Case No. S246541

IN THE SUPREME COURT OF THE STATE OF CALIFORNIA

THE NORTHWESTERN MUTUAL LIFE INSURANCE COMPANY,
Defendant and Petitioner,

vs.

SANFORD J. WISHNEV
Plaintiff and Respondent

After Order Certifying Question to the California Supreme Court by the U.S. Court of Appeals, Ninth Circuit, Case No. 16-16037, on Appeal from the U.S. District Court, Northern District of California, Hon. Edward M. Chen, Judge Presiding, Case No. 3:15-cv-03797-EMC

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

ANSWER BRIEF

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Table of Contents

TABLE OF AUTHORITIES

Page(s)

CASES

STATUTES

SUMMARY OF ARGUMENT

This case requires resolution of two legal questions referred from the Ninth Circuit:

> 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"? [1]
>
> 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?

This Court should answer the first question "yes" and the second question "no."

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[1] The voter initiative at issue in this case was passed in 1918 and enrolled as Stats. 1919, p. lxxxiii, but never officially codified. *Ghirardo v. Antonioli* (1994) 8 Cal.4th 791, 798 n. 2. The two major legal publishers have given different unofficial designations. Deerings designates the initiative as "Deering's Uncod. Initiative Measures & Stats., 1919-1". *Id.* West Publishing has designated the measure as "Civil Code Sections 1916-1 through 1916-5". The Ninth Circuit utilized the West's unofficial designation in framing its questions, but the term "the Initiative" in the body of its opinion. *Wishnev v. Nw. Mut. Life Ins. Co.* (9th Cir. 2018) 880 F.3d 493, 494. This brief uses the latter term.

Question 1:

The Initiative requires that lenders wishing to charge compound interest first obtain the borrower's signature on a clear written disclosure of that intent (hereafter the "disclosure/consent" requirement). The same Initiative also imposed interest rate caps on all loans in California, although those caps are no longer in effect.

California voters thereafter enacted two Constitutional Amendments which expressly exempted certain classes of lenders, ultimately including insurance companies, from the otherwise-applicable interest rate caps. Neither Amendment mentions the Initiative's disclosure/consent requirement. This Court should reject NWM's argument that the disclosure/consent requirement was partially repealed by implication as to the lenders designated as exempt from the Amendments' interest rate caps.

1. The most reasonable reading of the Constitutional language now codified as Cal. Const, Art. XV – certainly, one reasonable reading – is that exempt lenders remain bound by the Initiative's disclosure and consent requirement before compounding interest.

a. The scope of exemption is expressly stated in Article XV and does not embrace the Initiative's procedural disclosure/consent requirement.

b. Repeals by implication are disfavored. The vitality of the Initiative must be maintained to the fullest extent reasonably possible when construing the later Constitutional Amendment. Since the Initiative requirement is a remedial measure, it should be construed broadly.

c. Requiring exempt lenders to comply with the disclosure/consent requirement would not interfere with the Amendments' grant of authority to the Legislature to regulate such lenders even if compounding of interest is squarely within that grant. The two enactments can be harmonized.

d. In any event, a reasonable reading of the Amendment's express grant of authority to the Legislature does not include the question of compounding of interest.

2. The legislative history of Article XV and its predecessor, and the applicable case law support the continued vitality of the Initiative's compound interest provisions as to all lenders, to the limited extent that guidance can be gleaned therefrom.

Question 2:

The Initiative's express requirement of disclosure in a document signed by the borrower was not met by NWM's subsequent delivery to Wishnev of a never-signed policy. NWM argues that an unsigned document provided after Wishnev signed his application met

the requirement because, as a matter of contract law, both documents comprised the parties' insurance contract. But this argument ignores clear statements by this Court that a lender violates the Initiative "by failing to clearly express in a writing signed by its customers that compound interest would be charged" and that "the provision for compounding must be in writing and signed by the borrower." As, indisputably, no writing disclosing the intention to compound interest was signed by Wishnev, NWM's argument fails.

The issues presented require judicial clarification of the scope of the Initiative's application and the circumstances in which its requirements are met. The Court's resolution of these legal question will not alter settled law, as they have not been previously addressed by the Court. Therefore, as with the vast majority of judicial decisions, especially ones involving interpretation of existing laws, the Court's ruling on the above two issues will apply retrospectively. NWM's arguments otherwise are unmeritorious.

STATEMENT OF THE CASE

Factual Allegations of the Complaint

Certain life insurance policies sold by The Northwestern Mutual Life Insurance Company ("NWM") provide that the policyholder is permitted to borrow amounts from NWM. NWM charges interest, compounded annually, on any such loan balances. (ER 163-164.)[2]

Plaintiff Sanford Wishnev owns four life insurance policies issued by NWM between 1967 and 1976. Plaintiff's policies allow him to take out loans using the policy's cash basis as collateral under certain circumstances. (ER 165.)

For each policy, Wishnev signed an insurance application form provided by NWM. Those applications did not say anything about compound interest. Subsequently, after each insurance contract was already in effect, NWM provided a policy to Wishnev, that disclosed that compound interest would accrue on any unpaid interest. But NWM did not ask Wishnev to sign the policy form, nor did he ever do so. Wishnev has never signed *any* written document disclosing an

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2 "ER" refers to the "Excerpt of Record" filed in the Ninth Circuit accompanying NWM's Opening Brief in that court on 10/19/2016.

intent to charge compound interest or authorizing NWM to do so. (*Id.* at 165-166.)

After 1980, NWM extended loans to Plaintiff for each of his policies. NWM subsequently assessed Plaintiff compound interest charges on those loans. (*Id.*)

Legal Claims Asserted

The Initiative, passed by California voters in 1918, prohibits the charging of compound interest on any loan unless the intention to do is disclosed in writing and signed by the borrower:

> [I]n 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 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....

Initiative, §2.

Based upon his allegations that NWM charged him compound interest without obtaining his signature on a document disclosing such intent, Wishnev asserted four claims, individually and on behalf of a putative class: (1) Declaratory Relief; (2) Unfair Competition Law (Cal. Bus. & Prof. Code §17200 *et seq.*); (3) Relief under the Initiative

itself; and (4) For Money Had and Received and Unjust Enrichment. (ER 168-172.)

Procedural History

Plaintiff filed his complaint in Contra Costa Superior Court in July 2015. NWM removed the case to the Northern District of California on August 19, 2016. NWM's motion to dismiss Plaintiff's First Amended Complaint was denied, per Judge Edward Chen, on February 9, 2016. (ER 1.) On interlocutory appeal to the Ninth Circuit Court of Appeals, that court issued an order, pursuant to California Rule of Court 8.548, requesting that this Court answer two unresolved questions of California law, which this Court accepted on March 14, 2018.

ARGUMENT

I. THE INITIATIVE'S REQUIREMENT OF A SIGNED DISCLOSURE BEFORE CHARGING COMPOUND INTEREST APPLIED TO THE LOANS EXTENDED BY NWM

In 1918, the people of California enacted a clear and simple procedural requirement that, before charging compound interest to borrowers, authorization must be "clearly expressed in writing and signed by the party to be charged therewith." Initiative, §2. "Compliance with these clear requisites does not impose an onerous

burden." *McConnell v. Merrill Lynch, Pierce, Fenner & Smith, Inc.* (1978) 21 Cal.3d 365, 381 ("*McConnell I*").

Subsequent Constitutional Amendments expressly provided that certain lenders are exempted from otherwise applicable interest rate caps. The Initiative's disclosure/consent requirement unquestionably survived these Amendments as a general matter.[3] But no appellate precedent addresses the question whether "exempt" lenders are or are not relieved from complying with that requirement.

A. The History of California's "Usury Law"

1. The Initiative

The Initiative provided as follows:

- Section 1 set the default maximum rate of interest at 7%, but authorized rates up to 12% by written contract;

- Section 2 capped the maximum allowable interest rate for any loan under any circumstances at 12%. In addition, that section also prohibited compounding of interest unless authorization to do so "is clearly expressed in writing and signed by the party to be charged therewith". Finally, this section declared that any agreement to pay interest in violation of its provisions is void and, in such a case, no interest is collectible;

- Section 3 authorized the recovery of treble the amount of any interest paid in violation of sections 1 or 2 within one year of suit.

Penziner v. W. Am. Fin. Co. (1937) 10 Cal.2d 160, 171-172.

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[3] *McConnell I, supra*, 21 Cal.3d 365.

2. The 1934 Constitutional Amendment – Art. XX, Sect. 22

The inflexibility of the Initiative's interest rate caps and the practical difficulty in preventing circumvention through added lender charges caused significant dissatisfaction. *Carter v. Seaboard Fin. Co.* (1949) 33 Cal.2d 564, 576-577:

> After the adoption of the usury law and during its operation the Legislature undoubtedly recognized the inadequacy, from a business and economic standpoint, of the fixed rate of 12 per cent per annum as applied to small loans and likewise concluded that the initiative measure was inadequate in that it did not prevent charges in addition to the interest which might be exacted from the borrower.

After early attempts to modify the Initiative's provisions were rejected as unconstitutional Legislative alterations to a voter initiative (*id.*at 577*; see* Cal. Const., Art. II, §10(c)), the Legislature proposed a Constitutional Amendment to address the Initiative's perceived inadequacies. This Amendment was adopted in 1934 as Cal. Const., Art. XX, §22. *Carter*, 33 Cal.2d at 577.

Paragraph 1 of Art. XX, sect. 22 modified the Initiative's maximum permissible rate of interest, reducing it from 12% to 10%.

Paragraph 2 prohibited the charging of "any fee, bonus, commission, discount or other compensation" which would result in

receipt of payments exceeding the 10% interest rate cap. As the Court has noted: "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. **The many other provisions of section 2 of the usury law find no counterpart in the constitutional amendment.**" *Penziner*, 10 Cal.2d at 172 (emphasis added). One of those "other provisions" is the Initiative's disclosure/consent requirement before charging compound interest. Notably, Art. XX, §22 made no mention of compound interest nor did it explicitly address the Initiative's disclosure/consent requirement.

Paragraph 3 provided that "none of the above restrictions shall apply" to certain classes of lenders specified therein. It also provided that the Legislature could specify the maximum rates of interest to be charged by these exempt classes of lenders and regulate the "fees, bonuses, commissions, discounts or other compensation" charged or received by exempt lenders in connection with any loan. *Id.* at 172-173.

Paragraph 4 contained "a limited repealing clause" (*Penziner,* at 176): "The provisions of this section shall supersede all provisions of this Constitution and laws enacted thereunder in conflict therewith."

As explained below, the Court held that the provisions of the Initiative remain in full force except to the extent that they are "irreconcilable, clearly repugnant, and so inconsistent" with the Constitutional requirements that the two cannot have concurrent operation. *Id.*

3. The 1979 Constitutional Amendment – Art. XV

In 1979, former Art. XX, sect. 22 (which had been re-numbered to Art. XV in 1976) was amended to its present form. Only one modification to the former language is relevant to any issue here: the phrase "or any other class of persons authorized by statute" was added to the list of exempt classes of lenders in paragraph 3.

In 1981, Cal. Insurance Code §1100.1 designated "admitted incorporated insurer[s]" as such an exempt class and specified that "the restrictions upon rates of interest contained in ... Article XV" shall not apply to such insurers.

B. Article XV Can Reasonably Be Read Such That Exempt Lenders Remain Bound By the Initiative's Disclosure/Consent Requirement Before Compounding Interest

1. The Language of Article XV Can Be Harmonized With the Initiative's Disclosure/Consent Requirement

Under familiar rules of statutory construction, the Initiative's disclosure/consent requirement retain its validity as to lenders exempt from the interest rate caps if any reasonable interpretation of the wording of Art. XV permits that result. As this Court said in addressing these identical provisions:

> Section 22 only repeals or supersedes 'all provisions of this Constitution and laws enacted thereunder in conflict therewith.' Such clauses have uniformly been held to repeal or supersede only those portions of prior acts repugnant to the later act. It must be presumed that the Legislature in proposing and the electorate in adopting the constitutional amendment acted with full knowledge of the existence of the prior statute relating to the same general subject. Such a limited repealing clause expresses indirectly the intent that nonconflicting prior statutes shall remain in force. ...
>
> The presumption is against repeals by implication, especially where the prior act has been generally understood and acted upon. To overcome the presumption the two acts must be irreconcilable, clearly repugnant, and so inconsistent that the two cannot have concurrent operation. The courts are bound, if possible, to maintain the integrity of both statutes if the two may stand together.

> Where a modification will suffice, a repeal will not be presumed. [Citations.]

Penziner at 176. *See also, Citizens Ass'n of Sunset Beach v. Orange Cty. Local Agency Formation Comm'n* (2012) 209 Cal.App.4th 1182 at 1192 ("[C]ourts are required to try to harmonize constitutional language with that of existing statutes if possible.").[4]

Furthermore, the Initiative's disclosure/consent requirement before compounding interest is remedial in nature, intended to protect unwary borrowers from being charged such interest. *McConnell v. Merrill Lynch, Pierce, Fenner & Smith, Inc.* (1983) 33 Cal.3d 816,

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[4] *Penziner's* summary of the presumption against implied repeals remains as valid today as when stated in 1937:

> There is a strong presumption against repeal by implication. (*People v. Park* (2013) 56 Cal.4th 782, 798, 156 Cal.Rptr.3d 307, 299 P.3d 1263.) "'Absent an express declaration of legislative intent, we will find an implied repeal "only when there is no rational basis for harmonizing the two potentially conflicting statutes [citation], and the statutes are 'irreconcilable, clearly repugnant, and so inconsistent that the two cannot have concurrent operation.'" [Citation.]' [Citation.]" (*Merrill v. Navegar, Inc.* (2001) 26 Cal.4th 465, 487, 110 Cal.Rptr.2d 370, 28 P.3d 116.) "Courts have also noted that implied repeal should not be found unless '... the later provision gives undebatable evidence of an intent to supersede the earlier....' [Citation.]" (*Western Oil & Gas Assn. v. Monterey Bay Unified Air Pollution Control Dist.* (1989) 49 Cal.3d 408, 420, 261 Cal.Rptr. 384, 777 P.2d 157.)

Tuolumne Jobs & Small Bus. All. v. Superior Court (2014), 59 Cal.4th 1029, 1039. *See also, id.* at 1035 ("In light of the initiative power's significance in our democracy, courts have a duty 'to jealously guard this right of the people' and must preserve the use of an initiative if doubts can be reasonably resolved in its favor.").

823 ("*McConnell II*").[5] Therefore, it is to be construed broadly in favor of maximum protection for the intended beneficiaries, in this case, borrowers. *State Dep't of Pub. Health v. Superior Court* (2015) 60 Cal.4th 940, 9511 ("a remedial statute ... is to be liberally construed on behalf of the class of persons it is designed to protect"); *McLean v. State* (2016) 1 Cal.5th 615, 622 (same).

Taken together, these rules of construction militate in favor of finding, if reasonably possible, that the Initiative's disclosure/consent applies to "exempt" lenders, (a) to preserve the integrity of the Initiative to the maximum extent possible and not clearly repugnant to the later enactment, and (b) to maximize protection to borrowers. Thus, the relevant inquiry here should not be focused on seeking to identify the single *most* reasonable construction of Art. XV. Rather, the pertinent question is whether *any* reasonable construction of Art. XV exists under which the Initiative's disclosure/consent requirement remains applicable to "exempt" lenders. If so, the Court should adopt that construction.

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5 "This conclusion [strictly enforcing the requirements of Section 2] not only safeguards the interests of the borrower, which is an important objective of section 2, but it also furthers the remedial purposes of the section." *McConnell II*, 33 Cal.3d at 823.

The result advocated by NWM is inconsistent with these rules of construction – rules which NWM does not even acknowledge.

As shown below, there is nothing unreasonable or inconsistent in construing Art. XV to allow enforcement of *both* the Initiative's procedural requirement of disclosure/consent and the Legislature's authority over loan-related rates and charges by exempt lenders. Indeed, Wishnev submits that this is the *best* construction of the provisions at issue. Regardless, certainly it is *one* reasonable construction and therefore should be adopted.

2. Art XV's Exemption Language Is Narrow In Scope

Article XV, paragraph 3, expressly states precisely *what* exempt lenders are exempt from: "However, **none of the above restrictions shall apply** to any obligations of, loans made by, or forbearances of, any … other class of persons authorized by statute…" (Emphasis added.)

What are those "above restrictions?" Paragraph 1 of Art. XV solely addresses maximum interest rates. Paragraph 2 provides: "No person, association, copartnership or corporation 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 or forbearance of any money, goods or things in action." Thus, Paragraph 2 enforces the maximum interest rates in Paragraph 1.

The phrase "none of the above restrictions" in this context is clear and unambiguous. "The above restrictions" require only that (a) loans carry interest rates at or below the specified maximums and (b) certain loan-related charges be counted in complying with those rate limits. It is simply impossible to read into this language an express exemption from the Initiative's disclosure/consent requirement. NWM does not even proffer any argument to the contrary.

Instead, NWM argues that the Initiative's disclosure/consent requirement was repealed by implication as to exempt lenders based upon the final sentence of the third paragraph of Art. XV. We turn next to that argument.

3. The Court Should Reject NWM's Argument That the Initiative's Disclosure/Consent Requirement Was Repealed By Implication

The final sentence of Art. XV's third paragraph states:

> 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.

NWM contends that there is an irreconcilable conflict between this language and the Initiative's disclosure/consent requirement and therefore that the Initiative was repealed by implication. For two alternative reasons, this contention is not meritorious.

First, as explained in the next section, there is no irreconcilable conflict between the Initiative's requirement and the Legislature's authority to substantively regulate exempt entities' loans even if the subject of compounding of interest falls within the scope of Art. XV's express statement of that authority.

Second, though the Court need not reach the question if it agrees with Wishnev on the first point, a fair reading of the language of the final sentence of Art. XV's third paragraph is that it does not embrace the question of compounding.

Preliminarily, it should be emphasized that the voters, when they adopted the Constitutional language at issue, included only "a limited repealing clause," repealing only those earlier enactments which stood in direct conflict with the later provisions. *Penziner,* at

176 (to find implied repeal "the two acts must be irreconcilable, clearly repugnant, and so inconsistent that the two cannot have concurrent operation."). As noted above, in such situations, courts seek to harmonize the enactments, giving maximum continuing effect to each whenever possible.

Similarly, the Court should be particularly reluctant to accept NWM's implied repeal argument because the voters included an explicit exemption provision in the Constitutional enactment itself – an exemption focused only on interest rate caps. It is undisputed that the purpose of the Constitutional Amendment in 1934 was to address perceived deficiencies in some of the Initiative's provisions. *Carter, supra*, 33 Cal.2d at 577. The Amendment expressly alters the treatment of certain lenders insofar as interest rate caps are concerned. Yet it is completely silent regarding the Initiative's disclosure/consent requirement. [6]

NWM thus faces a particularly heavy burden in persuading this Court that the voters intended to repeal the Initiative's disclosure and

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[6] The exemption language could easily have been phrased: "However, none of the above restrictions, nor any provisions of the Initiative, shall apply…[to exempt lenders]."

consent requirement as to exempt lenders *sub silentio*. Only the clearest showing of direct and irreconcilable conflict should suffice. NWM has failed to make such a showing. Indeed, as explained below, the pertinent provisions of the Initiative and Article XV can be harmonized, giving continued effect to the Initiative's provision as to lenders expressly exempted from the interest rate limitations without conflicting with the Legislature's authority over those same lenders.

a. *Assuming Arguendo That Compound Interest Is Embraced Within the List of Charges Expressly Subject to Regulation by the Legislature, the Initiative's Disclosure and Consent Requirement Is Consistent with Such Regulation*

There are strong reasons, explained below, to conclude that compounding of interest is not among the charges which Art. XV expressly lists as under the control of the Legislature. However, even if Art. XV were construed to imbue the Legislature with exclusive authority over compounding of interest by exempt lenders as a substantive matter, application of the disclosure/consent requirement can be harmonized with that construction.

The Initiative does not purport to affirmatively *authorize* (let alone to mandate) the compounding of interest under any

circumstances, nor does the compound interest portion of the Initiative require or forbid any particular rate of interest or total amounts of loan charges. Instead, the Initiative merely imposes a procedural threshold of disclosure and consent before a particular loan agreement will be deemed to allow compounding of interest as a matter of contract.[7]

Therefore, applying the Initiative's requirement to loans by exempt entities still leaves the Legislature with the unfettered authority to substantively regulate those loans: The Legislature retains full authority to prohibit compounding by an exempt lender altogether if it so chooses -- compliance with the Initiative gives no immunity to such a Legislative ban. Similarly, the Legislature can limit the frequency of compounding by such a lender, or allow compounding but reduce the interest rate cap if the lender does so, or require additional disclosures or consent mechanisms before compounding.

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[7] NWM suggests that the Initiative's requirement should be viewed as "substantive," not "procedural," because failure to comply prevents the charging or collection of compounded interest (POB at 31), though NWM itself later urges the opposite when it suits its purposes. (*Id.* at 48.) Of course, failure to comply with procedural requirements can result in forfeiture of rights otherwise available. *E.g., People v. Shirokow* (1980) 26 Cal.3d 301, 304 (failure to comply with Water Code procedures results in loss of water rights). In any event, the characterization of the Initiative's requirement as "procedural" or "substantive" is of little importance to the outcome of this case.

There is nothing unreasonable about this harmonization of the two enactments. Both can be given effect. The Initiative is not irreconcilable with Art. XV, even if a broad view of the final sentence of the provision's third paragraph were to be adopted.

NWM crafts an opposing argument only through misrepresentation of the result of a ruling against it, listing a parade of horribles that it contends would follow. NWM states:

> 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.

(POB at 31.) And:

> 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.

(POB at 32.) And:

> 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.

(POB at 34.)

These assertions are simply wrong and depend upon inaccurate assumptions about the results of a ruling that the Initiative's disclosure/consent requirement applies to exempt entities' loans. The Initiative does not "allow[] a lender to charge compound interest if a written agreement is signed by the borrower" (POB at 31); it *prohibits* a lender from charging compound interest if it fails to obtain that written consent. The requirement is a necessary hurdle; it is not sufficient authorization. Thus, application of the Initiative's disclosure/consent requirement to loans by all lenders would *not* impair the Legislature's authority to prohibit exempt lenders from compounding interest.

For the same reason, a ruling against NWM here would not prevent the Legislature from "requir[ing] exempt lenders to provide annual or other periodic disclosures if unsigned by the borrower, or otherwise to regulate the charging of compound interest." (POB at 32.) To the contrary, the Legislature will remain free to require any additional disclosures (signed or unsigned) as it sees fit and to regulate in whatever way is deemed appropriate, including limiting

the maximum interest rate to reflect the impact of compounding if the Legislature desires to do so.[8]

b. *Compounding of Interest is a Method of Calculation and Does Not Fairly Fall Within the Phrase "fee, bonus, commission, discount or other compensation" as Used in Article XV*

For the reasons stated immediately above, this Court need not reach the question whether compounding of interest falls within the items specifically enumerated within the final sentence of Art. XV's third paragraph, as to which the Legislature has been granted explicit authority to regulate. The Initiative's disclosure and consent

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[8] NWM states that "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." (POB at 33.) NWM cites Federal District Court decisions so noting. (*Id.* at 33-34.) However, those District Courts, like NWM, misstate the result of applying the Initiative's disclosure/consent requirement to exempt lenders. The Initiative's provision does not act as an affirmative grant of authority to charge compound interest. The Legislature's authority to prohibit or limit such charges is unaffected.

Moreover, NWM's argument confuses the question of the authority expressly granted to the Legislature *through Art. XV* with its more general authority to enact Legislation regulating a wide variety of commercial activities, including financial transactions. So long as it does not act in contravention of a voter-enacted initiative or constitutional provision, the Legislature has plenary power to regulate reasonably in furtherance of the public interest. *Cf. California Bldg. Indus. Assn. v. City of San Jose* (2015) 61 Cal.4th 435, 463-464 ("price controls, like other forms of regulation, are, as a general matter, a constitutionally permissible means to achieve a municipality's legitimate public purposes."); *Calfarm Ins. Co. v. Deukmejian* (1989) 48 Cal.3d 805, 816 (same, as to insurance regulation).

requirement can be harmonized with Art. XV even assuming *arguendo* that Art. XV's language does embrace compounding.

However, if the Court reaches the issue, it should find that the best reading of the language does not encompass compounding, particularly in light of the mandate to identify a harmonizing construction if possible. That conclusion would offer an additional, alternative ground for rejecting NWM's contention of an irreconcilable conflict between the two enactments.

The final sentence of the third paragraph of Art. XV covers two categories: First, it authorizes the Legislature to "prescribe the maximum rate per annum" for loans issued by exempt entities. Second, it authorizes the Legislature to "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" on exempt lenders' loans.

There is certainly no irreconcilable conflict between the Initiative's disclosure/consent requirement and the Legislature's power to set "maximum rate[s] per annum." The two are clearly different. The Initiative's requirement is completely independent of the rate of interest which applies to a loan. It does not limit in any

way the Legislature's power to set any maximum rate it wishes, including if desired, a lower maximum rate where compounding is intended than otherwise applicable.[9]

Nor is there any direct conflict insofar as Art. XV gives the Legislature authority to "in any manner fix, regulate or limit, the fees, bonuses, commissions, discounts or other compensation" on exempt entities' loans. Compounding of interest – which is a method of calculating interest – is indisputably not a loan-related "fee, bonus, commission or discount."[10] The only question, then, is whether the

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[9] To avoid this conclusion, NWM repeatedly mischaracterizes Art. XV, pretending that the language imbues the Legislature with the authority "in any manner" to regulate the interest charged or collected on exempt entities' loans. (POB at 23, 26, 27 and 32.) But the "in any manner" phrase applies only to the fixing, regulating or limiting of the specified list of charges appearing thereafter, i.e. "fees, bonuses, commissions, discounts or other compensation", not to the authority over "interest" which is stated simply as "prescribe[ing] the maximum rate per annum."

From this false premise, NWM argues that, if compounding of interest might impact or be counted in calculating total interest collected, the Initiative's provision should be deemed to conflict with Art. XV. (POB at 27-30.) The falsity of NWM's premise undermines its desired conclusion. *People v. Dominguez* (2006) 39 Cal.4th 1141, 1154 ("We reject defendant's simple syllogism because its premise fails.").

[10] NWM inaccurately asserts that this Court "likened" compounding of interest to a "bonus" in *Lewis v. Pac. States Sav. & Loan Co.* (1934) 1 Cal.2d 691, 695-96. (POB at 29.) A review of that case demonstrates nothing of the sort.

In *Lewis*, the trial court ruled that certain loan-related charges had been improperly assigned to principal rather than interest. In recalculating the amount due from plaintiffs on the loan, the trial court deducted the

final term "other compensation" should be read broadly to cover any loan-related compensation received by a lender including compounded interest. That reading should be rejected.

Construing the term "other compensation" to mean literally any amount received that is loan-related, as NWM urges, would be contrary to the principle of *ejusdem generis*. A broad term appended to a list of more specific terms must be read *narrowly* to mean only items similar to those specifically enumerated. "[W]hen 'specific words follow general words in a statute or vice versa,' the general words ordinarily are best construed in a manner that underscores their similarity to the specific words." *California Cannabis Coal. v. City of Upland* (2017) 3 Cal.5th 924, 939.

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improper charges and the interest attributable to them from the principal balance. *Lewis*, 1 Cal.2d at 694. Unsatisfied, the plaintiffs appealed, arguing that the charging of interest on the disallowed items prior to the trial court's ruling should be viewed as compound interest obtained without consent, entitling plaintiffs to recover treble the amount of those charges. *Id.*

This Court rejected that claim, holding that the proper approach was to compare the total amount of interest collected to the maximum amount legally permitted, with a usury violation only if the former exceeded the latter. In doing so, the Court discussed and followed a Minnesota case. The Minnesota case involved a loan "bonus" which was improperly assigned to principal rather than interest. This Court cited that case for the rule as to how to treat improperly assigned charges, not because that case involved a "bonus." *Id.* at 695-696. In no way, can *Lewis* properly be understood as equating compound interest to loan bonuses.

The reasoning underlying the *ejusdem generis* principle is directly applicable here: If the words "other compensation" cover all loan-related receipts of any kind, then the prior terms serve no purpose. *Harris v. Capital Growth Inv'rs XIV* (1991) 52 Cal.3d 1142, 1160, *superseded by statute on other grounds* ("if the [writer] had intended the general words to be used in their unrestricted sense, [he or she] would not have mentioned the particular things or classes of things which would in that event become mere surplusage." [citation omitted]); *People v. Rodriguez* (2012) 55 Cal.4th 1125, 1133 ("We give significance to every word in the statute actually enacted to implement the legislative purpose and avoid a construction that makes some words surplusage."). Thus, the Court should limit the meaning of the term "other compensation" to unlisted items of a similar nature to those explicitly listed.

The express terms used by the voters in passing Art. XV consist of loan charges (and discounts), not methods of calculating interest and certainly not procedures for ensuring consent to a loan attribute. Indeed, the very same sentence of Art. XV containing the list of charges treats "interest" separately from those charges, expressly

describing the Legislature's power being granted as only to set "maximum rate[s] per annum."

Art. XV's grant of authority to the Legislature to regulate "fees, bonuses, commissions, discounts or other compensation" received by exempt lenders should not be understood to include the compounding of interest, in light of the absence of any direct reference to that topic. A perfectly reasonable reading of Art. XV limits "other compensation" to *charges*, not interest computations, thus avoiding an unnecessary conflict with the Initiative's disclosure/consent requirement.

4. The Ballot Materials For The Constitutional Amendments Do Not Demonstrate Any Intention To Alter The Disclosure/Consent Requirement For Charging Compound Interest

The ballot materials leading to enactment of Article XX, §22 in 1934 are devoid of any reference to compound interest or any indication of an intent to eliminate or modify the disclosure/consent requirement of the Initiative. (Supp. E.R. 12-13[11].) Indeed, rather than proposing any argument for reducing the Initiative's consumer protections, the argument for passage of Article XX, §22 (no

[11] Supplemental Excerpts of Record, filed with the Ninth Circuit accompanying Wishnev's Answering Brief in that court on 12/16/2016.

argument in opposition was submitted), emphasized the need for better protection to borrowers from excessive interest charges.

> [The Initiative's] purpose has not been fulfilled. The loan shark still prospers and collects interest grossly in excess of the specified legal rate. Interest disguised as "charges" is currently exacted at rates that range as high as *eighteen hundred percent* per annum. The brazenness of the rapacious money lender is astounding; his ruthlessness is boundless.

(Supp. E.R. 12.) The argument continued:

> ...The financial distress of millions has sharpened the greed of the money leader, until today the necessitous borrower bows under the oppressive burden of legally assessed charges which force him deeper into the quagmire of debt.
>
> Only merciless loan sharks and their paid employees who wish to perpetrate present conditions and reap private profit from defenseless borrowers, and the uninformed, oppose this measure.

(*Id.* 13.)

Under the Initiative as it existed at the time that the Constitutional Amendment was proposed, the consent/disclosure requirement applied to all loans. Nothing in the ballot materials suggests that any alteration to that requirement was needed or intended. The ballot materials certainly never informed voters that a protection for borrowers - the requirement of advanced disclosure and consent - would be eliminated in whole or in part by passage of the measure.

In an attempt to make a silk purse out of a sow's ear, NWM argues a double-negative: Noting that the ballot materials omit any explicit statement that the disclosure requirement was *not* changing, NWM argues that the voters should have assumed that the newly-designated "exempt" industries would no longer be covered by the requirement. (POB at 35.) This strained argument is unsupported and unconvincing. Silence in ballot materials suggests that pre-existing law remains unchanged, not the opposite. *Katzberg v. Regents of Univ. of California* (2002) 29 Cal.4th 300, 320-21; *Davis v. City of Berkeley* (1990) 51 Cal.3d 227, 237-38; *Wiseman Park, LLC v. S. Glazer's Wine & Spirits, LLC* (2017) 16 Cal.App.5th 110, 122.

NWM also notes that the Attorney General's summary of the proposed amendment included the statement that passage of the measure would allow the Legislature to "prescribe their [exempt lenders'] maximum interest rate per annum and regulate their charges on loans." (POB at 35.) But this language adds nothing to the analysis; it simply parrots the language of the Amendment itself. Obviously, the proposed Constitutional Amendment would (and did) give the Legislature authority over the loan charges specifically listed therein ("fees, bonuses, commissions, discounts or other

compensation") as to exempt lenders. Nothing in the Attorney General's description nor any other part of the ballot materials suggests that the existing disclosure requirement before compounding interest was such a loan charge. For all the reasons stated above, the Constitutional language should not be so construed. The Attorney General language does not assist in that analysis one way or the other.

Similarly, NWM stresses that the purpose underlying passage of the Constitutional Amendment was dissatisfaction with the lack of flexibility resulting from uniform regulation of different classes of lenders. But this dissatisfaction was directed squarely at the Initiative's imposition of uniform maximum interest rates regardless of class of lender, as well as the Initiative's failure to prevent lenders from omitting ancillary charges when calculating interest as a means to circumvent those rate limits. *Carter, supra,* 33 Cal.2d at 576-577. There is no evidence whatsoever that the voters thought that the Initiative's requirement of disclosure before compounding interest was a cause for concern or a motivation for amendment. Indeed, the Initiative's disclosure requirement is completely "flexible" in that it allows *any* lender to charge compound interest on *any* loan – the

lender need only disclose the intention in advance and obtain the borrower's written consent.

NWM suggests that the voters might have supported a proposal to allow the disclosure/consent requirement to be dispensed with as part of an overall enthusiasm for industry-by-industry regulation. (POB at 35-36.)[12] But this suggestion is the rankest of speculation, without a shred of evidence to support it. The ballot arguments focused on the need for *more* protection for borrowers to prevent the exaction of interest at rates exceeding the specified legal rates. The ballot materials did *not* state, or even imply, that passage of the proposed Amendment would dispense with or modify the Initiative's disclosure/consent provision in any manner.

In any event, NWM ignores the high burden it faces in urging that legislative history justifies a finding of implied partial repeal of the Initiative's disclosure/consent requirement. Courts require "undebatable evidence of an intent to supersede the earlier

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[12] NWM describes "distinctive" features of life insurance loans, apparently in support of speculation that the voters might have desired different treatment (including presumably, dispensing with advanced disclosure/consent before compounding) for such loans. (POB at 36.) But, assuming the accuracy of NWM's descriptions, insurers were not listed as exempt lenders when the 1934 Amendment was passed; nor even when the 1979 Amendment was passed. Thus, it is not credible that the voters were motivated by any considerations about insurance loans.

[provision]." *Tuolumne Jobs & Small Bus. All. v. Superior Court, supra,* 59 Cal.4th 1039 (quoting *W. Oil & Gas Assn. v. Monterey Bay Unified Air Pollution Control Dist.* (1989) 49 Cal.3d 408, 420). Nothing NWM cites even comes close to meeting this standard.

5. California Precedents, To The Extent Relevant, Support The Conclusion That NWM Is Subject To The Initiative's Disclosure/Consent Requirement

No California precedent directly addresses the question at issue in this case: Does the Initiative's disclosure/consent prerequisite before charging compound interest apply to lenders "exempt" from the Constitutional interest rate caps? To the limited extent that guidance can be gleaned from the case law, Wishnev submits that the case law supports his position that the question should be answered in the affirmative.

a. Penziner v. W. Am. Fin. Co.

In *Penziner*, 10 Cal.2d 160, this Court analyzed the impact of the 1934 Constitutional Amendment on the Initiative and concluded that the portions of the Initiative not expressly modified remained fully in force. *Id.* at 173-177. The Court concluded that the Amendment did not address, much less repeal, many aspects of the Initiative:

> In reading the amendment it is at once apparent that the first two paragraphs, except as to reducing the maximum rate of interest, are wholly consistent with the Usury Law. Further, the amendment is wholly silent as to remedies or penalties and does not contain many of the other provisions of the Usury Law.

Id. at 173. Though the case did not require the Court directly to address the question presented here because the lender at issue was not within an exempt class, several aspects of the decision indirectly support Wishnev's arguments here.

First, as explained above, given the limited nature of the language in the Amendment's superseding provision and the presumption against repeal by implication, *Penziner* held that only the "irreconcilable" portions of the Initiative were impliedly repealed and that courts must search for a reasonable construction of the Constitutional Amendment that will permit the Initiative's provisions to remain in force to the maximum extent reasonably possible. *Id.* at 173-177.

Second, in discussing the effect of the Constitutional Amendment, the Court in *Penziner* twice noted that the power given to the Legislature over exempt entities' "charges" was not unlimited:

> The amendment does, however, place in the hands of the Legislature the power to control **certain of the charges** of certain designated classes of lenders.

Id. at 173 (emphasis added). The Court thus characterized the final sentence of the third paragraph of the Constitutional Amendment as conferring upon the Legislature authority over "certain of the charges" of exempt lenders, not over *all* loan-related assessments no matter how far afield from the specified list, as NWM would have it. [13]

The Court repeated this same point later in the decision:

> All that the constitutional amendment does is to reduce the maximum permissible rate from 12 per cent. to 10 per cent. per annum; to exempt certain enumerated classes of lenders from certain of its provisions; and to place in the legislature **a certain degree of control over the fixing of charges** made by the exempted groups.

10 Cal.2d 160, 176-77 (emphasis added.)[14]

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[13] *See also, Wolf v. Pacific Southwest Discount Corp.* (1937) 10 Cal.2d 183, 184, noting that exempt lenders "are exempt from the *general* provisions of the usury law." (Emphasis added.)

[14] As to this second statement by the Court, NWM seeks to undermine its force by noting that the following sentence reads: "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." (POB at 25-26.) NWM argues the this reference to "control of the charges," i.e. without any qualifier that it is only a "certain degree of control" granted to the Legislature, should trump the immediately preceding sentence. This contention is singularly unpersuasive, since it is unlikely that the Court meant to undermine its immediately preceding statement. In any event, NWM offers no answer to the Court's *prior* statement at page173 that the Legislature's control over "charges" (whatever was deemed to be included in that word) is not unlimited.

NWM argues that *Penziner* is "fully consistent" with its contention that the Constitutional Amendment repealed the disclosure/consent requirement insofar as exempt lenders are concerned, quoting portions of the decision where the case notes that the Amendment treats exempt lenders differently than non-exempt ones for certain purposes. (POB at 24.) If NWM means that *Penziner* did not directly address the question at issue here and does not itself dictate the proper outcome, Wishnev of course agrees. Neither *Penziner* nor any other case does so. But nothing in the portions of *Penziner* cited by NWM directly support *its* view. Nowhere does the decision state or even suggest that the disclosure/consent provision does *not* apply to exempt lenders.

b. *Carter v. Seaboard Fin. Co.*

In *Carter,* 33 Cal.2d 564, the Court analyzed the scope of the Amendment's exemption language but only insofar as maximum interest rates were concerned. The case does not mention the Initiative's compound interest provision or address in any way its continued application. Thus, as the District Court concluded in denying NWM's motion to dismiss after extensive discussion of the

case, *Carter* offers no direct assistance in resolving the current question. 162 F.Supp.3d at 942-944.

To the extent that indirect insight can be gleaned from the decision, portions of it support the conclusion that the Initiative's disclosure/consent requirement remains applicable to exempt lenders.

The plaintiff in *Carter* argued that the "none of the above restrictions" language in the Amendment's third paragraph referred only to the immediately preceding paragraph pertaining to loan-related charges but not to the first paragraph containing the interest rate caps. Thus, the plaintiff therein argued that exempt lenders were subject to the Amendment's interest rate caps until the Legislature set a different cap. *Id.* at 579. In analyzing and ultimately rejecting this claim, the Court clearly understood the scope of the exemption to be circumscribed by the actual exemption language – "However, none of the above restrictions...." It was the meaning of *those words* which governed the issue. While it noted the ending language giving the Legislature authority over interest rates and charges imposed by exempt lenders as supportive of its construction of the "none of the above restrictions" language, it did not find that the later grant of

authority to the Legislature somehow subsumed the exemption language itself, as NWM urges here.

Carter thus supports Wishnev's contention that the scope of the exemption in Art. XV (and its predecessor) is circumscribed by the actual wording used therein and that the Court should resist finding a broader scope imbedded in later language. 33 Cal.2d at 578-580. The Court stressed that "the language of the amendment must be applied by the courts as it is written," absent uncertainty as to the meaning of the words used. *Id.* at 579. Only after finding a portion of the Amendment ambiguous (the inclusion of the phrase "nor shall any such charge of any said exempted classes of persons be considered in any action or for any purpose as increasing or affecting or as connected with the rate of interest hereinbefore fixed"), did the Court turn to a wider-ranging analysis of the provision's purposes. *Id.* at 580-582.

Moreover, language in *Carter* suggests that the list of charges specified in the Amendment ("fee, bonus, commission, discount or other compensation") describes items separate and apart from interest rather than interest itself, however calculated. The *Carter* Court described the motivation for the Constitutional language: "[T]he

initiative measure was inadequate in that it did not prevent charges **in addition to** the interest which might be exacted from the borrower." 33 Cal.2d at 577 (emphasis added). There is absolutely no language in *Carter* supporting the contrary proposition, i.e. that the Court thought that collection of compound interest *was* a "charge" as meant by the Amendment. There is certainly nothing in the case to support the conclusion that the requirement of *disclosure* of an intent to compound was repealed as to any lenders.

NWM relies on a general statement in *Carter* that exempt lenders' "interest and charges" were placed within the hands of the Legislature by the Amendment. (POB at 20, 27.) But the issue in *Carter* involved maximum interest rates and the decision was exclusively focused upon the interest rate cap provisions of the Constitutional amendment. The Court had no occasion to address the details of what might or might not constitute a "charge" or whether the Initiative's disclosure/consent requirement remained applicable and it certainly did not do so.[15] It is most reasonable to assume that

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[15] The same point applies to *West Pico Furniture Company v. Pacific Finance Loans* (1970) 2 Cal.3d 594, 614. (POB 20-21.) In that case, the plaintiff asserted that certain transactions were actually loans with interest charges exceeding the maximums allowed under the law. This Court agreed that the transactions at issue were loans, but held that they fell

the Court used the word "charges" throughout the opinion as shorthand for the specific charges listed in the Amendment itself: "fees, bonuses, commissions, discounts or other compensation." As already explained above, there are compelling reasons to conclude that a method of calculating interest, such as compounding, does not fall within the scope of that list of items, and – even if that were not true – a requirement of *disclosure and consent* is quite distinct from a direct regulation of a charge. Nothing whatsoever in *Carter* suggests otherwise.

c. *McConnell Cases*

McConnell I, 21 Cal.3d 365, squarely holds that the disclosure/consent portion of the Initiative remains a enforceable requirement as a general matter. However, the defendant in the case was not an exempt lender, so the Court did not address whether that status would have altered its holding.

As explained below, *McConnell II,* 33 Cal.3d 816 is critically important to this case in answering the second question referred by the

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within the "personal property broker" exemption to Art. XV. The case did not purport to address whether the Initiative's disclosure/consent requirement applied to the transactions.

Ninth Circuit. However, it does not assist in resolving the exemption aspect.[16]

d. *Heald v. Friis-Hansen*

The decision in *Heald v. Friis-Hansen* (1959) 52 Cal.2d 834 involved neither the Initiative's disclosure/consent provision nor an exempt entity. The case involved loan agreements by a non-exempt lender which expressly provided for the charging of compound interest upon default and which were disclosed to the borrower and consented to in writing prior to the transaction. *Id.* at 835-836. Obviously, thus, *Heald* does not speak directly to the issue raised in this case.

The question addressed in *Heald* was the proper interpretation of the Constitutional Amendment's "10 per cent per annum" interest rate cap. The borrower in that case paid back the loans at issue, including 10 per cent interest, compounded annually after default. The borrower then argued that he was entitled to treble recovery under

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[16] NWM suggests that the *McConnell* cases "impliedly" support its view because the plaintiffs therein alleged a class period which ended on the date that the defendant became an exempt entity. (POB at 21.) But NWM's speculation – weak in any event -- fails to recognize that the plaintiffs in *McConnell* alleged **two** claims, one of which was that the defendant charged an excessive interest rate to them prior to its receiving an exemption from Art. XV's interest rate caps, an obvious reason to limit their class period. 21 Cal.3d at 369.

the Initiative of all compounded interest, as exceeding the 10 per cent maximum rate. The Court found otherwise, finding that 10 per cent interest, compounded annually, did not exceed the "10 per cent per annum" interest cap. *Id.* at 839. The Court did not expressly set out its reasoning, but cited several cases from other jurisdictions so holding.

> Several jurisdictions, on differing theories, have held that an agreement to compound interest annually at the maximum rate after default does not render a loan usurious. For example, in *Palm v. Fancher*, 93 Miss. 785, it was held that compounding was permissible where it was imposed only upon default and the borrower could avoid compounding by fulfilling his contract. (*See also Morgan v. Rogers*, 166 Ark. 327.) And in *Jones v. Nossaman*, 114 Kans. 886 *et seq.*, the court reasoned that overdue interest is simply money due and that, since the parties, after interest is due, can make an agreement to pay interest on the accrued interest, they should be permitted to anticipate the possibility of default and to provide, in the loan agreement, that accrued interest shall itself bear interest. (*See also Greer v. Greer*, 56 Ariz. 394; Webb on Usury (1899), § 129, pp. 145-146; *cf. Newton v. Woodley*, 55 S.C. 132.)

52 Cal.2d at 839-40. The Court disapproved an earlier decision (*Haines v. Commercial Mortgage Co.* (1927) 200 Cal. 609, 625) which had held that a contract calling for interest at the maximum rate may not provide for the compounding of interest after default. *Id.*

Apparently tied to its mistaken belief that the Amendment's "in any manner" language relates to interest, not fees (*see* n. 9, *supra*), NWM contends that *Heald* offers significant support to its arguments. But even taking its characterization of the case at face value, its argument is illogical. Whether a particular loan at a particular rate of interest and with a particular frequency of compounding does or does not exceed the maximum permitted rate has nothing whatsoever to do with the Initiative's requirement of *disclosure and consent*, which applies to loans regardless of the rate of interest involved.

Put another way, the Initiative presents one reason why compounding may not be permissible as to a particular loan: the disclosure/consent requirement is not met. *Heald* discusses a second reason why compounding may not be permissible as to a particular loan: the total interest charged exceeds the maximum permissible rate. The two are completely different reasons. There is no conflict between the two. Again, the Initiative's disclosure/consent requirement and the Legislature's power to limit maximum rates for exempt lenders can exist together.

6. NWM's Suggestion That California's Insurance Code Aids Its Cause Is Misplaced

NWM suggests that certain sections of California's Insurance Code support its proposed construction of Article XV because, purportedly, application of the Initiative's disclosure/consent requirement would create a direct conflict with the code sections. (POB at 37-39.) Not so.

First, NWM fails utterly to demonstrate an irreconcilable conflict which would prevent the application of both the Insurance Code and the Initiative's disclosure/consent provision to insurance loans. None of the code sections directly address disclosure of compound interest or, indeed, compound interest in any manner. Certainly, no code section states that insurers need *not* disclose and get written authorization before compounding; nor does any code section state that compounding may be assessed regardless of advanced disclosure and consent.

NWM attempts to manufacture an implied conflict by noting that the Legislature did require some disclosures but did not require any disclosure before compounding. (POB at 37.) But such a weak inference is not sufficient to find irreconcilable conflict. The lack of

an explicit directive to disclose and obtain consent before compounding is at least as consistent with a *recognition* that the Initiative already requires such disclosure as NWM's unsupported speculation that the Legislature decided that the Initiative provision did not apply to insurers and then considered but rejected the imposition of the same requirement itself.[17]

Second, NWM ignores the specific language of the two codes sections upon which it primarily relies in positing the possibility of conflict. Both Insurance Code section 1100.1 and Insurance Code section 1289 are phrased in terms of loan *interest rates* and do not purport to be generalized all-encompassing provisions. Section 1100.1 (emphasis added) provides:

> 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

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[17] Moreover, as one of NWM's own case citations notes, this Court searches for a reasonable construction of statutes that will avoid finding them invalid. (POB at 38 [citing *Dyna-Med, Inc. v. Fair Employment & Housing Com.* (1987) 43 Cal.3d 1379, 1387].) Yet, to support its speculation that the Legislature thought the Initiative's disclosure/consent requirement did not apply, NWM argues that the Court should stretch to *adopt* a construction which would conflict with the Initiative.

> of, loans made by, or forbearances of, any incorporated admitted insurer.[18]

The Initiative's disclosure and consent requirement is not a "restriction[] upon rates of interest." Nor is it contained "in Section 1 of Article XV," for that matter. Clearly, nothing in this section aids NWM's arguments.

Similarly, Section 1239 states only that (emphasis added):

> No other provision of law shall **apply to policy loan interest rates** unless made specifically applicable to these rates."

Again, the Initiative's requirement is to disclose and obtain consent before compounding. It is not directed to "policy loan interest rates;" certainly, a reasonable construction of that section's language exists which would avoid any conflict between the two provisions. *Dyna-Med, supra.* Thus, the "presumption of constitutionality" of statutes (POB at 38) is not relevant here.

Third, if *arguendo* it were to be concluded that an irreconcilable conflict exists between application of the Initiative and one or more

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[18] The following sentence of section 1100.1 provides that insurers are an "exempt class of persons pursuant to Section 1 of Article XV of the Constitution." That sentence does not assist in analyzing the question whether the Initiative's disclosure/consent requirement applies to insurers, since it begs the question of precisely what "exempt" entities are exempt from.

Insurance Code sections, it is the Initiative which must be upheld. Under our Constitution, the Legislature lacks power to modify or repeal voter initiatives without another vote of the people. Cal. Const., Art. II, §10(c); *id.*, Art. XVIII. If the provisions of Article XV do not excuse exempt lenders from the Initiative's disclosure/consent requirement, no action by the Legislature could do so, even if it so desired. Indeed, this Court has previously found legislative action to be in conflict with this very Initiative and on that basis invalidated it. *Carter, supra*, 33 Cal. 2d at 577.[19]

Finally, the code sections NWM relies on were expressly made inapplicable to pre-existing insurance policies when they were enacted. Section 1239.5 provides that "[t]he provisions of this article

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[19] NWM's suggestion that this Court should infer a legislative understanding that the Initiative's provision does not apply to insurers and then defer to that supposed legislative understanding (POB at 37-38) is meritless. The case it cites (*Pacific Legal Foundation v. Brown* (1981) 29 Cal.3d 168, 180) clearly states that a necessary prerequisite for such deference is that the Legislature acted "with the relevant constitutional prescriptions clearly in mind." *Id.* at 180. NWM offers no evidence whatsoever to support that proposition here. Obviously, the Legislature "had in mind" Art. XV's interest rate limits, but there is no reason to presume that the Legislature had any particular view as to the applicability of the Initiative's disclosure/consent when it enacted the pertinent Insurance Code sections.

In any event, the construction and validity of statutes and other enactments is ultimately a question for the judiciary, not the Legislature. *State Bldg. & Const. Trades Council of Cal., AFL-CIO v. City of Vista* (2012) 54 Cal.4th 547, 565.

[Ins. Code §§1230 *et seq.*] **shall not apply** to any insurance contract issued before the effective date of this article [i.e. 1982] unless the policyholder agrees in writing to the applicability of these provisions (emphasis added)." The policies at issue in this litigation were issued between 1967 and 1976 (ER 165 [¶12]), at a time when insurers were not even designated as exempt lenders at all. The Insurance Code provisions cited by NWM were enacted thereafter, in 1981 (as to section 1100.1) and 1982 (all other sections). Thus, nothing in Insurance Code sections 1230 - 1239 could impact the viability of Wishnev's claims: by their own terms, they do not apply to his policies.

II. THE INITIATIVE'S STRICT REQUIREMENT OF DISCLOSURE IN A DOCUMENT SIGNED BY THE BORROWER WAS NOT MET BY NWM'S SUBSEQUENT DELIVERY OF A NEVER-SIGNED POLICY

The Initiative explicitly prohibits compounding of interest "unless an agreement to that effect is clearly expressed in writing and signed by the party to be charged therewith." This Court has previously held that that language means precisely what it says: "the provision for compounding must be in writing and signed by the borrower." *McConnell II*, 33 Cal.3d at 822. It is undisputed in this

case that there is no document that both discloses an intention to charge compound interest and was signed by Wishnev.

Nonetheless, NWM argues that the Initiative's requirement has been met because, *after* Plaintiff signed his applications (which said nothing about compounding of interest), NWM sent insurance policies (which he never signed) stating that loan interest would be compounded. NWM reasons that, as a matter of contract law, the insurance application is incorporated into the insurance contract terms and argues that it should not matter that Wishnev never signed the document containing the compounding interest disclosure. (POB at 39-42.) NWM's argument is inconsistent with the language of the Initiative, as previously elucidated by this Court, and should be rejected.

Wishnev does not dispute that an insurance contract is comprised of both the policy and any attached application, as a matter of insurance and contract law. But the pertinent question is not whether – as a matter of contract law – NWM could charge compound interest, absent the Initiative's requirement of disclosure/consent. The Initiative imposes its own requirement before charging compound interest on a loan, i.e. a signed, written disclosure. Insurance

contracts, like any other contracts, "must not be against public policy or in contravention of specific provisions of law." *Boyer v. U.S. Fid. & Guar. Co.* (1929) 206 Cal. 273, 276. Moreover, the Initiative expressly provides that "[a]ny 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..." Initiative, Sect. 2. Thus, that the insurance contract consists of both the application and the policy does not answer the question whether the Initiative's prerequisite for compounding of interest is met.[20]

The Initiative requires that a lender's intent to charge compound interest be "clearly express[ed] in a writing signed by its customers." *McConnell II*, 33 Cal.3d at 823. Unsigned subsequent disclosures do not meet that requirement. As the plain wording of the Initiative as well as this Court's characterization of that wording make clear, that requirement is not met by a subsequent, unsigned

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[20] To the extent that NWM is contending that Insurance Code section 10113 (providing, by negative implication, that an insurance application - if attached to the policy - becomes part of the insurance contract) modifies the explicit requirement of the Initiative that the disclosure about compounding be signed by the borrower, that argument has no merit whatsoever. As noted above, the Legislature lacks power to modify or repeal voter initiatives without another vote of the people. Cal. Const., Art. II, §10(c); id., Art. XVIII.

disclosure.[21] The requisite written consent to the disclosed intention to compound is not met by getting a signature first and then disclosing the relevant information later.

NWM facilely asserts that the overall insurance contract is an "agreement" and then argues that the Initiative just requires a signature (whenever obtained) to an "agreement" which includes a disclosure of the intent to compound. But among other defects, that argument mischaracterizes the Initiative's language, which states 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." (Emphasis added.) It is indisputable that the words "agreement to that effect" mean an agreement to pay compound interest. It is *that agreement* (i.e. consenting to compounding of interest) which must be clearly expressed in writing and signed by the borrower. NWM may have expressed the intent later, but that is not what Wishnev signed. He signed an application that said nothing

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[21] Applications for insurance become part of the contract of insurance to protect the insurer from material misstatements of fact in the application (*Mitchell v. United Nat. Ins. Co.* (2005) 127 Cal.App.4th 457, 469), not to allow an insurer to contend that the insured's signature on the application is written consent to matters which were required to be disclosed prior to signing but are not disclosed until later.

about compound interest; he did not sign the later expression of NWM's intent to charge it.

NWM's position cannot be squared with this Court's decision in *McConnell II*, the only appellate case to construe the Initiative's requirement. The Court described the Initiative as requiring that the borrower sign the very document containing the disclosure in order to assure that the borrower has agreed to the practice:

> Section 2 is designed to protect borrowers, prevent the unjust enrichment of lenders, and deter lenders from violating its terms. It achieves the first of these goals by providing that a lender who intends to charge compound interest must express that intention in clear terms **and**, in order to assure that the language employed by the lender meets this requirement and that the borrower agrees to pay compound interest, it prescribes that **the provision for compounding must be in writing and signed by the borrower**. The second and third goals of the section are evident from the provision therein that an agreement which does not comply with its requirements shall be "null and void" with regard to the promise to pay interest.

33 Cal.3d at 822 (emphasis added). *See also, id.* at 823 (a lender's intent to charge compound interest be "clearly express[ed] in a writing signed by its customers").

Apparently recognizing that the description of the Initiative's requirement in *McConnell II* dooms its argument, NWM seeks to distinguish that case as involving different facts than this one. NWM

omits important aspects of the facts arising in that case. More importantly, the Court's explication of the meaning of the Initiative's requirement, quoted above, was not dependent upon any particular set of facts – it was a statement of statutory interpretation just as applicable to the facts here as it was to the facts there.[22]

In the *McConnell* cases, the Merrill Lynch's customer agreement (signed by the customers) had not sufficiently disclosed the intention to compound, as this Court ruled in *McConnell I,* 21 Cal.3d at 375. On remand after *McConnell I*, Merrill Lynch proved that some customers nevertheless had actual knowledge of its practice of compounding interest before signing the customer agreement, either from prior dealings with Merrill Lynch or with other brokerages. In addition, other customers learned of the practice from disclosure brochures and monthly statements provided by Merrill Lynch after signing which noted the practice, and remained customers thereafter. *Id.* at 819-820. The Court found these facts irrelevant. Proof of customers' actual knowledge of Merrill Lynch's intention to

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22 If Wishnev were relying only on the *holding* of *McConnell II*, NWM's attempts to distinguish the case on its facts might make logical sense. But there is no reason why this Court would construe the Initiative language one way in *McConnell II* and a different way in this case. While the *application* of statutory language to different facts may lead to different outcomes, the *meaning* of the statute's language is unchanging.

compound when they signed the agreements was irrelevant because actual knowledge was no substitute for meeting the strict requirements of the Initiative.

> Such evidence is not relevant to the issue presented by the complaint, i.e., whether defendant violated section 2 by failing to clearly express in a writing signed by its customers that compound interest would be charged on money borrowed on their margin accounts.

Id. at 823.[23]

Similarly, this Court rejected the contention that the provision of post-signing disclosures could substitute for a written disclosure actually signed by the borrower. *Id.* (assuming the subsequent disclosures were sufficiently clear, "their receipt would not satisfy the unequivocal requirement of section 2 that the borrower must agree in writing to pay compound interest....[T]he documents relied on by defendant as providing notice to its customers do not satisfy the

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[23] The Court's conclusion that actual knowledge was not relevant to the question of compliance with the Initiative's requirement was consistent with its earlier treatment of a similar contention involving another consumer protection provision. In *Fletcher v. Sec. Pac. Nat'l Bank* (1979) 23 Cal.3d 442, 451, the Court held that bank customers' actual knowledge of their bank's misrepresentations about interest calculations precluded their monetary recovery under a breach of contract theory but not under a claim pursued under a consumer protection statute, Business and Professions Code section 17500 *et seq.* That decision was noted in *McConnell II*: "The protection of unwary borrowers against usury is at least as urgent a societal concern as safeguarding them against the unfair trade practices alleged in *Fletcher*." 33 Cal.3d at 823.

precise requirements of section 2.]"). [24] The Court concluded that "defendant violated section 2 by failing to clearly express in a writing signed by its customers that compound interest would be charged on money borrowed on their margin accounts." *Id.*

Here, as in *McConnell II*, NWM failed to meet the requirements of the Initiative by "failing to clearly express in a writing signed by [Wishnev] that compound interest would be charged." 33 Cal.3d at 823. NWM's post-signing provision of the insurance policy was not sufficient to "satisfy the precise requirements" of the Initiative. *Id.* Wishnev's signature came at the beginning; the policy disclosure came later and was never signed. For purposes of the Initiative requirement, it is the date Wishnev actually *signed* something that is relevant here, not the subsequent date when NWM accepted his application and sent him a policy.

The Initiative's requirement for charging compound interest is strict but simply met: All a lender need do is state clearly in writing that interest will compound and then have the borrower sign that

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[24] Thus, *McConnell II* precludes NWM's suggestion that its provision of the insurance policy to Wishnev after he signed the applications but before any loans were issued might be viewed as substantial compliance with the Initiative's requirement. (POB at 44 ["Further, Wishnev had the entire signed contract, including the written compound interest disclosure, before he took out any policy loans."].)

disclosure to demonstrate his or her express consent. "Compliance with these clear requisites does not impose an onerous burden." *McConnell I*, 21 Cal.3d at 381.

NWM, like Merrill Lynch, disclosed its intentions in a different document (never signed by the borrower), which was transmitted only after Plaintiff signed his applications. NWM did not meet the Initiative's requirement.

III. A RULING IN WISHNEV'S FAVOR MUST BE APPLIED RETROACTIVELY

"The general rule that judicial decisions are given retroactive effect is basic in our legal tradition." *Newman v. Emerson Radio Corp.* (1989) 48 Cal.3d 973, 978. While exceptions are occasionally made, they are rare. *Id.* at 979. Judicial decisions construing legislative enactments do not make new law, they merely announce what the law has always been, both before the decision is issued and afterwards. *McClung v. Employment Development Department* (2004) 34 Cal.4th 467, 474.[25]

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[25] Moreover, courts are cautious in limiting enforcement of legislative remedies for past conduct. As this Court stated recently:

> Furthermore, if we were to restrict our holding to prospective application, we would, in effect, negate the civil penalties, if any, that the Legislature has determined to be appropriate in this context, giving employers a free pass as regards their past conduct. (See Lab. Code, §§ 203, subd. (a), 226, subd. (e), 2699; Bus. & Prof. Code, § 17206.) In doing so, we would exceed our appropriate judicial role.

A threshold requirement for any exception to retroactivity is that the decision must change a settled rule of law.

> In determining whether a decision should be given retroactive effect, the California courts undertake first a threshold inquiry, inquiring whether the decision established new standards or a new rule of law. If it does not establish a new rule or standards, but only elucidates and enforces prior law, no question of retroactivity arises. Neither is there any issue of retroactivity when we resolve a conflict between lower court decisions, or address an issue not previously presented to the courts. In all such cases the ordinary assumption of retrospective operation takes full effect.

Donaldson v. Superior Court (1983) 35 Cal.3d 24, 36 (citations omitted).

> Courts sometimes make an exception to this general rule when the decision changed a settled rule on which the parties had relied. (*Droeger v. Friedman, Sloan & Ross* (1991) 54 Cal.3d 26, 45, 283 Cal.Rptr. 584, 812 P.2d 931.) But in this case, we are merely deciding a legal question, not changing a previously settled rule. As discussed above, *Stanley v. Superior Court, supra*, 130 Cal.App.3d 460, 181 Cal.Rptr. 878, does not control this case. We have not overruled *any* decision predating the arbitration, much less a prior decision of this court. (*Cf. Droeger v. Friedman, Sloan & Ross, supra*, 54 Cal.3d at pp. 45–46, 283 Cal.Rptr. 584, 812 P.2d 931.) We have certainly not disapproved "of a long-standing

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> Accordingly, we see no basis for limiting our holding to prospective application.

Alvarado v. Dart Container Corp. of California, (2018) 4 Cal.5th 542, 573.

> and widespread practice expressly approved by a near-unanimous body of lower court authorities." (*Id.* at p. 45, 283 Cal.Rptr. 584, 812 P.2d 931.) No reason appears not to apply today's decision to this case.

Brennan v. Tremco Inc. (2001) 25 Cal.4th 310, 318 (2001). *See also, Williams & Fickett v. Cty. of Fresno*, 2 Cal.5th 1258, 1282 (2017) (potential exception to retroactivity "when a judicial decision changes a settled rule on which the parties below have relied").

A decision in this case will not change a settled rule of law. Therefore, it will apply retrospectively.

The legal questions referred to this Court by the Ninth Circuit are questions of first impression, as to which no appellate court has yet weighed in. The Ninth Circuit so found in requesting that this Court resolves the questions. *Wishnev, supra,* 880 F.3d 493. This Court presumably agreed in accepting the questions for resolution over NWM's argument that the answers were already governed by settled law. Moreover, in its present briefing, NWM fails to cite a single appellate case (much less a case from this Court) directly addressing the legal issues presented here. No such decisions exist. Whichever way the Court rules here, it will be "merely deciding a legal question, not changing a previously settled rule." *Brennan, supra*, 25 Cal.4th at 318. *See Donaldson, supra,* 35 Cal.3d at 36 ("ordinary assumption of retrospective operation takes full effect" for

a decision addressing "an issue not previously presented to the courts").[26]

Presumably recognizing that it has no chance of prevailing under the applicable analysis, NWM proposes a new standard of its own invention. Even if no settled rule of law has been changed, NWM contends, decisions should not necessarily be made retroactive if they would disrupt "accepted business practices." (POB at 45-46.) NWM quotes from a court of appeal decision stating that an exception to retroactivity may exist if the new decision "disrupts a practice long accepted and widely relied on." (POB at 45 [quoting *Grobeson v. City of Los Angeles* (2010) 190 Cal.App.4th 778, 796].) NWM then immediately equates "disrupts a practice long accepted" with "disruption of accepted business practices" (POB at 45) and thereafter argues as if its characterization represents an established legal doctrine.

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> If the decision establishes a new rule of law, a second question arises: was there a prior rule to the contrary? If there was, the new rule—again—may or may not be retroactive, as we discuss below; if there was not, the new rule applies in all cases not yet final. This is so for the obvious reason that there cannot have been any *justificable* reliance on an old rule when no old rule existed. And the emphasized word is crucial: "Unjustified 'reliance' is no bar to retroactivity." [Citation.] It follows that "In all such cases the ordinary assumption of retrospective operation [citations] takes full effect." [Citation.]

People v. Guerra (1984) 37 Cal.3d 385 399-400.

NWM's suggestion does not withstand scrutiny. The quote from *Grobeson*, "a practice long accepted and widely relied on," was referring to a situation where widespread and uniform *judicial* rulings existed that apparently settled a legal rule even if not definitively resolved by the highest court. *Grobeson*'s meaning is made clear by the decision's citation of authority for the proposition, which was to *People v. Hicks* (1983) 147 Cal.App.3d 424, 427, citing *United States v. Johnson* (1982) 457 U.S. 537, 552. The **full** statement by the United States Supreme Court in *Johnson* leaves no doubt that NWM's interpretation is meritless. The *Johnson* decision summarized the reasons supporting non-retroactivity in its past cases as those constituting a "sharp break in the web of the law" (457 U.S. at 551) and then continued:

> Such a break has been recognized only when a decision explicitly overrules a past precedent of this Court, or disapproves a practice this Court arguably has sanctioned in prior cases, or **overturns a longstanding and widespread practice to which this Court has not spoken, but which a near-unanimous body of lower court authority has expressly approved**.

Id. (citations omitted; emphasis added). Thus, *Grobeson*'s "practice long accepted and widely relied on" exists only where "a near-unanimous body of lower court authority has expressly approved" it. Indeed, this Court has repeatedly recognized this point. *Brennan*,

supra, 25 Cal.4th at 318; *People v. Guerra ,supra,* 37 Cal.3d at 401; *Donaldson, supra*, 35 Cal.3d at 37.[27]

Beyond this failed contention, NWM presents no other argument in support of a conclusion that the Court's ruling here would alter a settled rule of law. Absent this threshold requirement, there is no need to address the factors that might support prospective-only application of the Court's ruling here had the requirement been met.[28]

Nevertheless, an observation about NWM's claim of reliance on its beliefs about the implications of its "exempt" status under Art. XV is in order: NWM issued Wishnev's four life insurance policies

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[27] It is not surprising that no court has ever endorsed NWM's "disruption of accepted business practices" proposal as adequate excuse for past failures to comply with legal requirements. A practice that is not lawful cannot become so merely from the passage of time or because its practitioners assumed that it was permitted. In simplest terms, ignorance of the law is no excuse. "This maxim is so long-standing and so well established that it is part of the very fabric of our legal system." *Diaz v. Grill Concepts Servs., Inc.* (2018) 23 Cal.App.5th 859; *see also, Williams & Fickett, supra*, 2 Cal.5th at 1274 n.11 (a taxpayer is charged with knowledge of the law).

[28] Having incorrectly assumed that a disruption to business practices would suffice to meet the threshold requirement, NWM proceeds to the other factors. In doing so, NWM suggests that a ruling in Wishnev's favor would overturn long-standing law holding that the contractual obligations contained in an insurance contract are those set forth in both the policy itself and any attached application(s). POB at 46-47. NWM does not explicitly contend that this might qualify as a new rule altering settled law.

However, in an abundance of caution, Wishnev notes that NWM's suggestion is incorrect in any event. *See* text accompanying note 20, *supra*. Nothing in the application of the Initiative to NWM's loans requires this Court to alter existing law.

between 1967 and 1976. (ER 165.) It did not obtain his signature to the policy on any of those occasions, nor did it otherwise request him to sign any disclosure of its intention to charge him compound interest, then or later. (*Id.* at 165-166.) When NWM issued those policies to Wishnev, not only were insurers not yet designated an "exempt" industry (which occurred in 1981), Art. XV had not yet even been enacted (which occurred in 1979). The "exempt" industries listed in former Art. XX, §22 did not include insurers. Thus, while NWM may have continued its practices unchanged following designation of insurers as exempt (although no facts pertaining to that question are in the record), it is indisputable that it did not rely on any beliefs about its exempt status when it designed those practices in the first place. Nor can it be denied that, as a non-exempt lender, NWM was subject to the Initiative's disclosure/consent requirement at the time it issued its policies to Wishnev.

IV. CONCLUSION

For the foregoing reasons, the Court should find:

1. The Initiative's disclosure/consent requirement was not partially repealed by implication and remains applicable to loans extended by entities exempt from the interest rate limits stated in Art. XV of the Constitution;

2. The Initiative's requirement of disclosure in a document signed by the borrower was not met by NWM's later delivery of a never-signed policy; and

3. As with the vast majority of judicial decisions, the Court's ruling on the above two issues apply retrospectively.

Dated: July 12, 2018

Respectfully submitted,

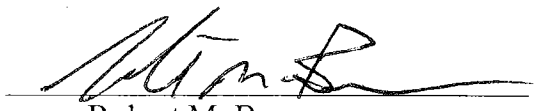
BRAMSON, PLUTZIK, MAHLER & BIRKHAEUSER, LLP

Robert M. Bramson

CERTIFICATE OF COMPLIANCE

I certify that the foregoing document contains 13,584 words, excluding the parts of the document that are exempted by Rule 8.204(c)(3).

July 12, 2018.



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PROOF OF SERVICE

I am a resident of the State of California, over the age of eighteen years, and not a party to the within action. My business address is Bramson, Plutzik, Mahler & Birkhaeuser, LLP, 2125 Oak Grove Road, Suite 120, Walnut Creek, California 94598. On July 12, 2018, I served the within documents:

ANSWER BRIEF

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Peggy Toovey