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## Interest Construed to Include Late Payment Charges

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## Claims must be related

The City also argued that the district court erred in awarding O'Neal \$4,715 in attorney's fees pursuant to her unsuccessful class certification motion. The City contended that this amount should be excluded from the award because the motion was denied and unrelated to the remaining claims. A two-part inquiry was used to determine if the fees for the unsuccessful motion were appropriate: 1) whether the plaintiff's unsuccessful claim was related to the prevailing claims; and 2) if the claims were related,

whether the plaintiff's claims were successful. If the plaintiff prevailed and obtained excellent results, full compensation may be appropriate, but if only limited success was obtained, full compensation may be excessive. The court concluded that the class certification was related to the other claims. The motion was not a separate claim, but rather a means of pursuing her successful claims. Because O'Neal prevailed on the merits of these claims, the court held that the district court was correct in awarding attorney's fees for the class certification motion. On remand, the district court was

instructed to reevaluate the attorney's fees after the reversal of the injunction.

In summary, the Ninth Circuit concluded that the City had violated O'Neal's equal protection rights by refusing to provide water service to her based on a prior tenant's unpaid water bill. O'Neal was awarded attorney's fees and costs as deemed appropriate on remand. However, the court found no justiciable controversy to warrant the issuance of an injunction against the City. Therefore, the court affirmed in part, reversed in part, and remanded.

## *Interest construed to include late payment charges*

*by John Bartels*

In *Smiley v. Citibank (South Dakota) N.A.*, 44 Cal. Rptr. 2d 441, 900 P.2d 690 (1995), the Supreme Court of California determined the National Bank Act must preempt California regulation of bank interest rates, and the term "interest," as used in section 30 of the National Bank Act of 1864, must be construed to cover late payment fees charged by credit card issuers, if such fees are allowed by a national bank's home state.

### **Class action suit in state court: late payment charges claimed to be penalties**

Plaintiff Barbara Smiley filed a class action suit in the Superior Court of Los Angeles County against defendant Citibank. Smiley was acting on behalf of herself and fellow California Citibank credit card holders who had been contracted for, or charged with, late payment fees by Citibank. Smiley contended that the regulation of interest rates by California was not preempted by the National Bank Act. Further, she argued that late payment fees charged by Citibank were properly considered penalties, and thus fairly regulated by California consumer law prohibiting the imposition

of such penalties. Citibank argued that the National Bank Act, which permits national banks to "export" the interest rates of their home states (late payment charges are permitted by South Dakota, Citibank's home state for credit card operations), should be determined to preempt California regulations. Citibank also argued that late payment fees must be included within the definition of interest. Citibank unsuccessfully attempted to remove the case to federal district court. The Superior Court of California denied Citibank's demur for a judgment on the pleadings; the Court of Appeals, finding that the National Bank Act preempted California regulation, reversed. Smiley appealed.

### **Section 85 preempts California law**

Section 30 of the National Bank Act of 1864, codified in section 85 of title 12 of the United States Code ("section 85") provides that a national banking association, or a national bank, "may take, receive, reserve, and charge on any loan . . . interest at the rate allowed by the laws of the State . . . where the bank is located." The court concluded that the federal act did

indeed preempt state law. The court relied on *Marquette Nat. Bank v. First of Omaha Corp.*, 439 U.S. 299 (1978), where the Supreme Court interpreted section 85 as preempting state legislation of interest rates, and also as permitting a national bank to demand and collect interest on any loan, at the rate permitted under the bank's home state's law. This includes rates of interest which might even be unlimited, and also permits a bank to "export" its home state's interest rate. The California court next determined the scope of the word "interest": Did the late payment charges required by Citibank fall within the definition of the term "interest?"

### **Scope of interest can include late payment fees**

The California Supreme Court first examined the purpose of section 85 of the National Bank Act: to facilitate a national banking system, and to specifically grant national banks "most favored lender" status in their home states in an effort to protect them from potentially unfriendly state legislation. Examining the word "interest" in the context of the Act, the court built upon the common understanding of the word "interest": a periodic charge based on a percentage of a certain sum of loaned funds.

The court reasoned that the word could be defined more broadly than as commonly understood to include late payment fees, payable in the event of default. Analogizing credit cards to loans, the interest paid on those cards was compensation for the use of a creditor's money. Payments of late fees were compensation for the retention or use of loaned funds beyond the date of maturity of the loan. The court rejected Smiley's classification of such fees as "penalties," and also found that late payment fees have never been held unlawful per se under the common law.

The court also indicated several policy concerns for holding the definition of "interest" to include late payment fees. If interest did not impliedly include late payment fees, the purpose of the National Bank Act, to grant national banks "most favored lender" status, would be frustrated by unfriendly state legislation. The court stated:

"Thus, a state could allow periodic percentage charges payable absolutely

by maturity for all lenders, including national banks, but fix them at a rate so low that they could lend only at a loss. It might then allow late payment fees to some lenders, not including national banks, at a level high enough that they could lend at a profit. Such a result would be untenable."

*Smiley*, 44 Cal. Rptr. 2d at 451."

The court was concerned that if late payment fees were not included within the definition of interest, national banks would lose their "most favored lender" status and be at the mercy of state banks, defeating the purpose of the National Bank Act. In addition, if the court were to accept Smiley's argument, that such fees could be regulated by state interests, such regulation could limit the availability and variety of credit terms permitted on interstate loans. Such limitations could restrict the ability of a national bank to lend on favorable conditions, and restrict the ability of national bank customers to borrow on reasonable conditions. Last, the court determined it was reasonable to make late payers shoulder the burden they themselves create, and that imposing late payment fees would create a deterrent effect against such individuals creating that burden.

The court also found further support for their holding in the fact that, despite amendments to the Act, the term interest as used in the Act has not been changed. The decision was also found to accord with the decisions of several other courts which had considered the same issue, was in line with interpretations of the same issue by the Comptroller of the Currency, and conformed with the opinions and views of experts on the issue.

### **Majority ignores statutory language and congressional intent**

Justice Arabian dissented from the decision, finding the majority came to a conclusion that ignored statutory text, and ignored a key feature of the American banking system, the interest of individual states, rather than the federal government, in regulating national banks. Justice Arabian believed it was unjust that California regulation of banks be determined by small states which have deregulated consumer credit in

attempts to attract the business of national credit card issuing banks.

Justice Arabian regarded the majority's expansive definition of interest, based on the need to protect national banks' "most favored lending" status, as seriously flawed. He asserted that such an expansive definition failed on the grounds that it simply was not supported by the language of the statute or Congressional record. The statute, in using the word "interest," was never unaccompanied by the word "rate"; he found it highly unlikely for Congress, in enacting the legislation, to have had any other definition in its mind other than the narrowly, popularly understood definition cited to by the majority — a sum linked to the lending of money, calculated at a rate or percentage of the loan over time. Further, Congressional debate centered on "interest rates," and did not consider any notions of the expansive definition embraced by the majority.

Justice Arabian also disputed the majority's determination that the purpose of the National Bank Act was to provide "favored lending" status to national banks. As the Act was passed during the middle of the Civil War, Justice Arabian found that the purpose of the Act was the financing of the conflict. Section 85 was provided, not to protect national banks from local efforts to destroy them, but to induce state banks to change their charters over to federal charters, and protect the future

of banking in the United States.

Further, Justice Arabian pointed out that at the time of passage of the National Bank Act in 1864, and at the time of the *Marquette* decision, interstate banking as it persists today simply was not in existence. It was untenable to conclude from the Act and the above case that non-interest credit terms such as late payment penalties were impliedly included within the definition of interest. It was not logical to hold that Congress should include late payment fees in its definition of interest when such fees were as of yet non-existent.

### **Late payment fees are penalties, not interest**

Justice George also dissented, and took exception to the majority reading into the word "interest" any definition other than its common and properly understood definition, believing such fees to be properly viewed as either penalties or liquidated damages. Nothing in the statute or legislative history suggested that Congress meant to include within the definition of "interest" such payments, and indeed, several leading Supreme Court cases at the time of enactment made it clear that such late payment charges would not be considered interest for the purpose of ruling on usury cases.

## ***USDA regulations eclipse Kansas farmer's state claims***

*by Russ Collins*

Robert Murphy purchased vaccinations for his cows that ultimately failed. However, in *Murphy v. Smithkline Beecham Animal Health Group*, 898 F.Supp. 811 (D. Kan. 1995), the Kansas District Court prevented Murphy from suing the vaccine's manufacturer. The Kansas court granted the defendant's summary judgment motion on the ground that Congress granted the United States Department of Agriculture ("USDA") ultimate authority to regulate the safety, efficacy, potency, and purity of veterinary biological products.

In late 1993, Murphy began injecting the cows from his cattle feeding business with BoviShield 4 and

BoviShield 4 + L5 — vaccines manufactured by Smithkline Beecham Animal Health Group ("Smithkline"). Although Murphy administered the injections until early 1994, the vaccines failed to prevent the cows from developing, and in some cases caused the cows to develop, debilitating or fatal infections and diseases.

Murphy sued Smithkline alleging breach of implied warranty, false advertising, fraudulent misrepresentation, negligence, and failure to warn of dangers associated with use of the vaccine. In response, Smithkline filed a motion for summary judgment and argued federal USDA regulations, specifically the Virus-