

California Supreme Court OKs Unlimited Fee Awards Against Holders of Credit Contracts

WRITTEN BY

David N. Anthony | Jon S. Hubbard | Scott Kelly | Timothy J. St. George | Alan D. Wingfield | Brooke K. Conkle | Noah J. DiPasquale | Sarah Siu

On May 26, California Supreme Court [ruled](#) that the Federal Trade Commission's (FTC) "Holder Rule" does not limit the award of attorneys' fees where a consumer seeks fees from a holder under a state prevailing party statute.

The Holder Rule and Previous California Precedent

The FTC's Holder Rule permits consumers to bring any legal claims against the "holder" of a credit contract that the consumer could assert against the original seller of the good or service, even if the claim springs from the seller's misconduct alone. The Holder Rule, however, states that a plaintiff's "recovery hereunder" from the holder "shall not exceed amounts paid by the debtor" under the sales contract.

Jurisdictions nationwide have disagreed about whether the Holder Rule's recovery cap prevents courts from requiring holders to pay a plaintiff's attorneys' fees and costs over and above the plaintiff's payments under the contract. *See, e.g., State ex rel. Stenberg v. Consumer's Choice Foods, Inc.*, 276 Neb. 481, 495–96 (2008) (capping attorneys' fees); *but see Home Sav. Ass'n v. Guerra*, 733 S.W.2d 134 (Tex. 1987) (declining to apply Holder Rule limits). The FTC has [added to the confusion](#), issuing a confirmation of the Holder Rule in 2019 that appeared to expressly reject limitless attorney fee awards against holders, but then releasing an [advisory opinion](#) earlier this year that sides with courts that have refused to automatically cap attorneys' fees and costs.

California courts in particular have struggled with whether the Holder Rule's recovery cap applies to a plaintiff's recovery of attorneys' fees and costs over and above the amount paid under the contract. In a 2018 decision, a California court of appeals held that the word "recovery" as used in the Holder Rule includes attorneys' fees, and therefore, the cap prevents courts from awarding attorneys' fees against the holder defendant over and above the amount paid on the contract. In response, the California Legislature passed California Civil Code Section 1459.5, a fee-shifting statute that purports to allow attorneys' fees against the holder. In 2020, another California court of appeals held that the Holder Rule's recovery cap applied to attorneys' fees and, citing the 2019 rule confirmation, that the Holder Rule preempted Section 1459.5.

California's Second District Court of Appeals, however, issued two recent decisions retreating from its previous position: *Pulliam v. HNL Automotive, Inc.*, 60 Cal. App. 5th 396 (2021), and *Melendez v. Westlake Servs., LLC*, No. B306976, 2022 Cal. App. LEXIS 70, at *9 (Jan. 28, 2022). These decisions held that the term "recovery" as used in the Holder Rule does not include attorneys' fees, the FTC's 2019 rule confirmation is not entitled to deference, and attorneys' fees above and beyond the amount paid under the sales contract are therefore

recoverable by a plaintiff from the holder defendant. And earlier this year, California's Fifth District Court of Appeals also allowed recovery of attorneys' fees, ruling that while attorneys' fees are part of "recovery" and are generally precluded by the Holder Rule, the Holder Rule did not preempt an attorneys' fee award under Section 1459.5. *Reyes v. Beneficial State Bank*, 2022 Cal. App. LEXIS 233 (Cal. Ct. App. Mar. 22, 2022).

The *Pulliam* Decision

Deviating from the logic of all prior lower appellate court decisions, the *Pulliam* court charted its own course to allow unlimited attorneys' fee awards under the Song-Beverly Act, California Civil Code Section 1794(d).

The court began by ruling that the phrase "recovery hereunder by the debtor" as used in the Holder Rule was ambiguous because it could refer only to money the debtor keeps (like damages) or also to money the debtor receives and passes along to its counsel (like attorneys' fees). Looking to extrinsic sources, the court noted that the FTC did not mention attorneys' fees until its 2019 rule confirmation, indicating that it was only intended to apply to limit damages awards. From there, the court noted that California law, including the Song-Beverly Act, does not consider attorneys' fees to be an element of damages, treating them as "costs" instead. The court concluded that the FTC, aware of these state laws at the time it created the Holder Rule, did not intend to preempt state laws allowing attorneys' fee awards.

The court also addressed the purpose of the Holder Rule, framing it as a consumer protection rule designed primarily to shift costs away from consumers. It reasoned that the FTC was concerned about consumers' ability to afford litigation, as well as consumers' ability to recover from sellers, but nonetheless expected that consumers would be able to afford to bring "affirmative claims." In the court's view, the Holder Rule acted as a "national floor," but did not "restrict the application of state laws authorizing additional awards of damages or attorney's fees against a seller or holder."

Finally, the court ruled that regardless of whether deference to the FTC's most recent interpretive guidance is warranted, the FTC's interpretation is consistent with its own. The court stated that claims for attorneys' fees by a prevailing party under Section 1794 are distinct from claims against a seller that are extended to a creditor solely by the Holder Rule, because Section 1794 applies to all defendants, not just to sellers. Notably, the court did not provide any analysis of the more recent Section 1459.5, although its brief references were generally favorable, relying instead on Section 1794 to authorize unlimited attorneys' fee awards.

Conclusion

Creditors will need to carefully consider both the existence and language of state fee-shifting provisions when analyzing their exposure, even when their liability otherwise appears entirely dependent on the Holder Rule. Troutman Pepper will continue to monitor and report on judicial and legislative developments nationwide with respect to application and interpretation of the FTC's Holder Rule.

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