

Developments in the Interstate Delivery of Consumer Financial Services

By Darrell L. Dreher, Hugh M. Hayden and Michael C. Tomkies*

INTRODUCTION

The emerging definition of the scope of authority granted to federally chartered and federally insured institutions to charge every borrower, regardless of the laws of the borrower's home state and the interest rates and fees permitted by the laws of the state where the lending institution is located, thereby allowing the institution to effectively "export" interest rates and fees, continues to be generally favorable to financial institutions. Cases in Alabama, California, Colorado, Pennsylvania, New Jersey, and South Carolina and interpretive letters from the National Credit Union Administration (NCUA)¹ and the Office of Thrift Supervision (OTS)² have dealt with the issue of the federal preemption of state regulation of fees. In addition, federal legislation regarding interstate banking and branching has been enacted that will have an impact on the interstate delivery of consumer financial services.

EXPORTATION OF FEES AND OTHER CHARGES

Over forty class action lawsuits were filed following the trial court decision in *Greenwood Trust Co. v. Massachusetts*.³ While some of these cases

*Mr. Dreher, a member of the Ohio bar, practices law with Dreher Langer & Tomkies in Columbus, Ohio. He is chairman of the Subcommittee on Interstate Delivery of Consumer Financial Services. Mr. Hayden, a member of the Illinois and New York bars, is vice president and associate general counsel with Dean Witter, Discover & Co. He is vice chairman of the Subcommittee on Interstate Delivery of Consumer Financial Services. Mr. Tomkies, a member of the Ohio and District of Columbia bars, practices law with Dreher Langer & Tomkies in Columbus, Ohio. The authors gratefully acknowledge the assistance of Mary W. Morgan of Dreher Langer & Tomkies in the preparation of this Article.

1. Letter from Richard S. Schulman, Esq., Acting Assoc. Gen. Counsel, National Credit Union Administration, 62 Banking Rep. (BNA) 766 (Apr. 11, 1994) [hereinafter Schulman Letter].

2. A *Federally-Chartered Savings Association Was Able to "Export" the Same Credit Card Fees as Were Authorized by State Law for the "Most Favored Lender" in Whose Shoes the Association Stood*, [Current] Fed. Banking L. Rep. ¶ 82,852 (Sept. 29, 1994) [hereinafter *Most Favored Lender Provision*].

3. 776 F. Supp. 21 (D. Mass. 1991), *rev'd*, 971 F.2d 818 (1st Cir. 1992), *cert. denied*, 113

have been dismissed, most continue to wind their way through the state and federal courts.

STOORMAN v. GREENWOOD TRUST CO.

*Stoorman v. Greenwood Trust Co.*⁴ involved the question of whether opt-out states were subject to fee exportation.⁵ A Colorado court of appeals, relying on the "well reasoned" decision of the United States Court of Appeals for the First Circuit in *Greenwood Trust*,⁶ affirmed the determination of the trial court that section 521 of the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDA)⁷ preempts Colorado law with respect to the assessment of late fees, concluding that "interest" under section 521 includes late fees.⁸ The Colorado court of appeals concluded that the plaintiff's contentions as to the meaning of "interest" were without merit.⁹ With respect to the effect of Colorado's opt-out provision,¹⁰ the court of appeals noted that effective August 9, 1989, Congress repealed section 525, the opt-out provision of DIDA.¹¹ But the court found that the repeal of the opt-out provision was immaterial because Colorado could only opt out with respect to loans made in Colorado and the loans involved in *Stoorman* were made in Delaware, where the bank was located.¹²

One argument advanced by the plaintiff was that section 521 did not preempt Colorado common law.¹³ Adopting the rationale of *Gilbert v.*

S. Ct. 974 (1993). See generally Michael C. Tomkies, *Interstate Consumer Credit Transactions: Card Issuers Win Fee Exportation Cases*, 47 CONSUMER FIN. L.Q. REP. 105 (1993); Darrell L. Dreher et al., *Developments in the Interstate Delivery of Consumer Financial Services: Location, Fees and Common Law*, 49 BUS. LAW. 1325, 1329 (1994). In *Greenwood Trust*, 971 F.2d at 821, the United States Court of Appeals for the First Circuit ruled that a federally insured, state-chartered bank may charge credit card holders a late fee permitted under the laws of the bank's home state, even when the law of a cardholder's state of residence would prohibit such fees.

4. 888 P.2d 289 (Colo. Ct. App. 1994), *reh'g denied* (May 26, 1994), *cert. granted* (Jan. 30, 1995).

5. Colorado opted out of the federal preemption of state usury laws in DIDA. COLO. REV. STAT. § 5-13-104 (1992 repl. vol.). Greenwood Trust Company, the card issuer, is an FDIC-insured state-chartered bank located in Delaware, relying on the § 521 preemption to export late fees, which are prohibited under the Colorado Consumer Credit Code, COLO. REV. STAT. §§ 5-3-203 & 5-5-202 (1992 repl. vol.).

6. *Greenwood Trust*, 971 F.2d at 818.

7. 12 U.S.C. § 1831d (1988).

8. *Stoorman*, 888 P.2d at 292.

9. *Id.* at 293.

10. Colorado has repealed its opt-out provision. See 1994 Colo. Legis. Serv. S.B. 94-176 (West 1994).

11. *Stoorman*, 888 P.2d at 293.

12. *Id.* at 294.

13. *Id.* at 293 ("Plaintiff . . . alleges that even if § 521 preempts Colorado statutory law, it does not preempt the common law.").

*Greenwood Trust Co.*¹⁴ and finding that federal preemption under section 85 of the National Bank Act¹⁵ does not permit relief under state common law theories, the court ruled against the plaintiff.¹⁶

AMENT v. PNC NATIONAL BANK

Ten Pennsylvania class action cases challenging a variety of fees were consolidated with *Ament v. PNC National Bank*.¹⁷ In *Ament*, the plaintiffs argued (i) out-of-state lenders,¹⁸ including national banks and state-chartered banks, were subject to Pennsylvania laws¹⁹ which prohibited such lenders from charging annual fees, late fees, returned check fees, and overlimit fees; and (ii) even if Pennsylvania law were preempted by section 85 of the National Bank Act²⁰ and sections 521-523 of DIDA,²¹ the fees

14. [Current] Fed. Banking L. Rep. (CCH) ¶¶ 89,412, 89,830 (1993).

15. 12 U.S.C. § 85 (1988).

16. *Stoorman*, 888 P.2d at 294.

17. 849 F. Supp. 1015 (W.D. Pa. 1994); *Bartlam v. Bank of Am.*, No. 92-1427 (W.D. Pa. filed June 12, 1992) (defendant's motion for summary judgment granted April 8, 1994); *Caplan v. Mellon Bank (DE) N.A.*, No. 92-302 (W.D. Pa.) (defendant's motion for judgment on the pleadings granted April 8, 1994); *Deffner v. CoreStates Bank & Household Bank, f.s.b.*, No. 92-349 (W.D. Pa.) (consolidated with No. 92-398) (defendant's motion for judgment on the pleadings granted April 8, 1994); *Goehl v. Mellon Bank (DE) N.A.*, No. 92-2547 (E.D. Pa.), transferred to Western District, No. 93-878 (W.D. Pa.) (defendant's motion for judgment on the pleadings granted April 8, 1994); *Spellman v. Meridian Bank (DE)*, No. 92-CV-3860 (E.D. Pa.), transferred to Western District, No. 93-868 (W.D. Pa.) (defendant's motion for judgment on the pleadings granted April 8, 1994); *Szydluk v. Associates Nat'l Bank (DE)*, No. 92-1025 (W.D. Pa. filed Apr. 6, 1992) (defendant's motion for judgment on the pleadings granted April 8, 1994); *Szydluk v. Associates Nat'l. Bank, N.A.*, No. 92-357 (W.D. Pa.) (dismissed by stipulation of the parties); *Szydluk v. First Omni Bank, N.A.*, No. 92-330 (W.D. Pa.) (defendant's motion for judgment on the pleadings granted April 8, 1994); *Thompson v. Maryland Bank*, No. 92-346 (W.D. Pa.) (defendant's motion for judgment on the pleadings granted April 8, 1994); *Tompkins v. American Gen. Fin. Ctr.*, No. 92-375 (W.D. Pa.) (stayed pending outcome of *Tompkins v. Greenwood Trust Co.*); *Tompkins v. Chase Manhattan Bank (USA)*, No. 92-714 (W.D. Pa.) (defendant's motion for judgment on the pleadings granted April 8, 1994). These 11 cases, originally filed in state court and then removed to federal court, were consolidated for purposes of motions to remand. In addition, *Tompkins v. American Gen. Fin. Ctr.* is challenging cash advance fees. These cases collectively claim violation of Pennsylvania's Unfair Trade Practices and Consumer Protection Law, 73 PA. CONS. STAT. ANN. §§ 201-1 to 201-2 (1994).

18. Most of the defendants were national banks incorporated in Delaware. Chase Manhattan Bank (USA) was a national bank and a state bank at different times during the relevant period, and three defendants, Household Bank, Bank of America, and Associates National Bank of Delaware (California), were located in California. *Ament*, 849 F. Supp. at 1018.

19. Pennsylvania Unfair Trade Practices and Consumer Protection Law, 73 PA. CONS. STAT. ANN. §§ 201-1 to 201-2 (1994); Pennsylvania Goods and Services Installment Sales Act, 69 PA. CONS. STAT. ANN. §§ 1101-1501 (1994) (restricting banks issuing credit cards to periodic interest at 18% per year); Pennsylvania Banking Code of 1965, 7 PA. CONS. STAT. ANN. §§ 101-2201 (1994).

20. 12 U.S.C. § 85 (1988 & Supp. V 1993)

21. *Id.* § 1831d (1988 & Supp. V 1993).

at issue were not included in the definition of "interest" in the National Bank Act or sections 521 through 523 of DIDA.²²

The *Ament* court, relying, in general, on the First Circuit decision in *Greenwood Trust* and in particular on the statement that "federal case law has long suggested that, in ordinary usage, interest may encompass late fees and kindred charges,"²³ asserted that the "strong weight" of the legal authority on the issue of whether late fees and other charges constitute "interest" under section 85 supported its holding in favor of the defendants.²⁴ The court stated its holding was consistent with "ordinary congressional intent that the national banks should not be subject to more restrictive interest provisions than state banks."²⁵ The court also deferred to the technical expertise of the Office of the Comptroller of the Currency (OCC), quoting from the OCC's amicus brief²⁶ and noting prior OCC rulings.²⁷

This case has been appealed to the United States Court of Appeals for the Third Circuit, briefed and argued.²⁸

HUNTER v. GREENWOOD TRUST CO.

Hunter v. Greenwood Trust Co.,²⁹ a late fee exportation case under section 521, was filed in state court, removed to federal court, later remanded to state court, and subsequently dismissed. The defendant's motion to dismiss for failure to state a claim was granted and the Superior Court of New Jersey, Appellate Division, affirmed the trial court's dismissal.³⁰ The plaintiff appealed on grounds that "section 521 preempts state interest laws but excludes late charges from its preemptive scope."³¹ The Appellate Division cited and agreed with six federal court decisions (including *Ament*) holding that late payment charges are "interest," finding plaintiff's attempt to distinguish these cases unpersuasive.³²

The plaintiff argued, as did the plaintiff in *Stoorman*, that even if preemption applies to statutory claims, the plaintiff's state common law claims

22. *Ament*, 849 F. Supp. at 1018.

23. *Id.* at 1019 (citing *Greenwood Trust Co. v. Massachusetts*, 971 F.2d 818, 825 (1st Cir. 1992), *cert. denied*, 113 S. Ct. 974 (1993)).

24. *Id.* at 1018.

25. *Id.* at 1019 (citing *Marquette Nat'l Bank v. First of Omaha Serv. Corp.*, 439 U.S. 299, 315 (1978)).

26. *Id.* at 1020.

27. *Id.* ("The OCC has also issued rulings to the effect that a national, non-Pennsylvania bank may charge its Pennsylvania customers annual fees, and other credit card charges, at its home state rates.")

28. No. 94-3215 (3d Cir. filed Apr. 29, 1994).

29. 640 A.2d 855 (N.J. Super. Ct. App. Div.), *cert. granted*, 649 A.2d 1289 (N.J. 1994).

30. *Id.*

31. *Id.* at 857.

32. *Id.* at 860.

should not have been dismissed.³³ The court rejected the plaintiff's argument that state common law claims for breach of contract and conversion should fall outside the preemptive language of section 521.³⁴ The basis for the plaintiff's "non-preemption of common law" theory lies in the decision of the United States Supreme Court in *Cipollone v. Liggett Group, Inc.*³⁵ In *Cipollone*, the Court held that under a federal statute providing that "[n]o requirement or prohibition based on smoking and health shall be imposed under State law with respect to the advertising or promotion of any cigarettes,"³⁶ certain state common law claims were not preempted.³⁷ Section 521's express preemption clause reads in pertinent part: "notwithstanding any State constitution or statute which is hereby preempted for the purposes of this section."³⁸ It does not expressly mention state common law. The *Hunter* court thus found that the allowance of state common law claims would contravene the express congressional intent in DIDA to prevent discrimination against state-chartered banks.³⁹ Because national banks can charge late fees without interference of common law claims,⁴⁰ the *Hunter* court reasoned, allowance of plaintiff's common law claims would cause state-chartered banks to suffer "precisely the type of discriminatory disadvantage which Congress expressly sought to eradicate through DIDA."⁴¹

SHERMAN v. CITIBANK (SOUTH DAKOTA), N.A.

Section 85 preemption of New Jersey law was also the subject of *Sherman v. Citibank (South Dakota), N.A.*⁴² The defendant's motion to dismiss at trial was granted.⁴³ The trial court observed that interest "can come in many forms including (under relevant federal case law) late fees, closing costs,

33. *Id.* at 861.

34. *Id.* at 861-62.

35. 112 S. Ct. 2608 (1992).

36. *Id.* at 2617 (citing the Public Health Cigarette Smoking Act of 1969, Pub. L. No. 91-222, 84 Stat. 87 (1970) (codified as amended at 15 U.S.C. §§ 1331-1340 (1988 & Supp. V 1993))).

37. *Id.* at 2621.

38. 12 U.S.C. § 1831d (1989 & Supp. 1995).

39. *Hunter*, 640 A.2d at 862 ("State-chartered banks would therefore suffer a disadvantage in relation to national banks if plaintiff's common law claims were allowed.").

40. *Id.*

41. *Id.* The Federal Deposit Insurance Corporation (FDIC) also has concluded that state common law claims are preempted by section 521. *FDIA Section 27 Preempts State Common Law Restrictions on Credit Card Loans*, [Current] Fed. Banking L. Rep. (CCH) ¶ 81,635 (July 12, 1993).

42. 640 A.2d 325 (N.J. Super. Ct. App. Div.), *cert. granted*, No. A-1802-92T2, 1994 N.J. LEXIS 917 (N.J. Oct. 19, 1994).

43. *Sherman v. Citibank (South Dakota), N.A.*, No. L-01834-92 (Super. Ct. Camden, N.J. Nov. 25, 1992) (order dismissing plaintiff's Complaint).

prepayment charges and 'other varieties,'"⁴⁴ and therefore section 85 preempts New Jersey law.⁴⁵

The Superior Court of New Jersey, Appellate Division, affirmed the trial court's dismissal.⁴⁶ The court reviewed recent and historical case law and concluded that "federal case law and administrative opinions support the trial judge's decision and undercut plaintiff's position that section 85 incorporates only a state's numerical rate of interest."⁴⁷ The court found the plaintiff's reference to the debates of the 1864 Congress "not determinative of whether the term 'interest' could also include other fees."⁴⁸ With respect to the plaintiff's other "equally unavailing" arguments, the court determined, *inter alia*, that Congress did not unlawfully delegate its legislative authority but rather adopted state usury laws with respect to national banks and specifically rejected the plaintiff's reliance on legislative history under section 501 of DIDA.⁴⁹ Appeal to the New Jersey Supreme Court was granted on October 19, 1994.⁵⁰

SYX v. GREENWOOD TRUST CO.

Relying on the First Circuit's decision in *Greenwood Trust* and the many decisions consistent with that ruling, an Alabama trial court has granted Greenwood Trust's motion for summary judgment on the grounds that section 521 preempts Alabama law limits on late fees.⁵¹ No appeal has been taken.

SMILEY v. CITIBANK (SOUTH DAKOTA), N.A.

In *Smiley v. Citibank (South Dakota), N.A.*,⁵² the plaintiff challenged the exportation of late fees by a national bank located in South Dakota to credit card customers in California.⁵³ The plaintiff contended that California law, not South Dakota law, should apply to these transactions.⁵⁴ The trial court granted defendant's motion for judgment on the pleadings.⁵⁵ The court of appeals affirmed the trial court's decision in favor of

44. Transcript of Proceedings, No. L-01834-92 (Super. Ct. Camden, N.J. Nov. 25, 1992) at 31, lines 20-22.

45. *Id.* at 32, lines 23-25 through 33, lines 1-8.

46. *Sherman*, 640 A.2d 325.

47. *Id.* at 331.

48. *Id.*

49. *Id.*

50. No. A-1802-92T2, 1994 N.J. LEXIS 917 (N.J. Oct. 19, 1994).

51. *Syx v. Greenwood Trust Co.*, No. CV 91-8824-MC, slip op. (Ala. Cir. Ct. May 2, 1994).

52. 32 Cal. Rptr. 2d 562, *cert. granted*, 883 P.2d 387 (Cal. 1994).

53. *Id.* at 564.

54. *Id.* at 565-66.

55. No. BC059202 (Super. Ct. Los Angeles County, Cal. filed July 7, 1992).

federal preemption,⁵⁶ following the decision of the First Circuit in *Greenwood Trust*,⁵⁷ as well as other court decisions and OCC Interpretations.⁵⁸

The *Smiley* decision included a lengthy dissent criticizing the *Greenwood Trust* decision.⁵⁹ The dissent noted that *Greenwood Trust* was based on section 521 of DIDA⁶⁰ and addressed section 85, the basis of the *Smiley* case, only indirectly.⁶¹ The dissent criticizes the argument in *Greenwood Trust* that utilizing the dictionary definition of the term "interest" could allow for items other than a numeric rate of interest, even though other items may not be in the term's "common parlance" meaning.⁶² In the dissent's view, "late payment fees are costs, such as those which might accompany an attachment or foreclosure, which are contingent on a failure of performance on the part of the borrower. They are not what the ordinary citizen thinks of as part of the 'rate of interest.'" ⁶³ The dissent also contended that a bank's home state's law cannot determine the meaning of the term "interest"; otherwise, Congress has unconstitutionally delegated to state legislatures the authority to establish the scope of federal preemption under section 85.⁶⁴ Finally, the dissent took issue with the majority's deference to the opinion of the OCC, stating in a footnote that the question is one of statutory construction, not administrative expertise, and that the OCC itself has not been entirely consistent in its interpretations.⁶⁵ In its conclusion, the dissent called upon the California Supreme Court to take up the case.⁶⁶

Petition for review was granted on October 27, 1994.⁶⁷

56. *Smiley*, 32 Cal. Rptr. 2d at 562.

57. *Greenwood Trust Co. v. Massachusetts*, 971 F.2d 818 (1st Cir. 1992), *cert. denied*, 113 S. Ct. 974 (1993).

58. *Smiley*, 32 Cal. Rptr. 2d at 566.

59. In response to the First Circuit's railroad metaphor in *Greenwood Trust*, the dissent stated the following:

Taking a ride on the First Circuit's railroad I don't hear the whistle at all. Maybe that's because there is no collision between California's consumer-protection law governing late fees and federal banking law, since the federal banking law is on another track. It is speeding down the "interest" track, while this state's laws and judicial decisions limiting late fees are chugging up the "penalty" track. Giving out-of-state banks a clear signal to charge whatever rate of interest their home state may allow on credit cards does not mean Congress intended state governments should be precluded from regulating other aspects of credit card transactions.

Id. at 567 (Johnson, J., dissenting).

60. 12 U.S.C. § 1831d (1988 & Supp. V 1993).

61. *Smiley*, 32 Cal. Rptr. 2d at 567.

62. *Id.*

63. *Id.* at 567-68.

64. *Id.* at 569.

65. *Id.* at 572 n.7.

66. *Id.*

67. *Smiley*, 883 P.2d 387 (Cal. 1994).

In an *amicus* brief,⁶⁸ the OCC has stated its conclusion that the definition of "interest" is governed by federal, not state, law, although federal law looks to state law to establish the limits of interest.⁶⁹ The OCC drew upon the United States Supreme Court's decision in *First National Bank v. Dickinson*⁷⁰ to illustrate the manner in which federal and state law can interact to further the legislative policy of competitive equality by establishing a self-executing mechanism to accommodate changes in state regulation in response to the changing economic conditions and requirements of the nation.⁷¹ The OCC noted that it "has long had in place a regulation that explicitly recognizes the application of section 85 to all aspects of loan compensation that are 'material to the determination of the interest rate.'"⁷² This regulation, along with judicial interpretations of section 85 and many OCC interpretive letters, the OCC argued, establishes that "interest" under section 85 has not, and should not, be narrowly construed.⁷³ Failure to broadly construe section 85 would expose national banks to the very discrimination section 85 and the most favored lender doctrine were designed to overcome, the OCC asserted.⁷⁴ The Supreme Court's recent decision in *NationsBank of North Carolina, N.A. v. Variable Annuity Life Insurance Co.*,⁷⁵ in which the Court expressed support for deference to the OCC as the administrator of the National Bank Act, bolsters the OCC's assertions.⁷⁶

HARRIS v. CHASE MANHATTAN BANK, N.A.

A California court of appeals has affirmed the general demurer granted in favor of the defendant in *Harris v. Chase Manhattan Bank*.⁷⁷ The court rejected in turn the various arguments made by the plaintiff and the *amici* supporting the plaintiff. The court noted that cases interpreting section 85 do not recognize a contingent/non-contingent fee distinction and that "section 85 (and by implication section 521)" allows the exportation of

68. DRAFT Amicus Brief of the Office of the Comptroller of the Currency, Smiley v. Citibank (South Dakota), N.A., No. S041711 (Cal. S. Ct.) [hereinafter OCC Amicus Brief].

69. *Id.* at 5-7.

70. 396 U.S. 122, 130-134 (1969), *reh'g denied*, 396 U.S. 1047 (1970).

71. OCC Amicus Brief, *supra* note 68, at 5-6.

72. See 12 C.F.R. § 7.7310(a) (1994). While admitting that its letters have not been entirely consistent in their methods over the years, the OCC asserted that its letters have consistently reached the same result in permitting national banks to charge fees that are necessary to compensate banks for extending credit and for borrowers' default, subject only to state law limitations on charges for state-chartered lenders where the national bank is located.

73. OCC Amicus Brief, *supra* note 68, at 7-9.

74. *Id.* at 6.

75. 115 S. Ct. 810 (1995).

76. See *id.* at 813 ("As the administrator charged with supervision of the National Bank Act . . . the Comptroller [of the Currency] bears primary responsibility for surveillance of the 'business of banking' . . .").

77. 35 Cal. Rptr. 2d 733, *cert. granted*, 889 P.2d 540 (Cal. 1995).

