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William J. Barkett and Lisa Barkett
800 Silverado Street
Suite 301
La Jolla, CA 92037
Telephone: (858) 456-9301

In Pro Per

COURT OF APPEALS, DIVISION I
OF THE STATE OF WASHINGTON

Foundation Management, Inc.,
Respondent,
v.
William J. Barkett & Jane Doe Barkett,
Appellants.

CASE NO. 68318-7
APPELLANTS' OPENING BRIEF

2012 MAY 21 4:11:22
COURT OF APPEALS
STATE OF WASHINGTON
DIVISION I

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Appellant William J. Barkett and Lisa Barkett, erroneously sued as Jane Doe Barkett, appeal from the order and judgment of the trial court granting summary judgment in favor of Respondent Foundation Management, Inc.

I.

STATEMENT OF THE ISSUES

Three issues are presented for review.

The Trial Court erred by failing to apply California law in its analysis of the contracts underlying the dispute.

The Trial Court further erred when it granted summary judgment for Respondent because the underlying loans made by Respondent were illegal and the guaranties of Appellants unenforceable.

II.

STATEMENT OF THE CASE

This is not the simple breach of contract Respondent portrays in its pleadings. Rather, like the irony of a “jury, passing on the prisoner’s life, [m]ay in the sworn twelve have a thief or two [g]uiltier than him they try,” Respondent hopes to pass judgment on Appellants without regard for its own transgressions. William Shakespeare, All’s Well That Ends Well act 2, sc. 1. But unlike Shakespeare’s juror, Respondent used the courts in Washington to perpetuate its wrongs.

Respondent made a loan to an entity owned by Appellants. Respondent did so without being properly licensed to do so in violation of California law. Among other things, the loan agreement violates California’s usury laws.

Respondent came into California to loan money to a California corporation secured only by California real estate and guaranteed by a California resident. None of the funds went anywhere but California. The documents were all executed in California. Yet Respondent never bothered to register to conduct business in California nor did it bother to obtain an appropriate license to act in California as a lender. It did, however,

charge high rates of interest to make the loans in violation of California's strong public policy against usury and included a default rate of interest that is nothing less than a penalty.

Respondent Foundation contrived to act in California thereafter still in total disregard of the obligations imposed under California law. Respondent contends it can ignore California law simply by putting in a choice of law or a choice of forum clause. Respondent thus contends it can conduct business in California in disregard of California law with impunity. The trial court agreed with Respondent. Both are wrong.

III.

STATEMENT OF THE FACTS

Appellants and Defendants William J. Barkett, an individual, and his wife Lisa Barkett, an individual (herein "Barketts") are residents of the County of San Diego. CP 66. They have never resided in the State of Washington and own no property in Washington. *Ibid.*

On September 10, 2007, Merjan Financial Corporation, a California corporation ("Merjan") signed a Commercial Promissory Note (the "Note") for the sum of \$1,400,000.00 with Respondent Foundation Management, Inc., a Washington corporation ("Foundation"). CP 8. Appellant William J. Barkett ("Barkett"), the President of Merjan, executed a personal guaranty for the Note. CP 14. The Note sets forth the rate of interest to be charged and contains both a choice of law and a forum selection clause. CP 8. The rate of interest set forth in the Note was 15%. *Ibid.* In the event of a default, however, the Note called for a rate of interest not less than 36%. CP 9-10.

The loan is secured by real property located in the State of California. CP 67-101. The Note was executed in La Jolla, California. CP 67, 106. And as stated on its face, the guaranty was as well. CP 67, 113-114. At all relevant times, Foundation was not registered to do business in California nor was it licensed as a lender in California. CP 116-118.

By its terms, the Note was due and payable by September of 2008. CP 8-12. Payments totaling \$323,466.24 were made on behalf of Merjan to Foundation, but no further payments were made. CP 23-24.

IV.

PROCEDURAL HISTORY

On August 31, 2011, Foundation filed a complaint with the King County Superior Court in the State of Washington. CP 1-21. Barkett filed his answer on November 17, 2011. CP 49-53. In the meantime, on October 17, 2011, Foundation moved for summary judgment. CP 22-27. On January 12, 2012, and over Barkett's objections, Foundation's motion was granted and judgment entered. CP 56-64, 236-238. Notice of this appeal was filed on February 12, 2012. CP 262-271.

V.

ARGUMENTS AND LAW

A. The Law of California Applies to the Agreements Notwithstanding the Choice of Law Provisions

The trial court erred when it applied the choice of law provisions as they are not enforceable in this case. Questions involving choice of law are reviewed de novo. *Hanson Indus., Inc. v. Kutschkau*, 158 Wn.App 278, 287, 239 P.3d 367 (2010). To resolve a choice of law dispute under the laws of the State of Washington the court must determine whether there is an actual conflict of laws between the potential forums and, if so, whether the choice of law provision is effective. *Erwin v. Cotter Health Ctrs.*, 161 Wash.2d 676, 690-691, 167 P.3d 1112, 1120 (2007) (en banc).

Erwin is distinguishable and a proper application of the rule results in the opposite outcome here. In *Erwin*, a fee dispute over services provided by the plaintiff, a broker from Washington, arose out of a contract he entered with the defendant, a resident of Texas. Under the contract, the plaintiff was to provide certain real estate services for various of the defendant's properties located in Texas, Oklahoma, California, and possibly other states. The contract included a choice of law provision selecting the State

of Washington. When the suit was filed in Washington the defendant moved to dismiss, claiming the choice of law provision violated public policy in California. The court upheld the choice of law provision because it had a substantial relationship with the chosen forum and there was a reasonable basis to enforce it. *Id.* at 1124.

At first glance, that case does appear to resemble this one. Both involve contracts negotiated between two sophisticated parties, one of whom was domiciled in Washington. In both instances, the contracts contained choice of law provisions selecting the State of Washington. Likewise, the contracts explicitly purported to waive certain rights and protections. The similarities end there, however, and the differences are striking.

Merjan did not seek out Foundation for the loan. The loan was negotiated in California, the real property is located in California, and the loan proceeds were used entirely within California by California residents. CP 66-67. Applying the analysis from *Erwin* to the facts of this case reveals the dispute lacks a substantial relationship to the chosen forum, without which there can be no reasonable basis to enforce the forum selection clause.

1. There Exists An Actual Conflict of Laws Between California and Washington

The threshold issue is whether there is an actual conflict of laws between the two potential forums. “If the result for a particular issue is different under the law of the two states, there is a real conflict. [Citations.]” *Erwin*, 167 P.3d at 1120.

Under California law, the loan is illegal and the guarantees unenforceable. To avoid usurious loans within the state, California law provides that “[n]o person shall engage in the business of a finance lender or broker without obtaining a license from the commissioner.” Cal. Fin. Code § 22100(a). Unless a loan is made by a licensed California lender (or the lender was otherwise exempt which Respondent here was not), interest on the loan may not be in excess of the amount permitted by Article 15, Section 1 of the California Constitution, which provides for an interest ceiling not to exceed the

higher of (a) 10% per annum or (b) 5% per annum over the discount rate set by the Federal Reserve Bank of San Francisco operative on the 25th day immediately preceding the date of origination of the loan.¹ Where an unlicensed lender makes a loan with interest that exceeds this statutory maximum, the loan is usurious and no interest may be collected. *WRI Opportunity Loans II, LLC v. Cooper*, 154 Cal.App.4th 525, 533, 65 Cal.Rptr.3d 205 (2007).

In California, usurious loans are illegal and “cannot be ratified by any subsequent act...” *Id.* at 542. Moreover, because the underlying loan is illegal, the borrower’s obligations under a usurious loan are not enforceable against a guarantor. *Id.* at 545; *Wells v. Comstock*, 46 Cal.2d 528, 533 (1956); Cal Civ. Code § 2810.

It is immediately apparent that the results of this case would be different under California law. Foundation is not a licensed lender in California² and thus is not exempt from the state’s usury law. The interest charged on the loan exceeds the statutory maximum. At the time, the maximum permitted rate for a non-exempt lender was 10%, the loan here on its face calls for 15% with a default rate of a staggering 36%. Foundation engaged in loan practices that California deems predatory and condemns as usurious. *WRI Opportunity Loans II*, 154 Cal.App.4th at 533. Therefore, the loan agreement is illegal and unenforceable.

This is fatal to Foundation’s claim because it renders the subsequent guaranty unenforceable. California law would prevent Foundation from suing on the guaranty and underlying loan agreement because it was unlicensed and failed to register its business as required. Cal. Corp. Code §§ 2105, 2203. A corporation that neglects to register to do business in California exposes itself to a number of risks. *Neogard Corp. v.*

¹ As of August 25, 2007, the discount rate was 5.75% resulting in a maximum interest rate of 10.75%. Data publicly available from the Federal Reserve Bank at www.frbdiscountwindow.org.

² Foundation does not contend otherwise.

Malott & Peterson-Grundy, 106 Cal.App.3d 213, 226-227 164 Cal.Rptr. 813 (1980). The risk that Foundation undertook here by not obtaining a certificate from the Secretary of State is that the agreements it is relying upon are voidable at the option of the other party, that is Merjan and Barkett. *Performance Plastering v. Richmond American Homes of California, Inc.*, 153 Cal.App.4th 659, 668-669, 63 Cal. Rptr. 3d 537 (2007); [loss of certificate renders contract voidable]. Under California law, Foundation would not have been entitled to summary judgment and would likely not prevail at all.

Washington prohibits usury as does California. Rev. Code Wash. § 19.52 et seq. Its laws were “enacted to protect the residents of [Washington] from debts bearing burdensome interest rates...” *Id.* at § 19.52.005. Moreover, a rate that California would consider usurious, may be acceptable under the Washington statutes, because its standards differ. *Id.* at § 19.52.020. But the laws of Washington do not regulate the activities of lending activity in California, or to residents of California, specifically where California property is the collateral. Merjan and the Barketts are not residents of Washington and not protected by its usury law. The results would be different under the laws of the two states. Therefore, there is a real conflict.

2. The Choice of Law Provision Selecting Washington is Not Effective

Under Washington law, a choice-of-law provision is effective unless: (a) application of the law of the chosen state would be contrary to a fundamental policy of the other state; (b) the other state has a materially greater interest than the forum state in determining the disputed issue; and (c) the law of the other state would apply in the absence of the choice-of-law provision. *Schnally*, 171 Wn.2d at 266-267; Restatement (Second) Conflict of Laws § 187(2)(b) (1971).

a. Application of Washington Law is Contrary to California’s Fundamental Public Policy to Regulate Commercial Lending

Application of Washington law is contrary to California’s fundamental public policy to protect its commercial borrowers from predatory lending practices. When determining whether to enforce a choice-of-law provision the court first looks to

see if applying the provision would offend a fundamental public policy of the other state. *Erwin*, 167 P.3d at 1122.

California has a strong public policy against usury. Cal. Const., art. XV, § 1; *Gamer v. duPont Glore Forgan, Inc.*, 65 Cal.App.3d 280, 287, 135 Cal.Rptr. 230, 234 (1976). This fundamental public policy is manifested in the protections California affords its commercial and consumer borrowers under its Finance Lenders Law. *Brack v. Omni Loan Co., Ltd.*, 16 Cal.App.4th, 1312, 1316-1317, 80 Cal.Rptr.3d 275, 284 (2008); see Cal. Fin. Code § 22000 et seq. The public policy represented by the Finance Lenders Law is of such paramount importance in California that an out of state lender may not rely on choice of law provisions to avoid its protections. *Brack*, 146 Cal.App.4th at 1325; Fin. Code § 22000 et seq.

In accordance with its authority to promulgate regulations under the Finance Lenders Law, the Commissioner has adopted title 10, section 1408 of the California Code of Regulations, which provides: “A finance company shall not require or permit a borrower to waive any mandatory provision of the [California Finance Lenders] Law for his/her benefit . . . , nor shall a finance company require or permit a borrower to waive any mandatory provision of these rules and regulations.” See Cal. Fin. Code § 22150. These protections, available to both consumer and commercial borrowers represent an integrated, fundamental public policy. The provisions are not waivable. *Brack*, 146 Cal.App.4th at 1326-1327. A choice of law provision should not be given effect when application of the chosen state’s law would conflict with a state’s “fundamental public policy to protect consumers . . .” *McKee v. AT&T Corp.*, 164 Wn.2d 372, 191 P.3d 845, 852 (2008). To give effect to the forum selection clause here would violate the fundamental public policy of California.

The trial court cannot liken Barkett’s position here to the circular reasoning criticized in *Erwin*. The two situations present important factual distinctions. Whether the court here simply ignored the facts or changed them to reach its erroneous decision is not known. The order does not state the court’s logic or rationale, but the outcome was

wrong nonetheless. The court apparently failed to distinguish the policy implicated in *Erwin*. That policy was intended to protect California residents from incompetent brokers, and was based on California's narrowly construed broker's licensing statutes. *Erwin*, 167 P.3d at 1122. In that case, however, the dispute was a simple fee dispute that had nothing to do with activities the statute was designed to regulate. Because the public policy underlying the relevant statute bore no relation to the dispute, relying on it to avoid the forum selection clause risked "transform[ing] the statute into an unwarranted shield for the avoidance of a just obligation. [Citations.]" *Id.*

That court's reasoning is not applicable here because the public policy in this matter is triggered by the very conduct engaged in by Foundation. This dispute centers on California's Finance Lending Law which, unlike the broker's licensing laws in *Erwin*, must be construed liberally. Cal. Fin. Code § 22001(a). They represent a policy so strong that its protections cannot be waived. Both Merjan and the Barketts are residents of California. Foundation made a loan to Merjan for the purpose of acquiring and developing real property in California and secured by that same real property. CP 66-67. There is no comparison between the two situations.

The expectations of the parties here may have resembled those in *Erwin* because they were memorialized in contracts between sophisticated parties. In this case, however, neither Merjan nor Barkett was aware that Foundation was not licensed or registered as a lender (which rendered the loan usurious) or that it failed to register to do business in California. CP 66-67. That difference is critical. Had Merjan and Barkett known Foundation was not a properly licensed lender, they would have negotiated different terms or not made the deal in the first place. Unfortunately, they were never given that opportunity. As California commercial borrowers, they are entitled to the protections afforded by that state's statutory schemes.

Under Foundation's rationale, a lender can engage in predatory practices in California in complete disregard of California law simply by putting in a choice of law provision in the loan documents. Thus, an out of state lender could circumvent the

protections that cannot be waived under California law. Yet the lender still gets the benefit of California law to obtain California property as collateral for its loan. It can take advantage of California's non-judicial foreclosure system to take the California property back without involving the courts. Cal. Civ. Code § 2924; *cf.* Cal. Code. Civ. Proc. §§ 725a [judicial foreclosure]. It gets all the benefits but avoids all the burdens.

Foundation cannot have it both ways. Assuming Foundation first registered to do business in California, the choices available to a foreign corporation when making loans in California are either, (a) get properly licensed in order to charge what would otherwise be usurious, or (b) stop loaning money in California. The court must not give effect to the choice of law provision because it operates to defeat a fundamental public policy of the other affected state.

b. California Has a Materially Greater Interest

The second step in the analysis determines which state has a materially greater interest in the matter. *Erwin*, 167 P.3d at 1123. This is a fact specific analysis and is not limited to merely counting the contacts within a particular forum. *Id.*

California clearly has the greater interest here. The disputed transaction in this case involves conduct that is regulated under California's finance lending law, whereas Washington has no similar restrictions. Admittedly, both states have an interest in providing a forum for their citizens to seek relief. *Id.* Similarly, both states have "interests in protecting the justifiable expectations of the contracting parties." *Id.* at 1123. A state's interests do not, however, include permitting its residents to take advantage of citizens from neighboring states.

Further, Barkett and Merjan are not trying to avoid their just obligations, only those for which they are not liable. *Goodwin Co. v. Nat'l Disc. Corp.*, 5 Wn.2d 521, 531, 105 P.2d 805 (1940); *Gibbo v. Berger*, 123 Cal.App.4th 396, 403, 19 Cal.Rptr.3d 829, 834 (2004) [lender entitled to repayment of principal for usurious loan]. Merjan, and Barkett as guarantor, are not obligated to pay and Foundation is not entitled to collect usurious interest. Indeed, under California law, Foundation by demanding usurious

interest is entitled to no interest at all. *Gibbo v. Berger*, 123 Cal.App.4th at 403. Barkett is not liable at all under the guaranty since it is based on an illegal transaction to begin with. *Niederer v. Ferreira*, 189 Cal.App.3d 1485, 1506, 234 Cal.Rptr. 779 (1987).

It is not as if Foundation is without a remedy. Even without the guaranty, it still has an adequate remedy. Its interests are secured by real property in California. Nothing prevents it from coming to California and foreclosing on the Deed of Trust to obtain full relief. Of course, Foundation would need to register to do business in California if it wishes to file suit to foreclose judicially. Cal. Civ. Code § 2205; *United Medical Mgmt. v. Gatto*, 49 Cal.App.4th 1732, 1740 (1996).

California has a significant interest in protecting its commercial and residential borrowers as evidenced by its strong public policy to prevent predatory lending practices. California's interest in protecting its commercial and consumer borrowers greatly outweighs Washington's limited interest here.

None of the parties in *Erwin* were residents of California, rather they were from Washington and Texas. Here, however, both Merjan and Barkett reside and transact business in California alone. Moreover, instead of being scattered across several states, all the real property in this case is located within California. The *only* connection to Washington is Foundation has its office there. California has a greater interest in the subject matter of the transaction. California has the greater material interest.

c. California Law Would Apply in the Absence of the Choice-of-Law Provision

The third and final step is to determine which state's law would apply in the absence of a choice of law provision. *Erwin*, 167 P.3d at 1122. The test, known as the "Most Significant Relationship Test," allows the court to weigh the ties each state has to the litigation. *McKee*, 191 P.3d at 851, quoting Restatement (Second) of Conflict of Laws § 188 (1971). Under the test, the court balances the relative importance of several factors, including: (a) the place of contracting; (b) where the contract was negotiated; (c) where the contract was to be performed; (d) the location of the subject matter; and (e) the

domicile of the parties. *Id.*

In *McKee*, the Washington Supreme Court affirmed the trial court's refusal to enforce a New York choice of law provision. The court held that in the absence of the choice of law provision Washington law would apply because that state had more significant ties to the dispute than did the chosen forum.

In this case, although Foundation is a resident of Washington, Merjan and the Barketts are domiciled in California. Some minimal amount of the activities relating to the loan may have taken place in Washington, but most occurred in California. CP 67. Merjan negotiated the loan from California and it conducts all of its business there. CP 66-67. It signed the documents in California as did Barkett. CP 67. The subject matter of the transaction consists of property located in California and the Deed of Trust securing that property provides for California law and is recorded in California. CP 68-101. Moreover, the proceeds of the loan were put to use in California. Indeed, as the notary verifications bear witness, the last act consummating the transactions occurred in California when Barkett executed the guaranty. CP 113-114. Thus, the contracts were entered into in California. Cal. Civ. Code §§ 1581, 1583, 1584; *McKee*, 164 Wn.2d at 385. The ties to California are strong. Therefore, in the absence of the choice of law provision, California law would apply to this matter.

B. The Guaranty is Void as a Matter of Law Because the Underlying Contract is Illegal

The trial court erred because the guaranty on which this lawsuit is based is not enforceable. The court's ruling on a summary judgment is reviewed de novo. *Hanson Indust.*, 158 Wn.App at 287. Similarly, a court's conclusions of law are reviewed de novo. *The City College Place v. Staudenmaier*, 110 Wn.App. 841, 846, 43 P.3d 43 (2002).

California law prohibits usury. Cal. Const., art. XV, § 1; *Gamer*, 65 Cal.App.3d at 287. To avoid usurious loans within the state, California law provides that “[n]o person shall engage in the business of a finance lender or broker without obtaining

a license ...” Cal. Fin. Code § 22100(a). To this end, the rate of interest a non-exempt lender may charge is capped. *Id.* at § 22002. A usurious transaction consists of: (1) a loan or forbearance; (2) where the interest to be paid exceeds the statutory maximum; (3) the loan and interest is absolutely repayable by the borrower; and (4) the lender has a willful intent to enter into a usurious transaction. *WRI Opportunity Loans*, 154 Cal.App.4th at 533.

Under California law, for a transaction to be considered illegal, it is not necessary that the statute provide a private right of action. *Saunders v. Superior Court*, 27 Cal.App.4th 832, 839, 33 Cal.Rptr.2d 438, 441 (1994). The violation of any of California’s regulatory statutes may constitute an unlawful business practice. *Podolsky v. First Healthcare Corp.*, 50 Cal.App.4th 632, 647, 58 Cal.Rptr.2d 89, 98 (1996); Cal. Bus. & Prof. Code §§ 17200 et seq.

Usurious loans are illegal. *WRI Opportunity Loans*, 154 Cal.App.4th at 545. They are void and hence, not enforceable against guarantors. *Wells*, 46 Cal.2d at 533; Cal Civ. Code § 2810. “It is well-settled general law that the law will not grant relief when a cause of action is grounded upon an illegal transaction.” *Franklin v. Mortgage Guaranty & Sec. Co.*, 57 F.2d 834, 836 (9th Cir. 1932).

At the time it made the loan, Foundation was unlicensed and not one of the class of lenders exempt under the statutes for usury. The loan agreement called for absolute repayment of interest in excess of the statutory maximum allowed an non-exempt lender. The loan documents and guaranty demonstrate Foundation’s intent to enter a usurious transaction. The loan is usurious and illegal.

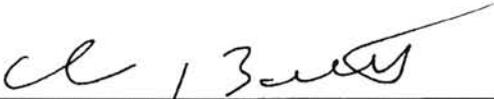
This action seeks recovery on a guaranty that is based on an illegal transaction. It is, therefore, unenforceable and the court’s grant of summary judgment was in error. At a bare minimum the Merjan and Barkett raised significant disputed material facts about the right of Foundation to get summary judgment and granting summary judgment was in error.

VI.

CONCLUSION

California law should apply to the dispute in this case. The agreements are not enforceable and cannot provide a basis for personal jurisdiction. The trial court's order granting summary judgment for Foundation should be vacated.

DATED: May 18, 2012



WILLIAM J. BARKETT, PRO PER

DATED: May 18, 2012



LISA BARKETT, PRO PER

PROOF OF SERVICE

STATE OF CALIFORNIA, COUNTY OF FRESNO

At the time of service, I was over 18 years of age and **not a party to this action**. I am employed in the County of Fresno, State of California. My business address is Post Office Box 28907, Fresno, California 93729-8907.

On May 18, 2012, I served true copies of the following document(s) described as **APPELLANTS' OPENING BRIEF** on the interested parties in this action as follows:

Brian H. Krikorian
2110 N. Pacific Street, Ste. 100
Seattle, WA 98103

BY MAIL: I enclosed the document(s) in a sealed envelope or package addressed to the persons at the addresses listed in the Service List and placed the envelope for collection and mailing, following our ordinary business practices. I am readily familiar with Gilmore, Wood, Vinnard & Magness's practice for collecting and processing correspondence for mailing. On the same day that the correspondence is placed for collection and mailing, it is deposited in the ordinary course of business with the United States Postal Service, in a sealed envelope with postage fully prepaid.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Executed on May 18, 2012, at Fresno, California.



Lisa Renwick