Interstate Consumer Credit Transactions: Card Issuers Win Fee Exportation Cases

By Michael C. Tomkies

Michael C. Tomkies is an Associate with the Columbus, Ohio office of Jones, Day, Reavis & Pogue. He is a member of the Ohio and District of Columbia Bars and the Ohio, District of Columbia, American and International Bar Associations. Mr. Tomkies is a graduate of the Harvard Law School (J.D. 1986) and Hampden-Sydney College (B.A. *summa cum laude* 1983). The author thanks Darrell L. Dreher, Esq. of Jones, Day, Reavis & Pogue for his comments on the manuscript. The views expressed in the article are the personal views of the author and do not necessarily reflect those of the law firm with which he is associated.

I. Introduction

This article is the fourth in a recent series of articles in the *Quarterly Report* discussing interstate lending in the context of consumer credit transactions.[1] The previous article appeared in the Spring 1992 issue and reported the Massachusetts district court decision in *Greenwood Trust Company v. Massachusetts*[2] prohibiting the exportation of late fees by Greenwood Trust, a federally insured Delaware-chartered bank, to Massachusetts cardholders under section 521 of the Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDA").[3] On appeal, the United States Court of Appeals for the First Circuit[4] ruled in favor of Greenwood Trust on the issue of federal preemption, holding that late fees are "interest" for purposes of exportation under section 521 and thus may be charged to residents of other states (referred to as the "exportation" of interest and fees). The United States Supreme Court denied certiorari in *Greenwood Trust* on January 11, 1993.[5]

In a ruling issued just days before the First Circuit's decision and involving two class action lawsuits filed in the wake of the district court decision in *Greenwood Trust*,[6] a Minnesota federal district court in *Hill v. Chemical Bank* and *Fasulo v. Chemical Bank*[7] (collectively, *Hill*) similarly concluded, in the course of denying motions to remand to state court, that late fees, overlimit fees, and similar charges are "interest" for purposes of exportation under section 521.

The First Circuit's decision in *Greenwood Trust* and the Minnesota district court's ruling in *Hill* followed a ruling of the Minnesota federal district court in *Nelson v. Citibank (South Dakota), N.A.* and *Tikkanen v. Citibank (South Dakota), N.A.*[8] (collectively, *Nelson*) in which the court concluded, in denying motions for remand to state court, that late fees and overlimit charges are "interest" for purposes of sections 85 and 86 of the National Bank Act.[9] The *Nelson* ruling was followed by a decision[10] in which the court granted defendants' motions for summary judgment and denied plaintiffs' motions for voluntary dismissal. The plaintiffs did not appeal. *Nelson*, like *Hill*, involved class action lawsuits filed in the wake of the district court decision in *Greenwood Trust*.

Three recently issued administrative interpretations also bear on interstate consumer credit transactions and are discussed *infra*.

II. The *Greenwood Trust* Appeal

In *Greenwood Trust* the First Circuit found express preemption of state usury laws based on the language of section 521.[11] Because federal preemption provided a resolution of the matter, the court did not reach any

1. *See* Tomkies, *Interstate Consumer Credit Transactions: Greenwood Trust and Other Developments*, 46 Consumer Fin. L.Q. Rep. 50 (1992); Tomkies, *Interstate Consumer Credit Transactions: Recent Developments*, 43 Consumer Fin. L.Q. Rep. 152 (1989); Langer & Wood, *A Comparison of the Most Favored Lender and Exportation Rights of National Banks, FSLIC Insured Savings Institutions, and FDIC Insured State Banks*, 42 Consumer Fin. L.Q. Rep. 4 (1988).

2. 776 F. Supp. 21 (D. Mass 1991).

3. Pub. L. No. 96-221, § 521, 94 Stat. 132, 164 (1980) (codified at § 27 of the Federal Deposit Insurance Act, 12 U.S.C. § 1831d (1988 & Supp. I 1989)).

   Section 521, as amended, states in relevant part:

   > (a) In order to prevent discrimination aginst State-chartered insured depository institutions . . . with respect to interest rates, if the applicable rate prescribed in this subsection exceeds the rate such State bank . . . would be permitted to charge in the absence of this subsection, such State bank . . . may, notwithstanding any State constitution or statute which is hereby preempted for the purposes of this section, take, receive, reserve, and charge on any loan or discount made, or upon any note, bill of exchange, or other evidence of debt, interest at a rate of not more than 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal Reserve bank in the Federal Reserve district where such State bank . . . is located or at the rate allowed by the laws of the State, territory, or district where the bank is located, whichever may be greater.

   12 U.S.C. § 1831d (1988 & Supp. I 1989).

4. 971 F.2d 818 (1st Cir. 1992).

5. ___ U.S. ___ (No. 92-784).

6. Over forty lawsuits and administrative proceedings were filed in nine states following the district court's decision in *Greenwood Trust*. *See* Appendix *infra*.

7. 799 F. Supp. 948 (D. Minn 1992); *Hill* was dismissed without prejudice Aug. 10, 1992; *Fasulo* was dismissed without prejudice Aug. 7, 1992. These non-consolidated cases were combined in a single decision by the court because of the similarities in facts and parties.

8. 794 F. Supp. 312 (D. Minn. 1992). These non-consolidated cases were combined in a single decision by the court because of the similarities in facts and parties.

9. 12 U.S.C. §§ 85, 86 (1988).

10. 801 F. Supp. 270 (D. Minn. 1992).

11. 971 F.2d at 831.

of the Massachusetts law issues raised on appeal.[12]

With respect to the scope of preemption under section 521, the court found that the inquiry reduces to a consideration of what Congress intended by the terms "interest" and "interest rates" in section 521.[13] The court rejected as unpersuasive the lower court's narrow "plain meaning" analysis of the text of section 521, noting that the plain meaning of "interest" is not necessarily restricted to numerical percentage rates and that federal court opinions have long suggested that, in ordinary usage, interest may encompass late fees and "kindred charges."[14] The First Circuit observed that plain meaning is more an axiom of experience than a rule of law and does not preclude consideration of persuasive evidence of Congressional intent contradicting supposedly plain meaning.[15]

Finding that the text of the statute is inconclusive, the court turned to a consideration of legislative and historical context. The court determined that "[t]he historical record clearly requires a court to read the parallel provisions of [section 521] and [section 85 of the National] Bank Act *in pari materia,*" because Congress intended to create parity between federally insured state-chartered banks and national banks.[16] The First Circuit noted that many principles inherent in section 85 are consequently "transfused" into section 521, including exportation authority (which the court characterized as a mechanism whereby a bank may continue to use the favorable interest laws of its home state in certain transactions with out-of-state borrowers), and the "most favored lender" doctrine.[17] The court stated that "[t]o the extent that a law or regulation enacted in the borrower's home state purposes [sic] to inhibit the bank's choice of an interest term under section 521, DIDA expressly preempts the state law's operation"; in *Greenwood Trust* Massachusetts law must yield to the preemptory force of section 521 insofar as the regulation of "interest" is concerned.[18] Because the court found DIDA's text and legislative history also to be "at bottom, inconclusive" with respect to the interpretation of the terms "interest" and "interest rates," the court indicated that federal common law or state law must give content to these terms.[19] Although the terms are contained in a federal statute, the court noted that resort to uniquely federal definitions is not automatic if Congress intends state law to fill the interstices within a federal legislative scheme.[20] The court stated that while state law cannot be permitted to define a statutory term in a way entirely strange to ordinary usage, where there are permissible variations in the ordinary concept of the term, a court may deem state law controlling.[21] However, because, in the court's view, both state law and federal common law produce the same result in *Greenwood Trust,* the court declined to decide which law is the appropriate point of reference.[22] If state law is applicable, the court said, it must in *Greenwood Trust* emanate from the laws of Delaware (the bank's home state), and the court expressly so held.[23] The court said that it was bolstered in its interpretation by recognition of the fact that section 85 "adopts the entire case law" of a bank's home state, not simply the numerical rate adopted by the state.[24] Because Delaware law explicitly incorporates late fees into its definition of interest and allows lenders to assess such fees against cardholders,[25] the court said that reference to Delaware law would include late fees in "interest" under section 85.[26] The court noted that federal common law provides "precisely the same result," observing that courts have had "little trouble" construing "interest" to encompass a variety of lender-imposed fees and financial requirements that are independent of a numerical percentage rate.[27] While noting that some such cases were decided with respect to intrastate loans and not in the exportation context, the court said that it discerned no principled basis for defining "interest" differently in intrastate and interstate contexts.[28] The court rejected the lower court's reliance on section 501 of DIDA for the meaning of "interest" as "misplaced," since these provisions are part of different statutes and have "materially different preemption terms."[29]

In the court's view, construing the terms "interest" and "interest rates" to include late fees "fits most comfortably with the rationale undergirding section 521."[30] The court also found "broad support" for its construction in administrative rulings and informal opinion letters of various federal agencies, citing by way of example the Comptroller's interpretive ruling on the most favored lender doctrine[31] for the proposition that all

12. *Id.* at 831 n. 12. Greenwood Trust challenged the lower court's rulings that Massachusetts' prohibition against late fees on credit card loans reaches out-of-state credit card issuers and that Massachusetts law evidences a fundamental public policy that overrides the contractual choice-of-law provision in the cardholder agreement choosing Delaware law. *See* Brief for Appellant Greenwood Trust Company, *Greenwood Trust,* 971 F.2d 818 (1st Cir. 1992); *Greenwood Trust,* 776 F. Supp. at 47; Mass. Gen. Laws Ann. ch. 140 § 114B (West 1991) (late fee prohibition); Tomkies, *supra* note 1, 46 Consumer Fin. L.Q. Rep. at 53, 55 (discussion).

13. 971 F.2d at 824.

14. 971 F.2d at 825.

15. *Id.* (quoting Boston Sand & Gravel Co. v. United States, 278 U.S. 41, 48 (1928) (Holmes, J.)).

16. *Id.* at 826-27. Section 85 contains language substantially similar to § 521, permitting national banks to charge:

> on any loan . . . . interest at the rate allowed by the laws of the State . . . . where the bank is located; or at a rate of 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal Reserve bank in the Federal reserve district where the bank is located, whichever may be the greater.

12 U.S.C. § 85 (1988); *cf.* § 521, *supra* note 3.

17. 971 F.2d at 827, 827 n. 8. The concept of exportation authority was established in Marquette Nat'l Bank v. First of Omaha Serv. Corp., 439 U.S. 299 (1978). The most favored lender doctrine was established in Tiffany v. National Bank, 85 U.S. (18 Wall.) 409, 411 (1874).

18. 791 F.2d at 827.

19. *Id.* at 828.

20. *Id.*

21. *Id.* at 829 (quoting DeSylva v. Ballentine, 351 U.S. 590, 581 (1956)).

22. 791 F.2d 829.

23. *Id.*

24. *Id.* (quoting First Nat'l Bank v. Nowlin, 509 F.2d 872, 876 (8th Cir. 1975) and citing numerous additional cases).

25. *See* Del. Code Ann. tit. 5, § 950 (1985 & Supp. 1990).

26. 971 F.2d at 829.

27. *Id.* at 829-30 (citing *Nelson, supra* note 8, among other cases).

28. *Id.* at 830.

29. 971 F.2d at 830 n. 10; *see* Pub. L. No. 96-221, § 501, 94 Stat. 132, 161 (1980) (codified at 12 U.S.C. § 1735f-7a (1988)). Section 501 preempts state law limitations on the rate or amount of interest, discount points, finance charges, or other charges that may be charged, taken, received, or reserved with respect to certain specified types of federally related first mortgage loans. Pub. L. No. 96-221, § 501(a)(1), 94 Stat. 132, 161 (1980) (codified at 12 U.S.C. § 1735f-7a(a)(1) (1988)).

30. 971 F.2d at 830.

31. *Id.* The Comptroller's interpretive ruling on the most favored lender doctrine provides in relevant part as follows:

> (a) A national bank may charge interest at the maximum rate permitted by State law to any competing State-chartered or licensed lending institution. If State law permits a higher interest rate on a specified class of loans, a national bank making such loans at such higher rate is subject only to the provisions of State law relating to such class of loans that are material to the determination of the interest rate. For example, a national bank may lawfully charge the highest rate permitted to be charged by a State-licensed small loan company or morris plan bank, without being so licensed.

12 C.F.R. § 7.7310 (1992). For a discussion of this interpretive ruling and case law interpretating the materiality concept, *see* Langer & Wood, *supra* note 1, at 7-14, 17. *See also Infra* Part VI.B.

"material" home-state laws are exportable. The court did not dwell on administrative interpretations because the court said it would have reached the same result independent of them.[32] Because the court found that Massachusetts had opted back into federal preemption,[33] the court did not address the issue of the effect of state opt-out under section 525 of DIDA[34] on the exportation authority of federally insured state-chartered banks.[35]

III. The *Hill* Decision

The Minnesota federal district court in *Hill* engaged in a two-step analysis: (1) whether section 521 completely preempted the field of usury claims against federally insured state-chartered banks and (2) whether the plaintiffs' claims were in fact usury claims challenging the rate of interest charged by a federally insured state-chartered bank within the meaning of section 521. The court noted that section 521 establishes the maximum interest rate for federally insured state-chartered banks and creates a federal remedy.[36] The court further noted that under the National Bank Act, section 86 has been construed to provide an exclusive remedy for violation of section 85.[37] Because section 521 contains provisions nearly indentical to sections 85 and 86, the district court concluded that, following the reasoning of *M. Nahas & Co. v. First National Bank,*[38] section 521 completely preempts the field of usury claims against federally insured state-chartered banks.[39]

With respect to whether the plaintiffs' state law claims nevertheless may fall outside the preemptive scope of section 521, the court cited the ruling in *Nelson* for referencing a "wealth of authority" in case law and agency determinations interpreting "interest" under section 85 to include fees other than periodic interest rate charges.[40] The court stated that the same result must hold true under section 521, because the statutes have nearly identical language and Congress enacted section 521 to prevent discrimination against federally insured state-chartered banks.[41] Among other authorities, the *Hill* court relied on *Fisher v. National Bank,*[42] for the proposition that flat fees (in *Fisher,* for cash advances on a credit card account) are "interest" under section 85 and, because of the parity intended between sections 85 and 521, under section 521 as well.[43] The court also cited a recent Federal Deposit Insurance Corporation ("FDIC") interpretive letter confirming the agency's interpretation that section 521 authorizes federally insured state-chartered banks to export the same fees and charges on interstate loans as section 85 authorizes for national banks, including late payment fees.[44] The *Hill* court, like the First Circuit, specifically rejected the district court's analysis in *Greenwood Trust*[45] with respect to the relevance and applicability of sections 501[46] and 525 of DIDA.[47]

Following the issuance of the *Hill* court's ruling on the motions for remand, the plaintiffs voluntarily dismissed their suits.

IV. The *Nelson* Decisions

The *Nelson* court's ruling denying remand to state court employed an analysis of the remand issue substantially similar to that later employed in *Hill.* Because the court found that under the authority of *M. Nahas, Fisher,* and other cases, sections 85 and 86 preempt the field of usury claims against national banks, and flat fees (in *Nelson,* late fees and overlimit charges) constitute "interest" for purposes of sections 85 and 86, the court concluded that the plaintiffs' claims were in fact federal questions properly removable to federal court.[48]

In its subsequent decision, the *Nelson* court rejected the plaintiffs' attempts, after the defendants had filed summary judgment motions, to obtain voluntary dismissal of the cases, or stays of the actions, on grounds that the relevant law was "unsettled."[49] The plaintiffs asserted that consideration by the United States Supreme Court was necessary to resolve the legal issues in question.[50] In response, the *Nelson* court noted that (1) the law had in fact become more settled since the cases were filed as a result of the First Circuit's decision in *Greenwood Trust* and the court's own remand ruling, (2) the United States Supreme Court did not appear to be prepared to address the issues imminently, (3) the defendants had already com-

32. 971 F.2d at 830 n. 11.

33. *Id.* at 823 n. 4.

34. Pub. L. No. 96-221, § 525, 94 Stat. 132, 167 (1980) (codified at 12 U.S.C. § 1730g note (1988)). Section 525 provides:

> The amendments made by sections 521 through 523 of this title shall apply only with respect to loans made in any State during the period beginning on April 1, 1980, and ending on the date, on or after April 1, 1980, on which such State adopts a law or certifies that the voters of such State have voted in favor of any provision, constitutional or otherwise, which states explicitly and by its terms that such State does not want the amendments made by such sections to apply with respect to loans made in such State, except that such amendments shall apply to a loan made on or after the date such law is adopted or such certification is made if such loan is made pursuant to a commitment to make such loan which was entered into on or after April 1, 1980, and prior to the date on which such law is adopted or such certification is made.

Pub. L. No. 96-221, § 525, 94 Stat. 132, 167 (1980); *see* 12 U.S.C. § 1730g note (1988).

The states of Colorado, Iowa, Massachusetts, Maine, Nebraska, North Carolina, Wisconsin, and the Commonwealth of Puerto Rico formally opted out of §§ 521 through 523 of DIDA, although two states have since repealed their statutes opting out of §§ 521 through 523. *See* Colo. Rev. Stat. § 5-13-104 (Supp. 1990); 1980 Iowa Acts ch. 1156 § 32 (not codified); Me. Rev. Stat. Ann. tit. 9A, § 1-110 (Supp. 1990); 1981 Mass. Acts ch. 231, § 2 (codified at Mass. Gen. L., ch. 183, § 63 note (1987), repealed by 1986 Mass. Acts ch. 177); 1982 Neb. Law 913, § 2; N.C. Gen. Stat. § 24-2.3 (1986); 1981 Wis. Laws ch. 45, § 50 (not codified); and P.R. Laws Ann. tit. 10, § 9981 (Supp. 1988).

35. 971 F.2d at 823 n. 4. Section 525 was codified at 12 U.S.C. § 1730g note. Section 1730 was repealed by Title IV of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. No. 101-73, § 407, 103 Stat. 183, 363. For a discussion of the effect of the repeal of § 1730g on opt-out authority under § 525, *see,* Langer, *FIRREA Removes Opt-Out Limitation on Interest Rate Exportation by Insured Savings Associations,* 44 Consumer Fin. L.Q. Rep. 213 (1990).

36. 799 F. Supp. at 951.

37. *Id.* at 952.

38. 930 F.2d 608 (8th Cir. 1991) (holding that 12 U.S.C. § 86 completely preempts the field of usury claims against national banks).

39. 799 F. Supp. at 952.

40. *Id.* at 953 (citing *Nelson, supra* note 8, 794 F. Supp. at 318-20); *see also infra* Part VI.

41. 799 F. Supp. at 953.

42. 548 F.2d 255 (8th Cir. 1977).

43. 799 F. Supp. at 953.

44. *Id.,* citing FDIC Letter from Douglas H. Jones, Deputy Gen. Counsel, FDIC (July 8, 1992) ("FDIC Letter"); *see infra* Part VI. A.

45. *See* 776 F. Supp. at 29-32, 35-36; Tomkies, *supra* note 1, 46 Consumer Fin. L.Q. Rep. at 52-53 (discussion).

46. Pub. L. No. 96-221, § 501; 94 Stat. 132, 161 (1980) (codified at 12 U.S.C. § 1735f-7a (1988)). Section 501 states in relevant part:

> The provisions of the constitution or the laws of any State expressly limiting the rate or amount of interest, discount points, finance charges, or other charges which may be charged, taken, received, or reserved shall not apply . . . .

Pub. L. No. 96-221, § 501(a)(1), 94 Stat. 132, 161 (1980); *see* 12 U.S.C. § 1735f-7a(a)(1) (1988). A Senate committee report on the House Bill that, after the later addition of §§ 521 through 523, eventually became the DIDA states that the purpose of the passage of § 521 was to ease the severity of mortgage crunches that were prevalent at the time of the bill's consideration through the "limited" preemption of mortgage ceilings. S. Rep. No. 368, 96th Cong., 2d Sess. 18-19, *reprinted in* 1980 U.S.C.C.A.N. 236, 254-55. The report further states that "[i]n exempting mortgage loans from state usury limitations, the Committee intends to exempt only those limitations that are included in the annual percentage rate. The Committee does not intend to exempt limitations on prepayment charges, attorney fees, late payment charges or similar limitations designed to protect borrowers." *Id.*

47. 799 F. Supp. at 953-54.

48. 794 F. Supp. at 320-21.

49. 801 F. Supp. at 273.

50. *Id.*

mitted substantial resources to the cases, and (4) ruling on the summary judgment motions (which had been fully briefed by both sides) would be the most efficient way to resolve the actions.[51] The court therefore deemed denial of the plaintiffs' motions appropriate.

With respect to the merits, the *Nelson* court noted that the issues arose out of two lines of cases interpreting section 85 of the National Bank Act: (1) cases interpreting the definition of "interest" under section 85 and (2) those interpreting the "exportation" principle of section 85.[52] With respect to the first line of cases, the court said that it held in its remand ruling that "interest under section 85 could not be defined narrowly to include only periodic interest charges, but included flat fees as well."[53] With respect to the second line of cases, the court noted that the United States Supreme Court acknowledged in *Marquette National Bank v. First of Omaha Service Corp.*[54] that the exportation of interest pursuant to section 85 could impair the ability of states to enact effective usury laws.[55] While acknowledging that the plaintiff's policy arguments for preserving an individual state's authority to enforce consumer protection laws had some appeal, the court dismissed them, stating that it must apply the controlling law.[56] The court consequently turned to a consideration of the plaintiffs' attempts to limit the application of the two lines of relevant case law.

The *Nelson* court reiterated its earlier rejection of the plaintiffs' arguments that section 85 refers only to numerical interest rates and that the broad definition of interest applied under the "most favored lender" doctrine should apply only to intrastate, and not interstate, transactions.[57] The court then explored a third argument proposed by the plaintiffs, that late and overlimit fees may be characterized under the common law as penalties outside the scope of interest limitations. The court ultimately rejected the penalty/interest distinction as unpersuasive, noting that the cases cited by the plaintiffs did not hold that late fees may never be deemed "interest" implicating usury laws and that the few cases cited by the plaintiffs did not necessarily reflect a universal common law approach.[58] The court observed that, indeed, the variation among state usury statutes and cases construing them was the very genesis of the actions before the court.[59]

Addressing the plaintiffs' attack on the exportation principle on historical grounds, the court rejected the plaintiffs' argument that the National Bank Act was created only to address intrastate problems of bank note redemption. The court noted that the Supreme Court determined in *Marquette*[60] that the National Bank Act was intended to facilitate a national banking system that included interstate loans.[61] Finally, the court addressed the plaintiffs' constitutional arguments that (1) exportation under section 85 violates principles of state sovereignty and (2) the incorporation of state law definitions of interest represents an unconstitutional delegation of Congress' legislative authority to the states. In disposing of these arguments, the court concluded that the impairment of state authority results from the interaction of state and federal laws, not simply conflicts between two state laws, and that such impairment results from the Supremacy Clause of United States Constitution.[62] The court also concluded that while section 85 limits the scope of an individual state's laws, the statute does not preempt state laws in their entirety.[63] Because section 85 dictates the laws governing national banks but does not affect the operation of a particular state's laws with regard to banks within its borders, the court concluded that section 85 does not constitute an impermissible delegation of Congressional authority.[64]

The *Nelson* decision addresses several issues respecting exportation authority not previously addressed by the First Circuit's *Greenwood Trust* decision or the *Nelson* court's remand ruling, such as the penalty/interest distinction and the constitutional arguments advanced by the *Nelson* plaintiffs. Because the district court decided the *Nelson* cases under section 85, the court did not reach arguments by the defendants that the plaintiffs' state law causes of action represented impermissible state law interference with lending powers conferred on national banks under section 24 (Seventh) of the National Bank Act.[65]

V. The Effect of the Decisions

These decisions are well reasoned, well written, and consistent and therefore are likely to be persuasive to other courts. Indeed, these decisions have been cited in several subsequent state court cases also allowing the exportation of additional fees as "interest" under federal preemption.[66] The First Circuit's decision in *Greenwood Trust* is binding only in Maine, Massachu-

51. *Id.* at 273-74.
52. *Id.* at 274-75.
53. *Id.* at 275.
54. 439 U.S. 299, 318-19 (1978).
55. 801 F. Supp. at 275.
56. *Id.* 276.
57. *Id.* at 276-77.
58. *Id.* at 278.
59. *Id.*
60. *See supra* note 54.
61. *Id.* at 279.
62. 801 F. Supp. at 280; *see* U.S. Const. art. VI, cl. 2.
63. 801 F. Supp. at 280.
64. *Id.*
65. 12 U.S.C. § 24 (Seventh) (1988 & Supp. II 1990).
66. *See, e.g.*, Sherman v. Citibank (South Dakota), N.A., No. L-01834-92 (Super. Ct. Camden County, N.J. Order filed Nov. 25, 1992) *dismissed with prejudice*, (court dismissed plaintiffs' challenge of late charge provisions on grounds of failure to state a claim; court found that the meaning of "interest" under § 85 is not limited to numerical interest rates, observing that "interest" is a charge on borrowed money that can come in many forms, including (under federal case law) late fees, closing costs, prepayment charges and "other varieties"); Mazaika v. BANK ONE, COLUMBUS, N.A., No. 4058, slip op. (C.P. Philadelphia County, Pa. Dec. 17, 1992) (court sustained defendant's objection that plaintiffs had no valid cause of action under Pennsylvania law; plaintiffs had challenged annual fee, late charge, returned check charge and overlimit charge provisions; court characterized the rationale of recent federal decisions as defining "interest" to include "those fees and charges that arise out of the extension and maintenance of credit"); Harris v. Chase Manhattan Bank, N.A., No. 941164 (Super. Ct. San Francisco County, Cal. Order filed Jan. 19, 1992), *dismissed* (court granted general demurrer on grounds that California statutory and common law limitations on late fees are preempted by §§ 85 and 521); Stoorman v. Greenwood Trust Co., No. 92-CV-1789 (Dist. Ct. Denver County, Colo. Order filed Feb. 4, 1993), *dismissed* (court followed First Circuit decision in *Greenwood Trust, supra* note 4).

setts, New Hampshire, Rhode Island and Puerto Rico. The district court rulings in *Hill* and *Nelson*, because they were based on precedents of the United States Court of Appeals for the Eighth Circuit, may indicate that the prevailing view within the Eighth Circuit[67] will be in accord with the First Circuit. While the federal court decisions to date have agreed that the meaning of "interest," for purposes of exportation by national banks or federally insured state-chartered banks, is broader than only a numeric rate, these decisions leave unanswered the full scope of federal preemption under sections 85 and 521 and the precise controlling law (whether federal or state law definitions of "interest"). Credit card issuers impose many kinds of fees and charges that have not been addressed specifically by the courts. Whether other courts will take divergent views remains to be seen.[68] At the time this article was prepared, a number of class actions precipitated by the district court decision in *Greenwood Trust* were still pending in a number of states against various federally insured state-chartered and national banks.

The decisions to date also do not directly address the permissibility of exporting non-fee terms under the concept of materiality[69] that originated under the most favored lender doctrine, although the First Circuit's passing reference to the Comptroller's interpretive ruling on the most favored lender doctrine[70] and the *Nelson* court's ruling that the most favored lender doctrine and exportation authority concepts of "interest" should not be divergently interpreted may portend judicial consideration and eventual adoption of a materiality concept to define the scope of "interest" under sections 85 and 521. Because the decisions to date do not demarcate the outer boundaries of the definition of "interest" and because cases are still pending within other federal circuits, debate and litigation over the scope of federal preemption of interest rates likely will continue.

VI. Administrative Interpretations

Recent administrative interpretations by the FDIC, the Office of the Comptroller of the Currency ("OCC") and the Office of Thrift Supervision ("OTS") confirm previous administrative analyses of exportation authority and the interconnection of the most favored lender doctrine (and the associated concept of materiality) and exportation authority.

A. FDIC Opinion Letter

In an opinion letter issued July 8, 1992 (before the First Circuit decision in *Greenwood Trust),* and cited in the *Hill* court's decision, the FDIC staff confirmed its interpretation that section 521 authorizes federally insured state-chartered banks to export the same fees and charges on interstate loans that national banks can export under section 85.[71] As stated in the FDIC letter, section 521 authorizes federally insured state-chartered banks to charge interest at the rate allowed to the most favored lender under the laws of the state in which the bank is chartered, even if that rate exceeds the maximum permitted by an out-of-state borrower's state of residence. That right necessarily includes, the FDIC continued, the right to charge late fees and other charges permitted by a bank's home state that are either a component of interest or material to the determination of the interest rate.

The FDIC based its interpretation on (1) the similarity in operative language between sections 521 and 85, (2) the expressly anti-discriminatory purpose of the statute, and (3) the legislative history of section 521. The FDIC acknowledged the inconsistency of its interpretation with the district court's decision in *Greenwood Trust* but asserted that, in the FDIC's opinion, the court did not properly recognize the compelling evidence of Congressional intent and the scope of the interest authority granted under section 85.[72]

The FDIC specifically disagreed with the district court's reliance in *Greenwood Trust* on the legislative history and cases interpreting section 501,[73] enumerating differences in the legislative histories, purposes and applications of sections 501 and 521. In addition, the FDIC opined that the mere existence of a state opt-out right under section 525[74] does not affect the scope of exportation rights provided by section 521 if the loans are not made in the opt-out state.[75]

B. OCC Letter

An OCC interpretive letter issued February 4, 1992, and cited in the *Nelson* case, adopted and reiterated in summary the OCC's position that out-of-state banks issuing credit cards to customers in another state are not bound by the borrower's state's law on credit card fees and charges but may adopt the rate allowed by the banks' home state.[76]

The OCC's discussion of exportation authority arose in the context of the OCC's consideration of the applicability of the Iowa Lender Credit Card Act[77] to national banks. Section 536C.6 of the Iowa law provides that "[t]he terms and conditions of a credit card agreement shall conform to the provisions of Chapter 537 [of the Iowa Code], the Iowa [C]onsumer [C]redit [C]ode."[78] The Iowa Consumer Credit

67. The Eighth Circuit includes the states of Arkansas, Iowa, Minnesota, Missouri, Nebraska, North Dakota and South Dakota.

68. In at least one class action challenging the exportation of late charges by a federally insured state-chartered bank into California, a court has denied a demurrer. Order Overruling Demurrer, St. John v. Greenwood Trust Co., No. 695111-5 (Super. Ct. Alameda County, Cal. Order filed Dec. 17, 1992). The court stated that it could not conclude that Congress had, in drafting § 521 (expressly preempting state statutes and constitutions), the purpose of preempting the state common law complaints of the plaintiff, which included charges of violation of an implied covenant of good faith and fair dealing.

69. *See, e.g.,* 12 C.F.R. § 7.7310 (1992).

70. *Id.*

71. *See* FDIC Letter, *supra* note 44 (citing as precedent by way of example FDIC Interpretive Letter No. 81-3 from Frank L. Skillern, Jr., Gen. Counsel, FDIC (Feb. 2, 1981), *reprinted in* [1988-89 Transfer Binder] Fed. Banking L. Rep. (CCH) para. 81,006 (most favored lender), and FDIC Interpretive Letter No. 81-7 from Kathy A. Johnson, Att'y, FDIC (Mar. 17, 1981), *reprinted in* [1988-89 Transfer Binder] Fed. Banking L. Rep. (CCH) para. 81,008 (exportation). The FDIC had previously expressed the same view in an *amicus curiae* brief filed in the First Circuit strongly urging reversal of the lower court's decision in *Greenwood Trust. See* Brief for the FDIC as Amicus Curiae, Greenwood Trust Co. v. Massachusetts, 971 F.2d 818 (1st Cir. 1992).

72. The FDIC cited, for example, OCC Interpretive Letter No. 452 from Robert B. Serino, Deputy Chief Counsel, OCC (Aug. 11, 1988), *reprinted in* [1988-89 Transfer Binder] Fed. Banking L. Rep. (CCH) para. 85,676.

73. *See supra* note 46.

74. *See supra* note 34.

75. In an *amicus brief* filed in the appeal to the First Circuit filed in *Greenwood Trust,* the FDIC stated that the issue of Massachusetts' opt-out of § 521 was irrelevant to the outcome of *Greenwood Trust* because, in the FDIC's opinion, Greenwood Trust's credit card loans were made in Delaware (the bank's home state), and Delaware has not opted out of § 521. *See* Brief for the F.D.I.C. as Amicus Curiae, Greenwood Trust Co. v. Massachusetts, 971 F.2d 818 (1st Cir. 1992) at 35-36.

76. OCC Interpretive Letter from William P. Bowden, Jr., Chief Counsel, OCC, 5-6 (Feb. 4, 1992) (unpublished) (following and summarizing OCC Interpretive Letter No. 452, *supra* note 72); available on LEXIS (BANKNG library, OCCIL file).

77. Iowa Code Ann. ch. 536C (West Supp. 1992).

78. Iowa Code Ann. § 536C.6 (West Supp. 1992).

Code imposes substantive limitations on interest rates and fees with respect to permissibility, prohibition and dollar amounts.[79]

In reviewing relevant authorities, the OCC stated that for purposes of section 85, the term "interest" is not limited to a numerical rate but includes other elements of state law, *i.e.,* provisions of state law that are material to the determination of the interest rate. Because the most favored lender doctrine "necessarily includes the right to charge other fees that 'most favored lenders' are allowed to charge under state law," the OCC reasoned that any permitted or prohibited charge could be considered material to the interest rate under state law. The OCC recognized in its letter that state laws regarding fees may differ and opined that the interpretation of state law concerning what is "material" to the determination of the interest rate under a particular state's law is for the courts of that state to decide. The OCC concluded that to the extent that Iowa law governing material terms conflicts with the laws of other states in which national banks issuing credit cards are located, the Iowa Lender Credit Card Act is preempted by section 85.

C. The OTS Opinion

In a letter issued in April 1992[80] that addressed whether a federal savings bank must comply with the Illinois Credit Card Issuance Act,[81] the OTS considered the preemptive scope of the Home Owners' Loan Act of 1933 ("HOLA"), in particular, section 4(g) thereof.[82] Based on a review of HOLA, implementing regulations, and relevant federal case law, the OTC concluded that compliance with the Illinois act is not required because state authority over the lending operations of federally chartered savings associations is preempted by HOLA. The OTS broadly asserted that compliance with state lending laws is required of federal associations "only if, and to the extent, those laws are expressly incorporated into federal law," for example, pursuant to the most favored lender doctrine. The OTS referenced case law and opinions by the OTS's predecessor, the Federal Home Loan Bank Board ("FHLBB"), for discussions of relevant principles of federal preemption supporting its decision.[83]

Because the OTS was asked to consider specifically the application of "substantive" state laws pursuant to the most favored lender doctrine and because such application turns on the location of the federal association, the OTS reviewed *Marquette*[84] and several interpretations of the FHLBB concerning the location of federal associations having out-of-state branches. The OTS concluded under the facts presented that, where a federal association's home office is not located in Illinois and the association has no branches in Illinois, the association is not located in Illinois and, therefore, is not subject to the Illinois Credit Card Issuance Act. Furthermore, the OTS opined that a federal association may use the most favored lender rate of the association's home state (or, at the association's option, the state where a branch of the association is located if the loan is "booked" from the branch), provided that the association complies with the substantive credit card laws of the relevant most favored lender jurisdiction.

If upheld by the courts, the OTS's interpretation of section 4(g) could provide federal associations distinct advantages in the area of interstate consumer credit transactions and could enhance the value of the thrift charter in relation to federally insured state-chartered banks and national banks, unless sections 521 and 85 are given similarly broad interpretation by the courts, perhaps through the adoption of the broad materiality concept of FDIC or OCC analyses.

VII. Conclusion

The federal regulatory agencies and those federal courts that have considered the issue at this point in time generally have agreed that the meaning of "interest," for purposes of exportation of interest rates by federally chartered or federally insured institutions, is broader than simply a numeric rate. The agencies and courts have adopted definitions that encompass, at a minimum, late fees, overlimit fees, cash advance fees, and "similar charges." How far the courts will follow the agencies with respect to other issues remains to be seen. As evidenced by the Appendix to this article, many cases are pending in both state and federal courts. The debate and litigation over the scope of federal preemption of state law is likely to continue for some time.

APPENDIX

Over forty actions were filed following the Massachusetts district court's decision in Greenwood Trust Co. v. Massachusetts, 776 F. Supp. 21 (1991), including the following: Syx v. Greenwood Trust Co., No. CV91-8824 (Cir. St. Jefferson County, Ala. amended complaint filed Nov. 12, 1991) (late fees), removed to federal court, No. CV-91-N2855S (N.D. Ala.), remanded to state court; order clarifying memorandum of decision to remand filed Apr. 3, 1992; Lagorio v. Citicorp, No. 91-13025S (D. Mass. filed Nov. 21, 1991) (Citicorp sued as proposed defendants' class representative for alleged defendant class of "over 200" banks and corporations) (late fees); Irwin v. Citibank (South Dakota), N.A. [retitled *In re:* Citibank (South Dakota) Credit Card Litigation], No. 2557 (C.P. Philadelphia County, Pa. filed Dec. 17, 1991) ("delinquency, late or similar charges") (consolidated with *Magaw,* No. GD 91-22507); Magaw v. Citibank (South Dakota), N.A. [retitled *In re:* Citibank (South Dakota) Credit Card Litigation], No. GD 91-22507 (C.P. Allegheny County, Pa. amended complaint filed Jan. 9, 1992) (annual fees, late fees, returned check charges, overlimit charges) (consolidated with *Irwin,* and moved to Philadelphia court); Magaw v. Barnett Bank, No. GD 91-22639 (C.P.

79. *See* Iowa Code Ann. ch. 537 (West Supp. 1992).

80. OTS Opinion No. 92/CC-14 from Harris Weinstein, Chief Counsel, OTS (Apr. 2, 1992), *reprinted in* [1991-92 Transfer Binder] Fed. Banking L. Rep. (CCH) para. 82, 592.

81. Ill. Ann. Stat. ch. 19, paras. 6000 *et seq.* (Smith-Hurd 1981 & Supp. 1992).

82. 12 U.S.C. § 1463(g) (Supp. I 1989). Section 4(g) of HOLA is substantially the same as former § 522 of DIDA. *Compare* Pub. L. No. 101-73, § 301, 103 Stat. 183, 282 (Aug. 9, 1989) (codified at 12 U.S.C. § 1463(g) (Supp. I 1989)) *with* Pub. L. No. 96-221, § 522, 94 Stat. 132, 165 (Mar. 31, 1980) (codified at 12 U.S.C. § 1730g (1982)); *see also* Langer, *FIRREA Removes Opt-Out Limitation on Interest Rate Exportation by Insured Savings Associations,* 44 Consumer Fin. L.Q. Rep. 213 (1990) (discussion of repeal of § 522 and enactment of § 4(g)).

83. The OTS's footnote is as follows:

> Fidelity Federal Savings and Loan Association v. de la Cuesta, 458 U.S. 141, 159-67 (1982); Conference of Federal Savings and Loan Association v. Beverly Hills Federal Savings and Loan Association, 499 F.2d 1145 (9th Cir. 1974); Olsen v. Financial Federal Savings and Loan Association, 434 N.E.2d 406 (Ill. AP. 1982); FHLBB Op. by Solomon (Dec. 13, 1988); FHLBB Op. by Smith (June 29, 1988); FHLBB Op. by Luke (June 13, 1989); FHLBB Op. by Quillian (Apr. 28, 1987); FHLBB Op. by Williams (Mar. 11, 1986); and FHLBB Op. by Raiden (Nov. 12, 1985).

84. *See supra* note 54.

Allegheny County, Pa. filed Dec. 24, 1991) (Florida bank; annual fees, late fees, returned check charges, overlimit charges), removed to federal court, No. 92-0243 (W.D. Pa.), *dismissed* without prejudice with tolling agreement; Ideson v. Citibank (South Dakota), N.A. *et. al.,* No. _____ (Dist. Ct. Hennepin County, Minn., voluntarily *dismissed* before proper service Jan. 30, 1992) (complaint prepared against Citibank, FCC National Bank, Central Atlantic Bank, N.A. (f/k/a MBNA American Bank, N.A.), BANK ONE COLUMBUS, N.A., First National Bank of Omaha, Chemical Bank, VISA U.S.A. Inc., and MasterCard International, Inc.) (late fees, overlimit charges); Ament v. PNC Nat'l Bank, No. GD 92-129 (C.P. Allegheny County, Pa. amended complaint filed Jan. 8, 1992) (annual fees, late fees, returned check charges, overlimit charges), removed to federal court, No. 92-244 (W.D. Pa.), plaintiffs' motion to remand to state court denied on December 29, 1992 (federal question jurisdiction because 12 U.S.C. section 86 provides exclusive federal remedy for usury claims against national banks); Gilbert v. Greenwood Trust Co., No. 1233 (C.P. Philadelphia County, Pa. filed Jan. 20, 1992) (late fees), removed to federal court, No. 92-290 (E.D. Pa.), remanded to state court (consolidated with *Tompkins,* No. GD 92-1177) amendment to briefing schedule filed Dec. 3, 1992; Caplan v. Mellon Bank (DE) N.A., No. GD 92-1176 (C.P. Allegheny County, Pa., filed Jan. 17, 1992) (annual fees, late charges, returned check charges, overlimit charges), removed to federal court, No. 92-302 (W.D. Pa.), plaintiff's motion to remand to state court denied on December 29, 1992 (federal questions jurisdiction because 12 U.S.C. § 86 provides exclusive federal remedy for usury claims against national banks); Tompkins v. Greenwood Trust Co., No GD 92-1177 (C.P. Allegheny County, Pa., filed Jan. 17, 1992) (cash advance charges, late charges, returned check charges), removed to federal court, No. 92-321 (W.D. Pa.), remanded to state court (consolidated with Gilbert, and moved to Philadelphia court); Tompkins v. Chase Manhattan Bank [N.A.], No. GD 92-1178 (C.P. Allegheny County, Pa., filed Jan. 17, 1992) (annual fees, late charges, returned check charges), dismissed; Szvdlik v. First Omni Bank, N.A., No. GD 92-1214 (C.P. Allegheny County, Pa., filed Jan. 21, 1992) (late charges, returned check charges, overlimit charges), removed to federal court, No. 92-330 (W.D. Pa.), plaintiffs' motion to remand to state court denied on December 29, 1992 (federal question jurisdiction because 12 U.S.C. § 86 provides exclusive federal remedy for usury claims against national banks); Szvdlik v. Associates Nat'l Bank, N.A., No. GD 92-1216 (C.P. Allegheny County Pa., filed Jan. 21, 1992) (late charges, returned check charges, overlimit charges), removed to federal court, No. 92-357 (W.D. Pa.), plaintiffs' motion to remand to state court denied on December 29, 1992 (federal question jurisdiction because 12 U.S.C. § 86 provides exclusive federal remedy for usury claims against national banks); Deffner v. CoreStates Bank of Delaware, N.A. and Household Bank (F.S.B.], No. GD 92-1737 (C.P. Allegheny County, Pa., filed Jan. 28, 1992) (annual fees, late charges, returned check charges, overlimit charges), removed to federal court, No. 92-349 (W.D. Pa.), plaintiffs' motion to remand to state court denied on December 29, 1992 (federal question jurisdiction because 12 U.S.C. § 86 provides exclusive federal remedy for usury claims against national banks); Thompson v. Maryland Bank [N.A.], No. GD 92-1738 (C.P. Allegheny County, Pa., filed Jan. 28, 1992) (annual fees, late charges, returned check charges, overlimit charges), removed to federal court, No. 92-346 (W.D. Pa.), plaintiffs' motion to remand to state court denied on December 29, 1992 (federal question jurisdiction because 12 U.S.C. § 86 provides exclusive federal remedy for usury claims against national banks); Tompkins v. American Gen. Fin. Ctr., No. GD 92-1953 (C.P. Allegheny County, Pa., filed Jan. 31, 1992) (Utah-chartered bank; cash advance fees, late fees, returned check charges, overlimit charges), removed to federal court, No. 92-375 (W.D. Pa.), plaintiffs' motion to remand to state court denied on December 29, 1992 (federal question jurisdiction because 12 U.S.C. § 86 provides exclusive federal remedy for usury claims against national banks); Camlin v. Mellon Bank (DE) N.A., No. L0183292 (Super. Ct. Camden County, N.J. filed Feb. 19, 1992) (late charges), removed to federal court, No. 92-CV-1254 (D. N.J.), remanded to state court; defendant's motion to dismiss denied; Sherman v. Citibank (South Dakota), N.A., No. L0193492 (Super. St. Camden County, N.J. filed Fed. 19, 1992) (late charges), dismissed with prejudice on Nov. 25, 1992 (federal law preempts New Jersey law with respect to interest, including late charges; interest "can come in many forms including (under relevant federal case law) late fees, closing costs, prepayment charges and 'other varieties.' "; St. John v. Greenwood Trust Co. et al., No. 695111-5 (Super. Ct. Alameda County, Ca., filed Feb. 24, 1992) (late charges) (plaintiffs also named unknown Does 1 through 100 as defendants), removed to federal court, No. C92-1383 (S.C. Cal.), remanded to stte court, defendants' general demurrer denied December 17, 1992 (court could not conclude that Congress, in drafting section 521 [12 U.S.C. section 1831d], had the purpose to preempt stte common law); Wisconsin v. Ameritech Corp., Household Bank, N.A. et al, No. 92CV1013 (Cir. Ct. Dane County, Wis. filed Mar. 4, 1992) (late charges, cash advance fees, overlimit charges, credit insurance, attorneys' fees, court and collection costs, false advertising, choice-of-law provision, default clause, change-in-terms provision, research charge), defendants' motion to dismiss was granted in part and denied in part on October 9, 1992 (court granted the motion as to claims of false advertising with respect to interest rates being lower than those of competitors, statements made that Ameritech and Wisconsin Bell promoted the credit card, and disclosure of Household Bank as a sponsor, but denied the motion as to all other claims raised therein, including the charging of attorney's fees and collection costs in the face of a statutory prohibition (other fee issues not raised)), plaintiffs' motion for reconsideration denied on December 7, 1992; Richardson v. Citibank (South Dakota), N.A., No. 92-CV-1460 (Dist. Ct. Denver County, Colo. filed Mar. 2, 1992) (lated charges) (motion of United States filed on behalf of the Office of the Comptroller of the Currency); Frutkin v. Provident Nat'l Bank, No. 456 (C.P. Philadelphia County, Pa. filed Mar. 3, 1992) (annual fees, late charges, returned check charges, overlimit charges) plaintiffs' motion to discontinue granted; Cooperman

v. MBNA America Bank, N.A., Bank of America, N.T. & S.A., Marine-Midland Bank, N.A., First Chicago Corp., Household Bank, N.A., No. RC049848 (Super. Ct. Los Angeles County, Cal. filed Mar. 3, 1992) (late charges), removed by all defendants but Bank of America and Household Bank to federal court, No. 92-2031 (C.D. Cal.), remanded to state court; Nelson v. Citibank (South Dakota), N.A. First Nat'l Bank of Omaha, BANK ONE, COLUMBUS, N.A., MBNA America Bank, N.A., No. C1-92-1062 (10th Dist. Washington County, Minn. filed Mar. 3, 1992) (late charges, overlimit charges), removed to federal court, No. 4-92-CV-287 (D. Minn.), motion to remand to state court denied, 794 F. Supp. 312 (D. Minn. 1992) (court opined that late fees and overlimit charges are "interest" for purposes of 12 U.S.C. sections 85, 86), defendants' motions for summary judgment granted, 801 F. Supp. 270 (D. Minn. 1992); Tompkins v. The Chase Manhattan Bank (U.S.A.), No. 92-3625 (C.P. Allegheny County, Pa. filed Mar. 4, 1992) (annual fees, late charges, returned check charges), removed to federal court, No. 92-714 (W.D. Pa.), plaintiffs' motion to remand to state court denied on December 29, 1992 (federal question jurisdiction because 12 U.S.C. section 86 provides exclusive federal remedy for usury claims against national banks); Hunter v. Greenwood Trust Co., No. L0250992 (Super. Ct. Camden County, N.J. filed Mar. 6, 1992) (late charges), removed to federal court, No. 1-92-LV-01122 (D. N.J.), remanded to state court on Nov. 23, 1992; Stoorman v. Greenwood Trust Co., No. 92-CV-1789 (Dist. Ct. Denver County, Colo. filed Mar. 6, 1992) (late charges), removed to federal court, No. 92-C-493 (D. Colo.), motion to remand to state court dismissed on Feb. 4, 1993; Tikkanen v. Citibank (South Dakota), N.A. and MBNA American Bank, N.A., No. C1-92-_____ (10th Dist. Washington County, Minn. filed Mar. 9, 1992) (late charges, overlimit charges), removed to federal court, No. 4-92-CV-286 (D. Minn.), motion to remand to state court denied, 784 F. Supp. 312 (D. Minn. 1992) (court opined that late fees and overlimit charges are "interest" for purposes of 12 U.S.C. sections 85, 86), defendants' motion for summary judgment granted, 801 F. Supp. 270 (D. Minn. 1992); Gadon v. The Chase Manhattan Bank (USA), No. 2909 (C.P. Philadelphia County, Pa. filed Mar. 17, 1992) (late charges, overlimit charges), removed to federal court, No. 92-2252 (E.D. Pa.), remanded to state court; Mazaika v. BANK ONE, COLUMBUS, N.A., No. 4058 (C.P. Philadelphia County, Pa., filed Mar. 24 1992) (annual fees, late charges, returned check charges, overlimit charges), dismissed (no valid cause of action under Pennsylvania law), slip. op. (Dec. 17, 1992) (Pennsylvania consumer protection laws preempted by federal statute; definition of interest should be based upon the laws of the state where the bank is located under 12 U.S.C. section 85; interest is not limited to numerical interest rates and should include those fees and charges that arise out of the extension and maintenance of credit); Szvdlik v. Associates Associates Nat'l Bank (Delaware), No. GD 92-5903 (C.P. Allegheny County, Pa., filed Mar. [25], 1992) (annual fees, late charges, returned check charges, overlimit charges) (Associates National Bank (Delaware) sued as acquirer of accounts of Associates National Bank, N.A., *see* Case No. 13 above), removed to federal court, No. 92-1025 (W.D. Pa.), plaintiffs' motion to remand to state court denied on December 29, 1992 (federal question jurisdiction because 12 U.S.C. section 86 provides exclusive federal remedy for usury claims against national banks); Harris v. Chase Manhattan Bank, N.A. No. 941164 (Super. Ct. San Francisco County, Cal. filed Mar. 6, 1992) (late charges), removed to federal court, No. C92-1483 JPV (N.D. Cal.), remanded to state court, defendant's general demurrer granted on January 19, 1993; Copeland v. MBNA America (Deleware), N.A. No. 92-CV-3909 (Dist. Ct. Denver County, Co. filed June 5, 1992) (late fees), removed to federal court, No. 92-1388 (D. Colo.), motion to leave to file supplemental motion in support of plaintiffs' motion to remand filed; Fasulo v. Chemical Bank f/k/a Chemical Bank Delaware, No. C6-92-1772 (10th Dist., Washington County, Minn. filed Mar. 26, 1992) (late charges), removed to federal court No. 4-92-CV-390 (D. Minn.), motion to remand to state court denied (opinion, Aug. 4, 1992); court opined that late fees, overlimit fees, and similar charges are "interest" for purposes of exportation under section 521 [12 U.S.C. section 1831d]), dismissed without prejudice, 799 F. Supp. 948 (D. Minn. 1992); Holm v. First Bank of South Dakota, N.A., No. _____ (10th Dist., Washington County, Minn. filed Apr. 5, 1992) (late charges, overlimit charges), removed to federal court, No. 3-92-CV-436 (f/k/a/ No. 3-92-CV-462 before intra-district transfer) (D. Minn.), plaintiff has filed notice of dismissal with prejudice; Stevens v. First Bank of South Dakota N.A., No. _____ (10th Dist., Washington County, Minn. filed Apr. 21, 1992) (late charges) removed to federal court, No. 3-92-CV-288 (D. Minn.) dismissed without prejudice on Aug. 17, 1992; Goehl v. Mellon Bank (DE) N.A., No. 4744 (C.P. Philadelphia County, Pa. filed Mar. 27, 1992) (late charges), removed to federal court, No. 92-2547 (E.D. Pa.), motion to remand to state court filed, stayed by stipulated order pending decision in related cases in federal (W.D. Pa.) court; Spellman v. Meridian Bank (Delaware) and Mellon Bank (DE), No. 2970 (C.P. Philadelphia County, Pa. filed May 20, 1992) (late charges), removed to federal court, No. 92-CV-3860 (E.D. Pa.), placed in suspension pending decision on remand in *Caplan,* No. 92-302; Bartlam v. Bank of America, No. GD 92-_____ (C.P. Allegheny County, Pa. filed May 5, 1992) (annual fees, late charges, return check charges, overlimit charges), removed to federal court, No. 92-1427 (W.D. Pa.), plaintiffs' motion to remand to state court denied on December 29, 1992 (federal question jurisdiction because 12 U.S.C. section 86 provides exclusive federal remedy for usuary claims against national banks; Hill v. Chemical Bank f/k/a Chemical Bank Delaware, No. C3-92-1807 (10th Dist., Washington County, Minn. filed Mar. 30, 1992) (late charges, overlimit charges), removed to federal court, No. 3-92-CV-255 (D. Minn.), motion to remand to state court denied (opinion, Aug. 4, 1992); court opined that late fees, overlimit fees, and similar charges are "interest" for purposes of exportation under section 521 [12 U.S.C. section 1831d]), dismissed without prejudice, 799 F. Supp. 948 (D. Minn. 1992); Smiley v. Citibank South Dakota), N.A. No. BC 059202 Super. Ct. Los Angeles

Yet certain second mortgage lenders regularly pay referral fees as permitted by state law, including the Secondary Mortgage Loan Acts of Pennsylvania and New Jersey. Are second mortgage referral fees still permissible?

Arguably, state second mortgage laws permitting pure or "naked" referral fees are now preempted by RESPA. If a broker or other entity obtaining a fee performs more than a nominal service, it may be able to retain its compensation. When the rule is finalized, second mortgage lenders and brokers should limit their referral fee payment practices to payments that bear a "reasonable relationship to the market value" of the services actually performed.

C. Notices Re Servicing Transfers

RESPA was amended by the Cranston-Gonzalez National Affordable Housing Act in 1990 (effective 1991) to require application disclosures and advance notices covering the transfer of loan servicing. Procedures for responding to servicing inquiries were also implemented. Civil liability, including class action liability, can arise for violations.

Now that RESPA applies to subordinate lien loans, second mortgage lenders will probably have to implement the Cranston-Gonzalez servicing disclosures and procedures - even if such lenders never transfer servicing of loans. While this seems somewhat senseless, unless HUD eventually says otherwise, second mortgage lenders will not be able to close loans unless a RESPA servicing transfer application disclosure acknowledged by the applicants is in the loan file.

This short discussion only scratches the surface of new RESPA issues that have arisen for second mortgage lenders and brokers. While awaiting the new regulation, most second mortgage lenders and their counsel should initiate a comprehensive review of RESPA (and revised Regulation X discussed below) and determine the ultimate likely impact of the RESPA revisions on their operations.

III. HUD Revises RESPA Regulation X

While second mortgage lenders reel from one RESPA surprise, first mortgage lenders and brokers were caught off-guard when HUD published, on November 2, 1992, the long awaited final revision to RESPA's Regulation X.[2] Revised Regulation X took effect on December 2, 1992, so residential mortgage lenders and counsel should have reviewed the changes by now. A few of the Regulation X revisions are highlighted below.

A. *Graham Mortgage*

HUD formally reiterates its position that RESPA referral fee prohibitions extend to fees paid for the referral of mortgage loans. The Sixth Circuit found otherwise in *Graham Mortgage*,[3] finding that a mortgage loan is not a "settlement service." Yet HUD restated its position "unequivocally that the origination, processing, or funding of a mortgage loan is a settlement service in this rule."[4]

B. RESPA Extended to Refinances

According to revised Regulation X and the RESPA amendment discussed above, RESPA now covers "refinancings." All residential mortgage lenders and brokers participating in the refinance boom should undertake a complete review of RESPA and implement RESPA disclosures for refinancings immediately. According to revised Regulation X, the Special Information Booklet disclosure is not applicable to refinancings, but all other RESPA provisions apply.

C. Broker Compensation: Referral Fees

All mortgage bankers and mortgage brokers must comprehensively review revised Regulation X to assess their compensation procedures. With HUD's establishment of a Washington based enforcement unit nicknamed the "RESPA Police," enforcement activity is substantially greater than ever before, and RESPA criminal or civil liability can be costly.

Under RESPA, payment or receipt of a fee or other "thing of value" for a referral of a settlement service is illegal. However, it appears that a broker can be paid on a percentage basis or otherwise if the amount paid bears a "reasonable relationship to the market value of the goods or services provided." Only "naked referrals" or fees for "nominal" services are prohibited.

The mortgage banking industry unsuccessully sought dollar limits on payment of mortgage brokerage fees to real estate brokers. However, certain states have established limits on fees that realtors (not licensed as mortgage brokers) may impose for mortgage brokerage service (for example, Pennsylvania: $100, New Jersey: $250).

Lenders and brokers previously argued and HUD seemed to agree that RESPA did not prohibit payment of a referral fee to a broker under two circumstances, whatever the value of the services provided. First, the broker could charge the borrower a fee directly, without direct involvement by the ultimate lender, and be exempt from the RESPA referral fee prohibitions. Second, a loan could be "table funded" and closed in the "broker's" name and immediately sold at a markup to the "ultimate" lender.

Revised Regulation X appears to eliminate these "safe harbor" obstacles to HUD enforcement of RESPA's referral fee prohibitions. Fees cannot be collected by a broker from the borrower or anyone else for which nominal or no services are performed because "the source of payment does not determine whether or not a service is compensable."[5] Thus, fees paid directly by borrowers to brokers are no longer automatically insulated from RESPA compliance analysis.

Similarly, HUD expressly confirms that RESPA referral fee prohibitions now cover "table funding" transactions. Revised Regulation X states that only "bona fide" loan transfers in the secondary market are exempt from RESPA referral fee prohibitions, and "table funding" transactions are not exempt secondary market transactions. Table funders should review their compensation structure to make sure the yield

2. 57 Fed. Reg. 49600 (Nov. 2, 1992, to be codified at 24 CFR Part 3500).
3. U.S. v. Graham Mortgage Corp., 740 F.2d 414 (6th Cir. 1984).
4. 57 Fed. Reg. 49601 (Nov. 2, 1992) (background discussion).
5. 57 CFR Part 2500.14(c).