Recent Developments Regarding Interstate Lending and Non-Usury Theories Attacking Loan Charges

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I. Introduction

Lenders involved in interstate transactions today find themselves in the middle of a developing area of banking and consumer finance law. On one hand is the issue of the scope of the authority granted to federally chartered and federally insured institutions to charge to every borrower, regardless of the laws of the borrower's home state, the interest rates and fees permitted by the laws of the state where the lending institution is located, that is to "export" interest rates and fees. Courts and regulators are presently facing the challenge of determining the range of exportable fees and the "location" of particular institutions. On the other hand is the potential for interstate banking legislation and for legislative consideration of interstate lending ussues.[1] Selected developments affecting these issues are explored in Parts II, III, and IV below.

Lenders are increasingly confronting creative non-usury theories propounded by self-styled consumer advocates to attack the propriety of loan charges that are not expressly regulated or prohibited by applicable statutes. Whether cloaked in the rubric of "unconscionability," "unreasonableness," breach of a duty of "good faith and fair dealing," "unlawful penalties" or other terminology, these theories have been accepted by some courts.

The views expressed in this article are those of the authors and do not necessarily represent the views of Zeiger, Dreher & Carpenter.

1. *See, e.g.*, HR 3841, 103rd Cong. 2nd. Sess. (1994).

Certain recent developments regarding these types of claims are examined in Part V below.

II. Recent Developments in Post-*Greenwood Trust* Litigation Regarding the Exportation of Fees and Other Terms

A. Key Case Law Developments

1. Pennsylvania

On December 9, 1993, a Pennsylvania trial court held in *Irwin v. Citibank (South Dakota), N.A.*[2] that the United States Supreme Court's interpretation of section 85 of the National Bank Act ("section 85")[3] in *Marquette National Bank v. First of Omaha Service Corp.*[4] is unconstitutional because it delegates too much congressional power to individual states. According to the trial court, under *Marquette,* section 85 authorizes one state to determine the permissible rate of interest on a loan for another state by allowing a national bank to export interest rates allowed by the laws of its home state. The argument against the *Marquette* interpretation is that it prohibits Pennsylvania from protecting its citizens against out-of-state lenders. The *Marquette* court indeed noted that the effect of exportation is to "significantly impair the ability of States to enact effective usury laws"[5] and nonetheless endorsed exportation. Judge Avellino certified his order denying the bank's preliminary objection relating to federal issues for interlocutory appeal, and the parties are engaged in motion practice on the interlocutory appeal issue. On December 20, 1993, the court issued a stay pending the outcome of an interlocutory appeal.

The *Irwin* court's decision is contrary to the Pennsylvania state appellate court's decision in *Mazaika v. BANK ONE, COLUMBUS, N.A.*[6] The same court (but not necessarily the same panel) that would rule on the interlocutory appeal in *Irwin* affirmed the decision of a lower court that an out-of-state national bank may charge, as "interest," late fees, annual fees, overlimit fees and returned check fees permitted by the bank's home state's law to Pennsylvania residents, notwithstanding the prohibition on such fees under Pennsylvania law. This decision represents the first state appellate court decision authorizing a bank to export fees. As a memorandum opinion, however, the *Mazaika* decision carries no precedential value under Pennsylvania rules. Moreover, in the wake of *Irwin,* the appellate court reheard *Mazaika en banc* on April 18, 1994.

On April 8, 1994, a federal district court held in *Ament v. PNC National Bank*[7] that late charges constitute "interest" under section 85 and section 521 ("section 521") of the Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDA").[8] The court agreed with defendants' statement that courts have routinely held that charges for establishing a lending account with a national bank, or for drawing money on the account, are "interest" covered by section 85 even if the charges are not denominated as a percentage amount over time. The court asserted that its holding is consistent with ordinary congressional intent that national banks should not be subject to more restrictive interest provisions than state banks. The court also deferred to the technical expertise of the Office of the Comptroller of the Currency ("OCC"), quoting from the OCC's amicus brief and noting prior OCC rulings. The court determined that the same result holds for the defendant California-based national banks and Household Bank (a federal savings bank), notwithstanding plaintiffs' arguments to the contrary. This decision has special significance given the number of consolidated actions it affects.

2. California

The California cases are interesting because California courts have generally been more receptive to broad theories of creditor liability than other courts. These theories, some of which previously were used to attack the fee-charging practices of California-based banks, are now being employed to blunt efforts of out-of-state banks and other depository institutions to export fees on loans to California residents.

In *St. John v. Greenwood Trust Co.,*[9] a California court overruled defendant Greenwood Trust's general demurrer on December 17, 1992 on the grounds that the court could not conclude that Congress, in drafting section 521, had the purpose to preempt state common law (*e.g.,* claims of unconscionability, unlawful penalties and the like). A stipulation to stay the action pending the outcome of the contrary *Harris v. Chase Manhattan Bank, N.A.*[10] decision (discussed below) was approved on December 14, 1993.

In *Donald v. Golden 1 Credit Union,*[11] a federal district court in California rejected the claim of a credit union that section 523 of DIDA[12] completely preempts a California statute limiting liquidated damages.[13] Section 523 establishes the maximum interest rate that can be charged by federally-insured credit unions. Section 1671 of the California Civil Code ("section 1671") limits the ability of contracting parties to agree to liquidated damages clauses and provides that in certain circumstances, liquidated damages clauses are void unless the lender has made a "reasonable endeavor"

2. [Retitled *In re Citibank (South Dakota) Credit Card Litigation*], No. 9112-2557 (C.P. Philadelphia County, Pa. filed Dec. 17, 1991).

3. 12 U.S.C. § 85 (1989).

4. 439 U.S. 299 (1978).

5. *Id.* at 318-19.

6. No. 93-PA-231 (Pa. Super. Ct. Oct. 29, 1993).

7. 849 F. Supp. 1015 (W.D. Pa. 1994) (ruling on numerous cases); *see* prior ruling at 825 F. Supp. 1443 (W.D. Pa. 1992) (upholding removal to federal court on grounds of "complete preemption federal question jurisdiction").

8. 12 U.S.C. § 1831d (1989).

9. No. 695111-5 (Super. Ct. Alameda County, Cal. filed Feb. 24, 1992).

10. No. 941164 (Super. Ct. San Francisco County, Cal. filed Mar. 6, 1992).

11. 839 F. Supp. 1394 (E.D. Cal. 1993).

12. 12 U.S.C. § 1785(g) (1989).

13. *Cf.* Letter from Richard S. Schulman, Esq., Acting Assoc. Gen. Counsel, National Credit Union Administration (Apr. 11, 1994), reprinted in 62 Banking Rep. (BNA) 766 ("Schulman Letter").

to estimate a "fair average compensation" for the damages actually sustained and it would be impracticable or extremely difficult to fix the actual damages.[14] Plaintiff claimed that defendant's $5 late payment fee violated section 1671, and brought a suit in California state court. The defendant, a federally insured, state-chartered credit union, removed the action to federal court based on the federal law implications. The federal district court remanded the case back to state court, stating that DIDA does not govern all state regulation of bank services, and that there was no indication that Congress intended to completely preempt laws that set the general rules of contract, such as section 1671. However, on remand the state court granted defendant's motion to dismiss on February 27, 1994, without opinion.

The apparent basis for this "non-preemption of common law" theory lies in the U.S. Supreme Court's decision in *Cipollone v. Liggett Group, Inc.*[15] In *Cipollone,* the Court held that under a federal statute providing that "[n]o requirement or prohibition based on smoking or health shall be imposed under State law with respect to the advertising or promotion of any cigarettes . . . ,"[16] certain state common law claims were not preempted. Both section 521's and section 523's express preemption clauses provide in pertinent part: "notwithstanding any State constitution or statute which is hereby preempted for purposes of this section."[17] However, the National Credit Union Administration ("NCUA") and the Federal Deposit Insurance Corporation ("FDIC"), in separate interpretive letters (discussed in Part II. B below), have concluded that state common law claims are preempted by section 523 and section 521, respectively.[18] The non-preemption of common law theory has not arisen under section 85 because it does not contain an express preemption clause.

In *Harris v. Chase Manhattan Bank, N.A.,*[19] the court granted defendant's general demurrer on January 19, 1993. An appeal has been fully briefed and the parties are awaiting the scheduling of oral argument.[20] The primary issue in this case is the non-preemption of common law theory; therefore, the decision on appeal may influence the *St. John* court. A measure of the appeal's importance is that the Bankcard Holders of America has filed an amicus brief supporting the plaintiff, while VISA, MasterCard, the Consumer Bankers Association, the American Bankers Association, and a group of national banks have filed amici curiae briefs in support of Chase.

Finally, in *Smiley v. Citibank (South Dakota) N.A.,*[21] the plaintiff is challenging the exportation of late fees. The court granted defendant's motion for judgment on the pleadings on October 6, 1993. On appeal, the court of appeal affirmed the trial court's decision in favor of federal preemption, following the decision of the United States Court of Appeals for the First Circuit in *Greenwood Trust v. Massachusetts*[22] and other court decisions, as well as OCC interpretations.[23]

3. Wisconsin

Wisconsin v. Ameritech Corp.[24] is significant because it could impose limits on the range of exportable loan terms. The court granted defendant Household Bank, N.A.'s motion for judgment on the pleadings regarding its authority to export late fees, overlimit fees, and cash advance fees on July 9, 1993. Plaintiff's motion for summary judgment on the applicability of Wisconsin restrictions or requirements regarding attorneys' fees, collection costs, choice of law, research fees, and change in terms was denied. The potentially applicable Wisconsin statute prohibits the imposition of attorneys' fees and collection costs.[25] Trial was scheduled for April 25, 1994, but has been delayed. The case is currently on appeal to the Wisconsin Supreme Court after a Wisconsin appellate court upheld the granting of Ameritech's motion to strike the state's request for a jury trial.[26]

4. Colorado

A Colorado state trial court has rejected plaintiff's argument that MBNA America charged late fees in violation of the Colorado Consumer Credit Code.[27] In its order granting the defendant bank's motion for judgment on the pleadings, the court stated that " [i]t is better to know whether state law is preempted by federal law on the subject issues prior to trial of this large class-action law suit." The court granted defendant's motion for judgment on the pleadings on July 9, 1993. A Colorado court of appeals affirmed the trial court's decision.[28]

Another Colorado case, *Stoorman v. Greenwood Trust Co.,*[29] raised the question of the effect of a state's opt out of the section 521 preemption because Colorado so opted out and defendant Greenwood Trust is an FDIC-insured state-chartered bank relying on the section 521 preemption. Plaintiff challenged the exportation of late fees.

14. Cal. Civ. Code § 1671(d) (West 1994); *Garrett v. Coast & Southern Fed. Sav. & Loan Ass'n.*, 9 Cal. 3d 731, 738-39 (1973).

15. 505 U.S. _____, 112 S.Ct. 2608 (1992).

16. *Id.* at 2617 (citing the Public Health Cigarette Smoking Act of 1969, Pub. L. 91-222, 84 Stat. 87, as amended, 15 U.S.C. §§ 1331-1340).

17. Section 523 refers to the "subsection" rather than the "section." 12 U.S.C. § 1785(g) (1989).

18. *See also* discussion of cases in Parts II.A.4 and II.A.5 *infra.*

19. *Supra* note 9.

20. No. A060791 (Cal. Ct. App. filed Feb. 17, 1993).

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

22. 971 F.2d 818 (1st Cir. 1992), *rev'g*, 776 F. Supp. 21 (D. Mass. 1991).

23. No. B078913, slip op. (Cal. Ct. App. July 11, 1994). One judge wrote a lengthy dissent contending that (i) a late fee is not part of the compensation borrowers pay for the use of money, and thus is not "interest," but rather a penalty for breach of a loan contract, and (ii) the bank's home state's law cannot determine the meaning of the term "interest," or else Congress has unconstitutionally delegated to state legislatures the authority to establish the scope of federal preemption uder § 85.

24. No. 92 CV 1013 (Cir. Ct., Dane County, Wis. filed March 4, 1992).

25. *See* Wis. Stat. § 422.411 (1993).

26. No. 93-1750, 1994 Wis. App. LEXIS 656 (May 26, 1994).

27. Copeland v. MBNA America (Delaware), N.A., No. 92-CV-3909 (Dist. Ct. Denver County, Colo. filed June 5, 1992).

28. No. 93-CA-1191, 1994 Colo. App. LEXIS 144 (May 26, 1994).

29. No. 93CA0224, 1994 Colo. App. LEXIS 101 (Apr. 7, 1994).

On April 7, 1994, a Colorado court of appeals, relying on the "well reasoned" decision of the First Circuit in *Greenwood Trust,*[30] affirmed the determination of the trial court that section 521 preempts Colorado law with respect to the assessment of late fees. Having concluded that "interest" under section 521 includes late fees, the court of appeals further concluded that plaintiff's other contentions as to the meaning of "interest" were without merit. The plaintiff argued, among other things, that section 521 did not preempt common law. The court of appeals disagreed, siding with the court in *Gilbert v. Greenwood Trust Co.*[31] and finding that express federal preemption with an exclusive federal remedy does not permit relief under state common law theories. On the opt-out issue, the Colorado court of appeals found that effective August 9, 1989, Congress repealed the opt-out provision of DIDA. Moreover, even if Colorado's option remained effective, the court concluded that such opt-out was ineffective with respect to the loans in the case because Colorado could only opt out with respect to loans made in Colorado and Greenwood Trust was located in Delaware.

5. New Jersey

Hunter v. Greenwood Trust Co.,[32] a late fee exportation case under section 521, was removed to federal court,[33] but plaintiff's motion to remand to state court was granted November 23, 1992. Defendant's motion to dismiss for failure to state a claim was granted on February 5, 1993.

On April 22, 1994, the Superior Court of New Jersey, Appellate Division, affirmed the trial court's dismissal.[34] The plaintiff appealed on grounds that section 521 preempts state interest laws but excludes late charges from its preemptive scope and that, even if preemption applies to statutory claims, plaintiff's state common law claims should not have been dismissed. The Appellate Division court cited and agreed with six federal court decisions (including *Ament* above) holding that late payment charges are "interest," finding plaintiff's attempt to distinguish these cases unpersuasive. The court rejected the plaintiff's argument, based on *Cipollone,* that state common law claims for breach of contract and conversion fall outside the preemptive language of section 521. The court found that the allowance of such claims would contravene the express congressional intent in DIDA "to prevent discrimination against state-chartered insured depository institutions."[35] Because national banks can charge late fees without interference of common law claims,[36] the 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."

Section 85 preemption of New Jersey law is the subject of a pending appeal of *Sherman v. Citibank (South Dakota) N.A.*[37] Defendant's motion to dismiss was granted by the trial court on the grounds that section 85 preempts New Jersey law.[38] The trial court observed that interest "can come in many forms including (under relevant federal case law) late fees, closing costs, prepayment charges and 'other varieties.'"

On April 22, 1994, the Superior Court of New Jersey Appellate Division, affirmed the trial court's dismissal. The Appellate Division 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." 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. With respect to the plaintiff's other "equally unavailing" arguments, the court determined, among other things, 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.

6. Alabama

Relying on the First Circuit's decision in *Greenwood Trust* and 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.[39]

7. South Carolina

A federal district court denied plaintiff's motion to remand to state court in *Watson v. First Union Nat'l. Bank of South Carolina.*[40] Plaintiff challenged credit card overlimit fees charged by two national banks and argued that the action involved only state law issues. The court held that the challenged fees were "interest" for the purposes of sections 85 and 86 of the National Bank Act and that these sections completely preempt state usury laws with regard to national banks. While not a fee exportation case, this opinion supports the argument that overlimit fees are included in the definition of interest in the National Bank Act.

30. *Supra* note 22.

31. [Current] Fed. Banking L. Rep. (CCH) ¶ 89,412, 89,831 (C.P. Philadelphia County, Pa. Mar. 11, 1993).

32. No. L0250992 (Super Ct. Camden County, N.J. filed Mar. 6, 1992).

33. No. 1-92-CV-01122 (D.N.J.).

34. 272 N.J. Super. 526.

35. Citing 12 U.S.C.A. § 1831d(a).

36. Citing Tikkanen v. Citibank, N.A., 801 F. Supp. 270, 279-80 (D. Minn. 1992).

37. 272 N.J. Super. 435 (1994).

38. No. L0183492 (Super. Ct. Camden County, N.J. filed Feb. 19, 1992).

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

40. 837 F. Supp. 146 (D.S.C. 1993).

B. Key Regulatory Agency Developments

1. FDIC

The FDIC has rejected the theory that section 521 does not preempt state common law claims. In a letter from Deputy General Counsel Douglas H. Jones ("Jones Letter"),[41] the FDIC concluded that section 521 authorizes FDIC-insured, state-chartered banks to export charges permitted by the bank's chartering state on credit card loans to borrowers residing in states having common law prohibitions on the charges. The Jones Letter rejects the non-preemption of common law theory with respect to section 521 on the bases that (i) section 521 was intended to accord federally-insured state banks the same "most favored lender" status and power to export interest that national banks possess under section 85 (*e.g.*, "competitive equality") and (ii) a distinction based on the form of limitation "would necessarily eviscerate the underlying purpose of section 521," which is to create competitive equality among state and national banks. The FDIC found no evidence that Congress intended to exclude common law claims from section 521's preemptive scope.

2. NCUA

The NCUA has joined the federal banking agencies and courts that have determined that, under applicable federal law, late fees constitute "interest" and common law claims, as well as statutory claims, are preempted.[42] The NCUA's opinion interprets section 523 of DIDA to be consistent with section 85, section 521, and section 522 of DIDA.

3. Maine

The Maine Bureau of Consumer Credit Protection is challenging Greenwood Trust's authority to export late fees.[43] The bank has filed a motion to dismiss the proceeding based on the decision of the U.S. Court of Appeals for the First Circuit in *Greenwood Trust Co. v. Massachusetts*,[44] holding that an FDIC-insured state bank can export late fees as "interest" despite limits on late fees under the borrower's state's law. The Maine regulator may assert that Maine's opt-out of the section 521 preemption negates the bank's exportation rights.

III. "Location" of Depository Institutions for Exportation Purposes

A. Multistate Federal Savings Associations

Interpreting section 522 of DIDA, the Chief Counsel for the Office of Thrift Supervision ("OTS") has concluded that a federal savings association is "located" in the state where its home office is located, as well as in any state where the association maintains a branch office.[45] The OTS Counsel declared that when the association originates loans from a branch office, the association may apply (and export) the most favored lender rates of either its home state or the state in which the branch is located. Thus, the OTS Counsel determined that a federal savings association has the option of applying the branch state's rates to loans booked in that state.

B. "Cobranded" Loans

1. South Carolina

Beneficial National Bank ("Beneficial") provides loans to qualified H&R Block customers in the amount of a taxpayer's expected tax refund, less a fixed-amount finance charge (tax refund anticipation loan or "TRAL"). In *Cade v. H&R Block, Inc.*,[46] the plaintiff alleged that Beneficial, through H&R Block, charged usurious rates to South Carolina residents on the TRALs. The court rejected this claim, finding that H&R Block is not a lender in the TRAL program, but rather is Beneficial's disclosed agent. If Beneficial has complied with all applicable federal and state laws, stated the court, then so has H&R Block.

Relying on *Marquette*, the court stated that for purposes of section 85, a national bank is located in the state where the bank has its charter address (Delaware here). Under Delaware law, the fixed-amount finance charge is permissible if the parties so agree.[47] As the charge was included in Beneficial's loan documents, the court held the charge to be allowed under Delaware law and section 85.

The court rejected plaintiff's argument that H&R Block served as a branch of Beneficial in the TRAL program and so Beneficial thus lent money in South Carolina through H&R Block, triggering the application of the South Carolina Consumer Protection Code. As the two entities are unaffiliated and autonomous, the H&R Block offices were not in any way "established" by Beneficial. Consequently, they did not meet the definition of a "branch" under the McFadden Act.[48] The case has been appealed to the United States Court of Appeals for the Fourth Circuit.

2. Wisconsin

In *Wisconsin v. Ameritech Corp.*,[49] the court rejected Wisconsin's argument in a motion for summary judgment that because Ameritech Corp. and Wisconsin Bell acted in concert with Household Bank, N.A. in operating the Ameritech Complete MasterCard program, there was a possible material factual dispute as

41. Interpretive Letter from Douglas H. Jones, Deputy Gen. Counsel, FDIC (July 12, 1993), *reprinted in* [Current] Fed. Banking L. Rep. (CCH) ¶ 81,635, [5] Consumer Cred. Guide (CCH) ¶ 95,511.

42. *See* Schulman Letter, *supra* note 12.

43. *In re Greenwood Trust Co.*, No. CCP-92-01 (Me. Bureau of Consumer Credit Protection, filed Jan. 16, 1991).

44. 971 F.2d 818 (1st Cir. 1992), *cert. denied*, 113 S. Ct. 974 (1993).

45. Office of Thrift Supervision ("OTS") Gen. Counsel Op. No. 92/CC-59 (Dec. 24, 1992), *reprinted in* [1992-1993 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 82,645.

46. Cade v. H&R Block, Inc., No. 92-1454-21, slip ops., 1993 U.S. Dist. LEXIS 19041 and 19043 (D.S.C. July 16, 1993).

47. Del Code Ann. tit. 5, §§ 963-965.

48. *See* 12 U.S.C. § 36 (1989); Independent Bankers Ass'n. v. Marine Midland Bank, 757 F.2d 453 (2d Cir. 1985), *cert. denied*, 476 U.S 1186 (1986).

49. *Supra* note 19.

to whether the "joint venture" was "located" in Wisconsin or California for section 85 purposes. The court accepted Household's argument that it could export late fees, overlimit fees, and cash advance fees from the state where it was "located," California.

3. Arkansas

An Arkansas car dealer arranged a loan from an Oklahoma-based national bank to Arkansas residents. In *Wiseman v. State Bank & Trust. N.A.*,[50] the plaintiffs contended that the bank should be deemed "located" in Arkansas because a majority of State Bank and Trust's stock was owned by an Arkansas bank holding company. The Arkansas Supreme Court rejected this argument on two grounds: (i) a corporation is an entity separate from its shareholders and (ii) *Marquette* states that a bank' s charter address is an indicator of "location" under section 85. No facts were presented relating to other contacts by the bank with Arkansas.

IV. OCC Interpretive Letters on National Bank Act Preemption

In an interpretive letter, the OCC has concluded that Idaho, Wisconsin, and Wyoming statutes requiring a national bank to file annual notifications with state credit administrators and an Idaho statute requiring licensing of and recordkeeping by a national bank credit card issuer are preempted.[51] According to the OCC, these state statutes provide for an impermissible exercise of visitorial powers over national banks by the states.

On the same grounds, the OCC has determined that a Massachusetts statute requiring a credit card issuer to file comparative rate and fee information with the Massachusetts Commissioner of Banks on a quarterly basis is preempted to the extent that the statute applies to national banks.[52]

V. Recent Developments Regarding Unconscionability and Liquidated Damages/ Penalty Claims

A. Unconscionability

The plaintiff in *California Grocers Ass'n v. Bank of America*[53] alleged that the $3 fee that the bank charged the depositor of another person's NSF check (a deposited item returned ("DIR") fee) was unconscionable. The appellate court reversed the trial court, finding that the "shock the conscience" standard for unconscionability under California case law had not been met for two reasons: (i) the bank's $3 DIR fee is at the low end of DIR fees charged by other banks, which often range between $4 and $10, and (ii) the $3 fee is simply not so exorbitant as to shock the conscience. The court concluded that while a 100% markup on an assumed cost of $1.50 may be a "generous" profit, "it is wholly within the range of commonly accepted notions of fair profitability."[54]

The court held that the unconscionability doctrine, which has historically provided only a defense to enforcement of a contract, cannot be used offensively to obtain mandatory injunctive relief, unless specifically authorized by statute. While the court found that no such California statute existed for the benefit of commercial entities such as plaintiff, it noted that under the California Consumer Legal Remedies Act,[55] a consumer can bring an action for damages and injunctive relief based on insertion of an unconscionable provision in a contract.[56]

The court characterized the issue of whether service fees charged by banks are too high and should be regulated as a question of economic policy. In the court's view, it is primarily a legislative and not a judicial function to determine economic policy. This attitude surely comes as a relief to lenders, who have become accustomed to acceptance of economic policy arguments by the California courts.

B. Liquidated Damages/Penalty Claims

1. California

In *Hitz v. First Interstate Bank*,[57] a late fee case, a California court found that the bank's credit card late fee of 5% of the amount past due ($3 minimum, $5 maximum) and overlimit fee of $10 were unlawful penalties under Cal. Civ. Code § 1671(d) and that the imposition and collection of such charges constituted an unlawful business practice in violation of Cal. Bus. & Prof. Code § 17200. The court awarded nearly $14 million in damages plus costs to the plaintiff class. The case is on appeal.

Under California law, late and overlimit fees are not valid as liquidated damages unless (i) it is "impracticable or extremely difficult to fix the actual damage"[58] and (ii) the lender has made a "reasonable endeavor" to estimate a "fair average compensation" for its loss from such activity.[59] The court held that the bank did not meet either test. Arguably, in making its determination, the court ventured beyond the analysis under the leading California case, *Beasley v. Wells Fargo Bank*,[60] in three ways:

1. The court held that the test is whether it would have been impracticable or extremely difficult for the bank to estimate the average damage resulting from all late and overlimit activity, not the actual damage resulting from each late or overlimit transaction.

50. 313 Ark. 289, 854 S.W.2d 725 (1993).

51. OCC Interpretive Letter No. 614 from Wallace J. Nathan, Dir., Bank Operations & Assets Div. (Jan. 15, 1993) (unpublished).

52. OCC Interpretive Letter No. 616 from William B. Glidden, Asst. Dir., Bank Operations and Assets Div. (Feb. 26, 1993) (unpublished).

53. 20 Cal. App. 4th 1355, 25 Cal. Rptr. 2d 269 (1993).

54. *Id.* at 637.

55. Cal. Civ. Code, tit. 1.5 (1985).

56. Cal. Civ. Code §§ 1770(a), 1780(a); Truta v. Avis Rent A Car System, Inc., 193 Cal. App. 3d 802, 818, 238 Cal. Rptr. 806 (1987).

57. No. 870897 (Super. Ct. San Francisco County, Cal. opinion filed July 21, 1993).

58. Cal. Civ. Code § 1671(d).

59. Garrett v. Coast & Southern Fed. Sav. & Loan Ass'n., 9 Cal. 3d 731, 738-39 (1973) ("Garrett").

60. 235 Cal. App. 3d 1383, 1 Cal. Rptr. 2d 446 (1991), *appeal denied* Nos. S024422, S024455 (Cal. S. Ct. Mar. 12, 1992).

2. In the court's view, the cost study must be performed before establishing the fee, not after being sued for purposes of justifying the fee.

3. Under *Garrett* and *Beasley*, the bank could recover its actual damages, measured as to late fees "by the period of time the money was wrongfully withheld plus the administrative costs reasonably related to collecting and accounting for a late payment."[61] Thus, the plaintiff class should have recovered an amount equal to the bank's late and overlimit fee revenue less its actual damages. In applying this standard, the *Hitz* court added the extra interest that accrued on late and overlimit balances to the amount of the late and overlimit fees imposed. From this sum, the court subtracted not only the administrative costs "reasonably related to collecting and accounting for" late and overlimit balances, but also the bank's cost of funds for the extension of credit for such balances. The plaintiff thus receives more in damages than under a traditional measure of damages in an amount equal to the amount by which the extra interest exceeds the cost of funds.

If the approach of the trial court in *Hitz* is endorsed by the appellate court, lenders may find it extremely difficult to defeat a claim for unlawful penalties California.

2. South Dakota

The South Dakota Attorney General addressed the issue of whether credit card late charges agreed to by a South Dakota bank and its customer are subject to the liquidated damages provision in S.D. Codified Laws Ann. section 53-9-5.[62] The South Dakota banking statute allows "other charges made in connection with" a credit card account to be charged in "an amount agreed to by the bank and the customer." Such fees are "deemed interest."[63]

The Attorney General determined that to the extent that section 51A-12-13 of the South Dakota statutes is contrary to section 53-9-5, the former is the more specific statute as to late charges and therefore controls. Accordingly, the Attorney General concluded that because credit card late charges are "interest," and not liquidated damages, section 53-9-5 does not apply to such charges.

VI. Conclusion

A number of issues in the area of interstate lending have yet to be resolved. The courts and federal regulators have generally adopted a broad view of the federal preemption of state law, but lenders should continue to watch for new developments in the courts.

As federal preemption gathers strength, plaintiffs are looking more to unconscionability and liquidated damages statutes or common law theories as bases for their claims. Lenders should be aware of these potential claims and also that no clear consensus of interpretation has yet emerged.

61. *Garrett, supra* note 47 at 741.

62. Op. Atty. Gen. S.D. No. 93-08, 1993 S.D. AG LEXIS 5 (Sept. 20, 1993).

63. S.D. Codified Laws Ann. § 51A-12-13.