Additionally, compound interest also falls under the purview of Article XV as it is a 'charge' upon a loan . . . . Because compound interest is a 'charge' upon a loan and also 'compensation' received from a lender," article XV applies to the regulation of compound interest."]; *Martin, supra*, 179 F.Supp.3d at p. 956 ["The legislative history of the constitutional amendment also bolsters the conclusion the legislature's authority to regulate charges exempt classes impose supersedes the compound interest consent requirement."].)

- Suppose a policy owner borrows $100 and only simple interest of 10 percent is charged; $10 in interest is charged at the end of year one. The amount subject to repayment is now $110. At the end of year two, another $10 in interest makes the loan balance subject to repayment $120. The principal balance always remains $100.

- Now suppose compound interest. Year one is the same, but in year two 10 percent interest is charged on $110, adding $11 in debt. The policy owner is responsible for paying back $121 rather than the $120 under simple interest. This additional $1 of interest on interest charged under the compound interest loan agreement reflects additional money—i.e., "compensation"—charged to the policy owner for the use of the principal balance.

But beyond mere common sense, controlling precedent of this Court holds that compound interest is indeed compensation charged by a lender in connection with a loan. In *Heald*, this Court expressly considered the frequency of compounding interest in determining whether interest charged on the subject loan was in excess of the maximum rate under the 1934 amendment. (52 Cal.2d at pp. 839–40.) This Court held that compounding interest annually would not render usurious an otherwise nonusurious annual rate, but compounding interest more frequently would. (*Ibid.*) Similarly, in *Lewis v. Pac. States Sav. & Loan Co.* (1934) 1 Cal.2d 691, 695–96, this Court explained that compounded interest is added into the calculation of total interest charged for a given year when determining whether the interest charged in that year exceeded the allowed maximum rate of interest under the 1918 usury initiative: "The interest upon interest is taken into consideration when testing the transaction for usury . . . ."

Wishnev has no effective answer to this. He has argued that the term "other compensation" refers to "charges (and discounts), not methods of calculating interest," and is "best understood to refer to loan points" but not compounded interest. But in addition to being foreclosed by controlling precedent, Wishnev's argument lacks a rational basis. Loan points are, no more and no less than compound interest, a type of compensation paid to a

lender in connection with a loan. There can be no reasonable dispute that charging interest on interest results in more compensation to the lender than simple interest charged only on the original principal loan balance. Further, controlling precedent also specifically identifies the types of things that are ***not*** "other compensation" paid to lenders in connection with loans—i.e., compensation paid to third persons, and expense items paid by lenders. (*In re Fuller* (1940) 15 Cal.2d 425, 434 ["the word 'interest', while broad enough to cover 'bonus', 'commission', or any other form of 'compensation' paid to the lender for the use of money, does not include brokerage or other compensation paid to a third person, or expense items such as appraisals, recording fees, insurance, or similar charges"]; see also *Cambridge Dev. Co. v. U.S. Financial* (1970) 11 Cal.App.3d 1025, 1028 ["The word 'interest' as used in the usury law includes any bonus, commission, or any other form of compensation paid to the lender for the use of the money borrowed, but it does not include expense items for investigating, appraising, inspecting and otherwise servicing the loan." (emphasis omitted)] (citing *In re Fuller, supra*, 15 Cal.2d at p. 434).) These exclusions are limited indeed, and do not extend to any form of compensation paid by the borrower to the lender for the use of money.

As to Wishnev's characterization of compound interest as being a "method[] of calculating interest," this does not alter the analysis or conclusion. In explaining that compound interest is indeed taken into consideration when testing a transaction for usury, this Court in *Lewis* specifically likened compound interest to both a "bonus" as well as a "method of calculation." (*Lewis*, 1 Cal.2d at pp. 695–96.) Notably, the former term would later that same year be included in the 1934 amendment's list of charges that are to be taken into consideration in

testing a transaction for usury (i.e., "fee, bonus, commission, discount or other compensation").[7]

Wishnev also has argued in the alternative that the maximum interest rate restrictions in the first phrase of section 2 of the 1918 usury initiative are a "prohibition" and "of a completely different nature" than the compound interest restriction in the second phrase, which survives because it is a "procedural disclosure requirement" and "not a matter of 'usury' at all." That argument is flawed on at least two levels and ultimately unavailing in any event.

First, Wishnev cites no authority for the proposition that section 2 of the 1918 usury initiative should be viewed as containing a maximum interest rate restriction, which does not apply to exempt lenders, and a "completely different" compound interest restriction, which somehow survives to apply to exempt insurers. No such authority for this self-serving argument exists. In fact, the California courts refer to section 2 as being, in its entirety, a "usury prohibition." (See, e.g., *Bisno, supra*, 225 Cal.App.4th at p. 1099.) Further, the second sentence of section 2 provides,

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[7] The *Lewis* Court was interpreting the first sentence of section 2 of the usury law and not paragraph 2 of the 1934 amendment (which was not yet effective and at issue in the case before it), but as noted above, the *Penziner* Court subsequently observed that paragraph 2 of the 1934 amendment "is substantially similar to the first part of section 2 of the usury law" "except as to the reduction of interest from 12 per cent to 10 per cent per annum." (*Penziner, supra*, 10 Cal.2d at p. 172.) In his Ninth Circuit and trial court briefing, Wishnev repeatedly misstated that the *Penziner* Court was equating the first sentence of section 2 of the usury law with paragraph 1 of the 1934 amendment—i.e., the pure maximum permissible rate provision. This Court has always considered compound interest in testing a transaction for usury, whether in section 2 of the usury law ("No person . . . shall directly or indirectly take or receive in money, goods or things in action, or in any manner whatsoever, any greater sum or any greater value" for a loan than at the rate of 12%), or in paragraph 2 of the 1934 amendment ("No person . . . shall by charging any fee, bonus, commission, discount or other compensation receive from a borrower more than the interest authorized by this section upon any loan . . . .").

without discrimination, that any agreement "in conflict with the provisions of this section shall be null and void as to any agreement or stipulation therein contained to pay interest . . . ." (Civ. Code, § 1916-2.)[8] Indeed, it cannot be seriously disputed that the compound interest restriction is a substantive prohibition, in view of the fact that it bars a lender from charging compound interest unless an agreement to that effect is signed by the borrower.

Under Wishnev's theory that the compound interest prohibition was excluded from the exemption, the Legislature would lack the power to, for example, absolutely prohibit the charging of compound interest by exempt lenders because section 2 allows a lender to charge compound interest if a written agreement is signed by the borrower. There is no indication in the 1934 amendment or the decades of case law that followed of any intent to enshrine compound interest, of all the fees, bonuses, commissions, discounts or other compensation that could be charged by a lender, with constitutional protection from legislative regulation.

Second, as to Wishnev's assertion that the compound interest restriction of section 2 is "not a matter of 'usury' at all," this would no doubt surprise the drafters of the 1918 usury initiative, who provided in section 5 as follows: "This act whenever cited, referred to, or amended may be designated simply as the 'usury law.'" (Civ. Code, § 1916-5.) This assertion reveals the Alice in Wonderland nature of Wishnev's argument: He is asserting a claim under the usury law, but cannot acknowledge it as

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[8] In interpreting particular words, phrases, or clauses, "it is a cardinal rule that the entire substance of the statute or that portion relating to the subject under review should be examined in order to determine the scope and purpose of the provision containing such words, phrases or clauses." (*West Pico, supra*, 2 Cal.3d at p. 608; *People v. Superior Court* (1969) 70 Cal.2d 123, 133; see also 58 Cal.Jur.3d (2018) Statutes, § 145.)

such because he knows that Northwestern Mutual is exempt from the usury law.

In any event, Wishnev's argument is ultimately unavailing. Even assuming arguendo that the compound interest restriction was a mere "procedural disclosure requirement," it still would conflict with—and therefore be superseded by—the Legislature's power under Article XV to "in any manner . . . regulate" compound interest, as a disclosure requirement is a quintessential manner of regulation. Under Wishnev's one-size fits all theory, the Legislature would lack the power to, for example, require exempt lenders to provide annual or other periodic disclosures if unsigned by the borrower, or otherwise to regulate the charging of compound interest in whatever manner the Legislature saw fit as befitting the nature of the lender's industry.

Indeed, Wishnev's Ninth Circuit briefing never once cited the "in any manner . . . regulate" provision of the 1934 amendment. This is because Wishnev cannot reconcile that key language with his interpretation of the 1934 amendment. By contrast, Northwestern Mutual's reading of the exemption provisions of the 1934 amendment is the only plausible one that gives meaning to both key provisions: (1) pursuant to the "none of the above restrictions" sentence, all of the constitutional restrictions on interest and other forms of compensation that lenders may charge borrowers in connection with loans do not apply to exempt lenders; and (2) pursuant to the "in any manner . . . regulate" provision, the Legislature was granted the power to develop industry-specific rules that would prescribe the maximum interest rate and "in any manner" "regulate" the other compensation that exempt lenders may charge borrowers in connection with loans.

For these reasons, Wishnev has not shown (and cannot show) that the compound interest restriction in section 2 of the 1918 usury initiative survives to apply to exempt entities.

c. In Precluding the Legislature from Regulating Compound Interest Charges, Wishnev's Position Would Frustrate the Clear Purpose of the 1934 Amendment.

Further, this Court has been clear that Wishnev's position—that the Legislature can set maximum rates but cannot control charges that may be used by lenders to circumvent the maximum rates—would frustrate the clear purpose of the 1934 amendment. As this Court held in *Carter*, "[t]he unmistakable purpose of the second paragraph [of the 1934 amendment] was to prevent lenders from circumventing the limits on interest established in the preceding paragraph by forbidding any charges whereby the borrower is required to pay more than the ten percent." (33 Cal.2d at p. 579.) Similarly, as this Court explained in *West Pico*, "It has been for some time the settled law of this state, as set forth in a number of decisions of this court, that [the 1934 amendment] by exempting from its restrictions certain enumerated classes of persons . . . 'operates to exempt those classes from the restrictions in the Usury Law.' . . . **Any other result would frustrate the constitutional amendment which was designed to place in the hands of the Legislature the control of the charges to be made by the exempted groups.**" (2 Cal.3d at pp. 614–15 (emphasis added) (citing *Penziner, supra*, 10 Cal.2d at p. 177).)

The *Martin* and *Lujan* courts specifically recognized that plaintiffs' position (that the Legislature can set maximum interest rates and control charges ***other than*** compound interest) would impermissibly preclude the Legislature from regulating compound interest charges even though such charges may be used "to circumvent the interest rate cap." (*Martin, supra*, 179 F.Supp.3d at pp. 954–55 ["To plaintiff, the legislature can set a maximum interest rate of interest for an exempt industry, but is required to watch lenders exceed it with impunity by charging compound interest to those who have agreed."] (citing *Carter, supra*, 33 Cal.2d at p. 579); *Lujan,*

supra, 2016 WL 4483870, at *5 ["If Article XV did not regulate compound interest, the maximum interest rate established by the article would be too easily violated as a lender could simply compound the maximum interest rate with impunity."].) Wishnev's same position (adopted by the District Court in this case) would impermissibly frustrate the purpose of the 1934 amendment and usurp the Legislature's exclusive authority under the 1934 amendment to comprehensively regulate the compensation that exempt lenders may charge or receive in connection with loans. (See also, e.g., *Washburn, supra*, 158 F.Supp.3d at p. 896 ["Thus, the California Constitution vests in the California Legislature the sole authority to regulate the charging of compound interest by exempt classes."].)

Indeed, the notion that the Legislature would have the authority to prescribe a "maximum interest rate," but could not otherwise regulate, supervise, fix or limit compound interest charges that unquestionably impact the ***maximum amount of interest*** charged to the borrower and the total compensation received by the lender, is absurd. Accordingly, in addition to frustrating the clear purpose of the 1934 amendment and impermissibly usurping the Legislature's authority, Wishnev's theory would violate the fundamental interpretive principle that abhors absurd consequences.[9]

d. The Ballot Materials for the 1934 Amendment Further Support Northwestern Mutual's Position.

The absence of any uncertainty as to the legislative purpose and intent behind the 1934 amendment makes review of the ballot materials

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[9] (See *Wasatch Property Management v. Degrate* (2005) 35 Cal.4th 1111, 1122 ["The court will apply common sense to the language at hand and interpret the statute to make it workable and reasonable. [Citation.] Accordingly, the statute should be interpreted to avoid an absurd result."]; *Harris v. Capital Growth Investors XIV* (1991) 52 Cal.3d 1142, 1165–66 ["[I]t is presumed the Legislature intended reasonable results consistent with its expressed purpose, not absurd consequences."].)

unnecessary. But the ballot materials lend further support to Northwestern Mutual's position by stating (in the attorney general's summary) that the 1934 amendment broadly "[p]ermits [the] Legislature to regulate said exempted classes, prescribe their maximum interest rate per annum and regulate their charges on loans." (*Carter, supra*, 33 Cal.2d at p. 581.) The ballot materials do not contain any statement, or even suggestion, that the 1934 amendment was leaving the compound interest restriction in effect for exempt lenders. One would expect the authors of the ballot materials to state their intention to exclude the compound interest restriction from the effect of the amendment—***if*** that were the intention. Wishnev's interpretative arguments rest on the false premises that compound interest does not constitute interest, charges or other compensation, and that disclosure requirements do not qualify as "regulation" "in any manner." These premises are simply untenable.

For example, Wishnev asked rhetorically in his Ninth Circuit briefing why the voters might have wanted to allow exempt lenders to charge compound interest "without disclosing it and obtaining written consent." The straightforward answer is that a one-size-fits-all approach to the usury law did not work well in practice given the variety of potential lending agreements across a variety of different industries, and the better policy was to vest management of exempt classes of lenders, macro and micro, in the Legislature. As observed by this Court in *Carter*, the ballot argument presented to voters was that exempt classes "have distinctive and individual problems peculiar to their respective classes of business" (*id.* at p. 581), that "[t]he Usury Law attempted to cover all classes, and has failed miserably," and that the remedy was that "supervisory control of all of the exempted classes would be subject to the vigilant attention of the legislature." (*Id.* at p. 582.) Thus, in adopting the 1934 amendment, "voters were approving a plan by which the Legislature could regulate the

exempted classes in accordance with their peculiar requirements." (*Id.* at p. 587.) Subjecting exempted lenders to only one component of the usury law—the compound interest restriction—would be inconsistent with this rationale, no less than subjecting them to the "maximum interest rate" requirements would be. The ballot materials, and the enactment, were a decisive rejection of the "one-size-fits-all" approach that Wishnev advocates regarding compound interest regulation. (See *Martin, supra*, 179 F.Supp.3d at p. 956.)

The purpose of the 1934 amendment is starkly illustrated in the context of the life insurance industry. Life insurance policy loans are truly "distinctive" and unique. Unlike a commercial lending agreement, in which the loan is taken contemporaneously with the execution of the agreement, life insurance policy loans can only be taken once the policy has accumulated sufficient cash value to serve as collateral for the loan, so the policy owner is in possession of the policy for a substantial period of time before a loan is even possible. Life insurance policies permit the policyholder to borrow up to the amount of the accumulated cash value of the policy without additional security, they may be used to pay outstanding premiums or may be paid to policyholders in cash, and they are advantageous to borrowers because they do not require a credit check and do not need to be paid back, in whole or in part, while the policy is in force. (See 8-88 Appleman on Insurance § 88.04.) Unlike a mortgage or most commercial loans, there is no repayment schedule for a policy loan. Further, in those instances where policy loans are used to pay premiums, they prevent a policy from lapsing for nonpayment and serve to protect the policy owner and his or her beneficiaries. (*Ibid.*) These types of idiosyncrasies cogently explain the wisdom of superseding the usury law in favor of authorizing the Legislature to regulate with specific classes of loans or lenders in mind.

For these reasons, all three of the other district courts that have considered whether admitted insurers are exempt from the compound interest restriction of section 2 have concluded that the ballot materials support exemption. (See *Washburn, supra*, 158 F.Supp.3d at p. 894 [quoting the *Carter* court's discussion of the ballot materials]; *Martin, supra*, 179 F.Supp.3d at p. 956 ["The legislative history of the constitutional amendment also bolsters the conclusion the legislature's authority to regulate charges exempt classes impose supersedes the compound interest consent requirement."]; *Lujan*, 2016 WL 4483870, at *6 ["Contrary to Plaintiffs' allegation, the ballot materials illustrate the amendment went beyond simply setting a new maximum interest rate. This fails to provide support for the Plaintiffs' allegation that the Initiative survived Article XV for exempt groups."].)

e. Wishnev Fails to Acknowledge the Significance of Relevant Insurance Code Sections.

Finally, Wishnev's argument fails to acknowledge the significance of the Legislature's 1982 enactment of a comprehensive regulatory scheme expressly governing "Life Insurance Policy Loans." (Ins. Code, § 1230 et seq.) The significance of this regulatory scheme lies in the fact that it was enacted in the immediate wake of the 1981 insurer exemption (Ins. Code, § 1100.1), which was itself enacted in the immediate wake of the 1979 constitutional amendment permitting the Legislature to add exempt classes of lenders. The 1982 regulatory scheme for life insurance policy loans expressly established requirements not only for maximum interest rates, but also for disclosures that must be made to policyholders regarding rate calculations, policy cash values and dividends, and other charges.[10] The

[10] (See, e.g., Ins. Code, § 1232(a) [maximum interest rates applicable to policy loans]; §§ 1232(c), 1237 [written pricing and dividend policies, and disclosures relating thereto]; § 1233 [written disclosures to

Legislature's broad regulation of policy loans and interest charges by admitted insurers in direct response to the 1979 amendment and 1981 statutory exemption demonstrates that the Legislature understood it had the regulatory power to do far more than merely set maximum interest rates. That contemporaneous view of the Legislature's own regulatory authority and the scope of the authorizing provision is entitled to considerable weight. (See *Pacific Legal Foundation v. Brown* (1981) 29 Cal.3d 168, 180 ["when the Legislature has enacted a statute with the relevant constitutional prescriptions clearly in mind. . . . [A] focused legislative judgment on the question enjoys significant weight and deference by the courts." (citations omitted)]; *cf. Dyna-Med, Inc. v. Fair Employment & Housing Com.* (1987) 43 Cal.3d 1379, 1388–89.)

Indeed, if Wishnev were correct, then the Legislature exceeded its constitutional authority by enacting the detailed requirements set forth in Insurance Code section 1230 et seq. and by establishing that "[n]o other provision of law shall apply to policy loan interest rates unless made specifically applicable to these rates." (Ins. Code, § 1239.) If the compound interest restriction of section 2 of the 1918 usury initiative were indeed intended to apply to exempt lenders (as Wishnev argues), then Insurance Code section 1239 would amount to an unlawful declaration that the compound interest restriction does not apply to admitted insurers (as such restriction has not been "made specifically applicable to these rates"). Yet courts must presume that the Legislature exercised its authority in a constitutional manner, and statutes are construed to avoid constitutional doubt. (*Dyna-Med, supra*, 43 Cal.3d at p. 1387.)

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policyholders regarding the frequency of rate determinations for variable interest rates]; § 1235 [notice requirements for initial rate charged as well as any increases]; § 1236 [fixing the loan value as the cash surrender value of the policy].)

It is also relevant that the life insurance policy regulations enacted by the Legislature are part of a larger scheme of comprehensive regulation of insurance. The Legislature "enjoy[s] broad authority in regulating the dealings between insurers and their policyholders." (*American Int'l Group, Inc. v. Superior Court* (1991) 234 Cal.App.3d 749, 757 (citing *Cochran v. Paco, Inc.* (5th Cir. 1979) 606 F.2d 460, 463.) The Legislature has thus "enacted comprehensive legislation expressly designed to regulate the business of insurance." (*Ibid.*) Under the circumstances, it is difficult to see how the Legislature, in exempting insurers from the usury law in 1981 and enacting the life insurance policy loan regulations in 1982, could have intended to exempt life insurers from every provision in the usury law except for the one phrase that Wishnev relies on in this lawsuit.

For all of the foregoing reasons, this Court should hold that admitted insurers such as Northwestern Mutual are exempt from the compound interest restriction of section 2 of the 1918 usury initiative.

B. The Signed Life Insurance Agreement, Comprised of the Application and Policy and Delivered to the Borrower Prior to the Taking of Any Policy Loans, Meets the Requirements of Section 2 of the 1918 Usury Initiative.

The first Certified Question is dispositive, obviating any need to reach the Ninth Circuit's second Certified Question. Nevertheless, should the Court decide to reach the second Certified Question, it should hold, consistent with well-settled law, that there has been no violation of the compound interest restriction of section 2 of the 1918 usury initiative ***even if*** this restriction were deemed to apply to exempt insurers such as Northwestern Mutual.

The simple reason is that Wishnev did, in fact, sign an agreement with Northwestern Mutual stating that interest on policy loans would be compounded. He did so when he executed the life insurance contract, which is comprised of both the policy and the application signed by

Wishnev. Notably, except for the District Court's decision, no California state or federal court has ever concluded that an insurer violated the compound interest restriction. And the two other district courts to consider this issue (*Lujan* and *Martin*) have expressly found that the practice of delivering the signed application with the compound interest disclosure in the policy prior to the taking of any policy loans complied with the compound interest restriction.[11]

Here, there is no dispute that Wishnev signed an application for each of his policies. There is also no dispute that the signed application together with the policy constitutes the contract between Wishnev and Northwestern Mutual. The policies themselves expressly state that the attached application and the policy constitute the entire contract. (*Wishnev, supra*, 880 F.3d at p. 499.) Further, it is well established under California law that where the application is attached to or indorsed upon the policy, the application is part of the entire insurance contract. Section 10113 of the Insurance Code specifically codifies this rule of law:

> Every policy of life . . . insurance delivered within this State on or after the first day of January, 1936, by any insurer doing such business within this State shall contain and be deemed to constitute the entire contract between the parties and nothing shall be incorporated therein by reference to any constitution, by-laws, rules, application or other writings, of either of the parties thereto or of any other person, unless the same are indorsed upon or attached to the policy.

This is a long-standing principle of insurance law, and controlling California case law also provides that the policy and application together

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[11] (See *Martin, supra*, 179 F.Supp.3d at p. 957; *Lujan*, 2016 WL 4483870, at *7.) The *Washburn* court did not reach this issue.

constitute the agreement between the insurer and the policyholder. (See *Boyer v. U.S. Fid. & Guar. Co.* (1929) 206 Cal. 273, 276–77 ["The policy and the application therefore constitute the contract."]; see also *Burr v. Equitable Life Ins. Co. of Iowa* (9th Cir. 1936) 84 F.2d 781, 782 [recognizing that the application and policy are "a single insurance contract"]; *New England Mut. Life Ins. Co. v. Lauffer* (S.D.Cal. 1963) 215 F.Supp. 91, 97 ["The insurance policies with the applications attached are construed together as they constitute one contract."]; *Meyer v. Johnson* (1935) 7 Cal.App.2d 604, 609 [noting that the life insurance policies at issue stated that both the policy and attached application "constitute the entire contract," and finding it "apparent, therefore, that the whole application was necessary to constitute the contract. [Citations.]"].)

Nor is there any dispute that the contracts expressly provide for the charging of compound interest. And there is no dispute that Wishnev received the policies with both his signed application and the compound interest disclosure before the policies could accumulate sufficient cash value to allow Wishnev to take out a policy loan. Wishnev does not assert that he lacked either actual or constructive knowledge of the written compound interest disclosure in his life insurance policies prior to taking out a policy loan.

Boiled down, there is no dispute that (i) Wishnev signed the policy applications; (ii) the policy applications are part of Wishnev's integrated agreements with Northwestern Mutual, by operation of law and by the agreements' own terms; (iii) the agreements clearly provide that interest on policy loans will be compounded; and (iv) Wishnev had the integrated agreements with his signature and the compound interest disclosure prior to taking any policy loans. For these reasons, as a matter of law there has been no violation of the compound interest restriction of section 2 of the 1918 usury initiative. The statute requires only that "in the computation of

interest upon any . . . instrument or *agreement,* interest shall not be compounded, nor shall the interest thereon be construed to bear interest unless an *agreement* to that effect is clearly expressed in writing and signed by the party to be charged therewith." (Civ. Code, § 1916-2 (emphasis added).) That requirement has been met.

The District Court cited to, but failed to discuss, either (i) the term of the policies themselves expressly stating that the attached application and the policy constitute the entire contract between the parties, or (ii) Insurance Code section 10113. The District Court also failed to cite this Court's controlling *Boyer* decision or the *Lauffer* decision. The District Court stated that Northwestern Mutual's "reliance on *Burr* is misplaced" (*Wishnev, supra*, 162 F.Supp.3d at p. 948), because the issue in that case was whether a conversion policy constituted a continuation of the original insurance contract, which was comprised of the original term life insurance policy and the application therefor. But that is precisely the point: based on long-established common law, the *Burr* court considered it established that the original policy and application together constituted a contract; the only question was whether the conversion policy constituted a continuation of that contract. Here, Northwestern Mutual seeks nothing more than acknowledgment of the long-established common law applied in *Burr*.

The sole basis for the District Court's decision appears to be that Wishnev did not sign a separate "document" disclosing that compound interest would be charged on any policy loans because Wishnev did not sign the policy itself. (*Wishnev, supra*, 162 F.Supp.3d at p. 949.) This interpretation goes far beyond a plain reading of section 2, which requires only that the borrower sign an "agreement" containing the compound

interest disclosure.[12] Because the relevant agreement—which consists of both the application and the policy—contains the compound interest disclosure and was signed by Wishnev, Northwestern Mutual complied with section 2 of the 1918 usury initiative. The two other district courts to address this issue have reached this same conclusion on similar facts. (See *Lujan, supra*, 2016 WL 4483870, at *7 ["[T]he Initiative does not state, as Plaintiffs contend, that the compound interest language must appear on the 'actual document signed by the borrower.' . . . Rather, the Initiative simply requires an 'agreement' to be signed by the borrower . . . . ***Plaintiffs did sign an agreement when they signed the application*** that comprised the larger agreement for insurance." (emphasis added)]; *Martin, supra*, 179 F.Supp.3d at p. 957 ["***Plaintiffs signed only their applications***, but the policies and Insurance Code provide the application is part of the contract. Accordingly, the agreement clearly disclosed the compounding of interest, and ***plaintiffs gave written consent*** to such charges." (emphasis added)].)

The District Court cited *McConnell II*, but that case is inapposite. There, the contract at issue did not contain *any* disclosure regarding compound interest and instead stated only that "customary" interest would be charged. The defendant therefore had to resort to evidence outside of the contract, including the borrowers' testimony and monthly statements, to

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[12] Of course, it is black letter law that a "contract" constitutes an "agreement." (See Black's Law Dict. (10th ed. 2014) [defining "contract" as "[a]n agreement between two or more parties creating obligations that are enforceable or otherwise recognizable at law" or "[t]he writing that sets forth such an agreement"]; 2 Stephen's Commentaries on the Laws of England (L. Crispin Warmington ed., 21st ed. 1950) 5 ["The term 'agreement,' although frequently used as synonymous with the word 'contract,' is really an expression of greater breadth of meaning and less technicality. Every contract is an agreement; but not every agreement is a contract."]; 1 Williston, A Treatise on the Law of Contracts (Walter H.E. Jaeger ed., 3d ed. 1957) § 2, p. 6 ["An agreement, as the courts have said, 'is nothing more than a manifestation of mutual assent' by two or more parties legally competent persons to one another. Agreement is in some respects a broader term than contract, or even than bargain or promise."].)

try to establish that the parties understood "customary" interest to include compound interest. (*McConnell II, supra*, 33 Cal.3d at p. 820.) This Court considered whether the defendant was permitted to introduce such parol evidence to explain the meaning of the parties' written agreement regarding "customary" interest. It concluded that the parol evidence could not be used, reasoning that the purpose of the signature requirement in section 2 of the 1918 usury initiative was to avoid the uncertainty that would result from relying on extrinsic evidence of what the borrower likely understood rather than a clear written disclosure. (*McConnell II, supra*, 33 Cal.3d at p. 818.)

That purpose is fully served here, as, unlike in *McConnell II*, ***the written compound interest disclosure was undeniably in Wishnev's contract itself***, i.e., in the policy. Further, Wishnev had the entire signed contract, including the written compound interest disclosure, before he took out any policy loans. The policy is not a "subsequent, unsigned disclosure," as Wishnev has argued. Rather, it is part of the written agreement that Wishnev executed by signing the application—which is the method by which a policyholder agrees to *all* of the provisions of a life insurance contract.[13] Wishnev's right to take a policy loan exists only because he previously agreed to the all of the policy's terms and conditions, including the unambiguous disclosure that interest on a policy loan would be compounded.

Both the *Martin* and *Lujan* courts rejected plaintiffs' reliance on *McConnell II* and held that Insurance Code section 10113 as well as case law compelled the conclusion that plaintiffs signed an agreement clearly

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[13] California courts follow the general rule that "the receipt of a policy and its acceptance by the insured without an objection binds the insured as well as the insurer and he cannot thereafter complain that he did not read it or know its terms. It is a duty of the insured to read his policy." (*Mission Viejo Emergency Medical Associates v. Beta Healthcare Group* (2011) 197 Cal.App.4th 1146, 1155 (citations omitted).)

providing for compounding of interest on policy loans. (See *Martin, supra*, 179 F.Supp.3d at pp. 956–57; *Lujan, supra*, 2016 WL 4483870, at *6–7.) If this Court were to reach the second Certified Question, it too should hold that Wishnev signed an agreement containing a compound interest disclosure, and that Northwestern Mutual thus complied with section 2 of the 1918 usury initiative.

C. If this Court Were to Partially Unwind the Exemption from Section 2 of the 1918 Usury Initiative, or Require Changes to Long-Established Procedures for Forming Integrated Insurance Contracts, Retroactive Application of the Ruling Would Disturb Long-Standing, Ubiquitous Business Practices; Any Adverse Ruling Should Therefore Apply Only Prospectively.

Both Certified Questions challenge a well-settled status quo in a heavily regulated industry. Due to the unique nature of policy loans, the life insurance industry was granted an exemption from usury restrictions by the Legislature in 1981, and has been operating under that exemption ever since. And, relying on express statutory authority and consistent case law dating back more than 80 years, insurers have long been forming insurance contracts with policyholders by delivering policies with signed applications from the policyholder attached. Because an adverse decision would disturb settled industry-wide practices and settled law, any such ruling should be made prospective only.

A prospective decision is appropriate where the ruling "changes a settled rule on which the parties below have relied." (*Williams & Fickett v. County of Fresno* (2017) 2 Cal.5th 1258, 1282; see also *Grobeson v. City of Los Angeles* (2010) 190 Cal.App.4th 778, 796 [prospective application appropriate where "the new decision overrules clear past precedent or ***disrupts a practice long accepted and widely relied on***." (footnotes and citation omitted) (emphasis added)].) If the new decision represents a change in settled law or disruption of accepted business practices, courts

consider whether "fairness and public policy" support a departure from the general rule of retroactive application. (*Williams & Fickett, supra*, 2 Cal.5th at p. 1282; see also *People v. Carrera* (1989) 49 Cal.3d 291, 328 ["[I]ndeed, as a former Chief Justice [Traynor] of this court has noted, other policy considerations, such as the need to measure the benefits of a retroactive change against the hardship that might result, counsel against a blanket rule of retroactivity."] (citing Traynor, *Quo Vadis, Prospective Overruling: A Question of Judicial Responsibility* (1977) 28 Hastings L.J. 533, 540–542); *Camper v. Workers' Comp. Appeals Bd.* (1992) 3 Cal.4th 679, 688 ["This rule [of retroactivity], however, is not an absolute one and certain narrow exceptions to the rule have been recognized."].)

Four factors guide analysis of whether the decision should operate only prospectively: (1) "the reasonableness of the parties' reliance on the former rule"; (2) "the nature of the change as substantive or procedural"; (3) "retroactivity's effect on the administration of justice"; and (4) "the purposes to be served by the new rule." (*Williams & Fickett, supra*, 2 Cal.5th at p. 1282; see also *Doe v. San Diego-Imperial Council* (2015) 239 Cal.App.4th 81, 90 ["'[a] court may decline to follow the standard rule when retroactive application of a decision would raise substantial concerns about the effects of the new rule on the general administration of justice, or would unfairly undermine the reasonable reliance of parties on the previously existing state of the law.'" (citation omitted)].) These factors demonstrate that any adverse decision in this case should not apply retroactively.

1. Reasonable Reliance

To recap: A 1979 constitutional amendment authorized the Legislature to expand the classes exempt from the usury law; the Legislature made insurers a class of exempt lenders in 1981; and in 1982 the Legislature enacted within the Insurance Code a comprehensive scheme

regulating in detail the creation and operation of life insurance policy loans. Insurers created application and policy forms based on this regime, filed them with the Department of Insurance, and issued countless policy loans governed by the Legislature's specific requirements. And these forms, and these loans, were made with the customary contract-formation procedures that had been endorsed by settled statutory and case law for over 80 years, i.e., relying on the delivery of the policy along with the attached signed application to create and constitute the entire, integrated agreement. (See *Boyer, supra*, 206 Cal. at pp. 276–77; see also *Grobeson, supra,* 190 Cal.App.4th at p. 796 [the industry's contracting procedure has become a "practice long accepted and widely relied on"]. *Accord Martin, supra*, 179 F.Supp.3d at p. 957.)

There can be no doubt that the entire industry, including Northwestern Mutual, was, at a minimum, reasonable in relying upon an apparently valid constitutional amendment, apparently valid comprehensive legislation, the use of forms authorized by the Department of Insurance for more than three decades, and a method of contracting authorized by statute and well-established case law. If this Court were to now decide the law requires otherwise, it would significantly disrupt industry-wide practices that have been reasonably followed for decades. As the Ninth Circuit observed in its Order Certifying Question, a ruling in Wishnev's favor would require an "overhaul of insurers' business processes." (*Wishnev, supra*, 880 F.3d at p. 503.)

That the industry has reasonably relied on existing law and practice for an extended period is a compelling reason to limit the decision to prospective application, as consistent precedent finds such reliance deserving of great weight. (See, e.g., *Williams & Fickett, supra*, 2 Cal.5th at pp. 1265, 1282; *Camper, supra*, 3 Cal.4th at p. 688; *Newman v. Emerson Radio Corp.* (1989) 48 Cal.3d 973, 989.)

2. Procedural Change

Prospective application of a decision may be appropriate when the ruling "is essentially a procedural one." (*Camper, supra*, 3 Cal.4th at pp. 689-90.) That aptly describes the ruling Wishnev seeks.

A ruling that current practices are subject to, and insufficient under, section 2 of the 1918 usury initiative would require a core procedural change across the entire insurance industry, namely, the addition of a second signature on the policy itself or on a separate document containing a (redundant) compound interest disclosure. If required, such changes would not alter the substance of the combined insurance contract, just re-arrange how the disclosures are made and require additional paperwork. Such change is fairly characterized as procedural in nature.

Adding to the procedural character, any remedial changes required of insurers could not be self-executing. Rather, new forms to address mandated changes would require a further *procedure*—they would have to be filed with the California Department of Insurance before they could be implemented as to policy owners, and they would be subject to the Department's review. (See Ins. Code, § 10163.35(a).)

The procedural character of the changes that any adverse ruling would require further suggests the wisdom of prospective application.

3. Administration of Justice

A ruling may be made prospective-only where retroactive application "would raise substantial concerns about the effects of the new rule on the general administration of justice." (*Williams & Fickett, supra*, 2 Cal.5th at p. 1282.)

Retroactive application of an adverse ruling here would potentially disturb the settled rights and obligations governing countless policy loans dating back decades. Adjusting these rights and obligations by fashioning a

retrospective remedy would be problematic not only for the insurers who reasonably relied on existing law, but also for the Department of Insurance, and ultimately, the courts.

Retroactive application would pose substantial new burdens on business and the administration of justice, which supports a prospective ruling.

4. Purpose of the New Rule

A rule ultimately requiring a separate signed policy or separate signed disclosure would presumably be based on the interest in giving policyholders advance notice that any policy loan will be subject to compound interest. The existing procedure for providing notice and contracting already does that. Though the change urged by Wishnev would impose substantial procedural burdens, it would offer no practical enhancement in notice to policyholders. Indeed, the *Lujan* court found that the purpose of section 2 of the 1918 usury initiative is ***already*** served when life insurance contracts are formed in compliance with Insurance Code section 10113. (See *Lujan, supra*, 2016 WL 4483870, at *7 [noting usury law's purpose is "to protect the necessitous, impecunious borrower who is unable to acquire credit from usual sources and is forced by his economic circumstances to resort to excessively costly funds to meet his financial needs", and finding that insurance policies with attached, signed applications "complied with the Initiative and its purpose"; "To hold otherwise would threaten a responsible source of credit for the very 'necessitous, impecunious borrower' the law seeks to protect."].) Accordingly, prospective-only application of any change would not impair public policy.

Under existing practice, the policyholder is provided notice of compound interest when he is presented with the integrated application for life insurance and insurance policy at the inception of insurance

coverage. The notice is provided to the policyholder when he receives the policy with the signed application attached, which is expressly made part of the contract. Further, because of how policy loans work, a policy loan can only be taken ***after*** the policy owner has been notified of the compound interest disclosure; the integrated agreement containing the compound interest disclosure is in the hands of the policy owner; and the policy contract becomes effective. Any new and additional signature requirement—if applied retroactively—would essentially be redundant, merely re-serving the same purpose of ensuring there has indeed been advance notice and agreement to the compounding of interest.

Thus, the underlying purpose behind the disclosure requirement is already satisfied under existing practices, prospective-only application would not impair public policy, and there is no compelling need to apply any new requirements for obtaining additional signatures retroactively. (See *Camper, supra*, 3 Cal.4th at p. 689 [issuing prospective decision where purposes of the new rule were "not compromised by prospective application"].)

In sum, public policy supports limiting any adverse ruling to prospective application. Life insurers in this State have reasonably relied for decades on the Legislature's decision to exempt them from section 2 of the 1918 usury initiative, and on the normal, established course of contracting to alert policyholders to the compound interest to be charged on policy loans. A change would be essentially procedural and would not advance the purpose of providing notice; prospective-only application would not compromise any significant public interest; and any possible benefits of retroactivity are outweighed by the administrative and transactional burdens associated with retroactive application.

V.

CONCLUSION

For the foregoing reasons, this Court should answer the Certified Questions in favor of Northwestern Mutual. If it declines to do so, it should provide for any remedies to apply prospectively only.

Dated: June 12, 2018

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CERTIFICATE OF COMPLIANCE

The undersigned hereby certifies that the text of Petitioner's Opening Brief contains 11,818 words as counted by Microsoft Word.

Dated: June 12, 2018

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PROOF OF SERVICE

I, Sylvia Lee, declare that:

I am at least 18 years of age, and not a party to the above-entitled action. My business address is 50 Fremont Street, 20th Floor, San Francisco, California 94105, Telephone: (415) 591-7500. On June 12, 2018, I caused to be served the following document(s):

PETITIONER'S OPENING BRIEF

by enclosing a true copy of (each of) said document(s) in (an) envelope(s), addressed as follows:

☑ **BY MAIL**: I am readily familiar with the business' practice for collection and processing of correspondence for mailing with the United States Postal Service. I know that the correspondence is deposited with the United States Postal Service on the same day this declaration was executed in the ordinary course of business. I know that the envelope was sealed, and with postage thereon fully prepaid, placed for collection and mailing on this date, following ordinary business practices, in the United States mail at San Francisco, California.

☐ **BY PERSONAL SERVICE:** I caused such envelopes to be delivered by a messenger service by hand to the address(es) listed below;

☐ **BY E-MAIL:** I caused such documents to be transmitted by e-mail to the following e-mail addresses as set forth below.

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I declare under penalty of perjury under the laws of the State of California that the above is true and correct. Executed on June 12, 2018 at San Francisco, California.

Sylvia Lee