COMMENT

SMILEY v. CITIBANK (SOUTH DAKOTA), N.A.: CHARGING TOWARD DEREGULATION IN THE CREDIT CARD INDUSTRY

I. INTRODUCTION

The staggering profit potential of consumer credit has driven credit card competition to unprecedented heights.[1] In 1995 alone, credit card companies mailed out nearly 2.7 billion credit card solicitations to prospective customers.[2] The impact of this competitive boom has been a reduction of revenues from traditional sources, such as annual fees and periodic percentage interest rates.[3] Thus, to maintain their healthy profit margins, banks have significantly increased the use of late fees with their delinquent customers.[4] Late fee charges arise when cardholders fail to pay a minimum portion of their credit balances within the billing period marked on their monthly statements.[5]

National banks sparked great controversy when they began assessing late fees to customers who lived in states which had prohibited these charges by the adoption of strict usury and consumer protection laws. Under section 85 of the National Bank Act of 1864 (section 85),[6]

---

[1]*See Competition: The Card Industry Rides a Wave of Profitability*, CREDIT CARD NEWS, Apr. 1, 1994, *available in* 1994 WL 2534026.

[2]Joan Biskupic, *Credit Card Late Fees Upheld by Court*, DENV. POST, June 4, 1996, at 10A.

[3]Henry Gilgoff, *Pay Now or Pay Later, With Late Fees*, NEWSDAY, Jan. 22, 1993, at 49 (explaining that competition has forced reductions in periodic percentage-based interest rates); Ellen Stark, *Get Ready to Be Bopped with Higher Card Fees*, MONEY, Aug. 1, 1996, at 33 (contending that competition produced the introduction of no annual fee credit cards).

[4]*See* Stark, *supra* note 3, at 33.

[5]*See* Smiley v. Citibank (S.D.), N.A., 900 P.2d 690, 692-93 (Cal. 1995), *aff'd*, 116 S. Ct. 1730 (1996) (explaining Citibank's standard for assessing late fees).

[6]Section 85 reads in pertinent part that:

> [a]ny association may take, receive, reserve, and charge on any loan or discount made, or upon any notes, bills of exchange, or other evidence of debt, interest at the rate allowed by the laws of the State, Territory, or District 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, and no more, except that where by the laws of any State a different rate is limited for banks organized under State laws, the rate so

national banks are authorized to charge all out-of-state cardholders any interest permitted under the laws of the bank's home state.[7] The term "interest" originally applied only to numerical periodic percentage interest rates, but, with the emergence of late fees, national banks attempted to broaden the meaning of the term.[8] Naturally, many states protested that any expansion of the preemptive powers under section 85 was an infringement on their ability to protect their citizens through usury and consumer protection regulations.

In *Smiley v. Citibank (South Dakota), N.A.*,[9] the Supreme Court examined the scope of the term "interest" within the text of section 85 of the National Bank Act of 1864. The Court unanimously adopted the expansive interpretation of "interest," which effectively removed all state-imposed barriers nationwide, allowing national banks to export any late fee charges permissible within the laws of the bank's home state.[10]

This comment will analyze the Court's reasoning in *Smiley*, which represents the latest battle in an historical power struggle between the national banks and the states. Also, this comment will project how this deregulatory ruling effects both of these parties, in addition to its impact on credit card consumers.

II. BACKGROUND

Before the National Bank Act of 1864, Congress had twice attempted to create a national banking system: the First Bank of the United States created in 1791, and the Second Bank of the United States founded in 1816.[11] Both banks were quickly victimized by an on-going federalist debate, with those parties advocating States' rights eventually outlasting the supporters of a strong centralized government.[12]

---

limited shall be allowed for associations organized or existing in any such State under title 62 of the Revised Statutes.

12 U.S.C. § 85 (1994).

[7] *Id. See also* Marquette Nat'l Bank of Minneapolis v. First of Omaha Serv. Corp., 439 U.S. 299, 301 (1978) (citing 12 U.S.C. § 85 (1994)).

[8] Thirteen years after *Marquette Nat'l Bank*, the First Circuit of the United States Court of Appeals, in Greenwood Trust Co. v. Massachusetts, 971 F.2d 818 (1st Cir. 1992), *cert. denied*, 506 U.S. 1052 (1993), became the first appellate court to decide that late fees were included within "interest" under § 85. *Id.* at 831.

[9] 116 S. Ct. 1730 (1996).

[10] *Id.* at 1736.

[11] Copeland v. MBNA Am. Bank, N.A., 883 P.2d 564 (Colo. App. 1994), *aff'd*, 907 P.2d 87, 91 n.6 (Colo. 1995), *cert. denied*, 116 S. Ct. 2496 (1996).

[12] *Id.*

When President Andrew Jackson vetoed the rechartering of the Second National Bank in 1832, the individual states became solely responsible for controlling the banking industry in America.[13] During the next thirty years, commonly referred to as the era of "free banking," state-created currency removed the public's confidence in banks and resulted in the most chaotic era in our nation's financial history.[14]

A. The National Bank Act of 1864

By 1864, the United States had entered into its fourth year of civil war. In order to counteract the economic strain created by the war and the compounding effect of a decentralized banking system, Secretary of the Treasury Salmon P. Chase recommended the National Bank Act.[15] The Act reinstated a centralized federal banking system and developed a national currency, which, in turn, created a lending market that financially facilitated the Union's war efforts.[16]

Nine years later, in *Tiffany v. National Bank of Missouri*,[17] the Supreme Court interpreted the entire National Bank Act as conveying the Congressional posture that "[n]ational banks have been National favorites."[18] With this motto as its guide, the *Tiffany* Court believed that section 85[19] "was intended to give [national banks] a firm footing in the different States where they might be located"[20] and to prevent potentially discriminatory state litigation that could result in their inability to survive.[21] The Court determined that since section 85 provided the national banks with an opportunity to "charge . . . interest at the rate allowed by the laws of the State . . . where the bank is located,"[22] the national banks would at least be equally competitive with state banks. The Court further reasoned that the national banks may even have an advantage if the states where they were based permitted their citizenry to

---

[13]Smiley v. Citibank (S.D.), N.A., 900 P.2d 690, 711 (Cal. 1995), *aff'd*, 116 S. Ct. 1730 (1996).

[14]*Id.* at 711-12. Justice Arabian described the era of free banking as "decades of financial turmoil, cyclical bank 'panics', the sudden appearance and disappearance of 'wildcat' banks, the absence of a national currency (and of national banks), and volatile, often worthless notes issued by private state-chartered banks." *Id.* at 711.

[15]*Copeland*, 907 P.2d at 91 (quoting CONG. GLOBE, 38th Cong., 1st Sess. 1257 (1864)).

[16]*Id.*

[17]85 U.S. (18 Wall.) 409 (1873).

[18]*Id.* at 413.

[19]12 U.S.C. § 85 (1994).

[20]*Tiffany*, 85 U.S. (18 Wall.) at 412.

[21]*Id.* at 412-13.

[22]*Id.* at 411.

charge higher rates of interest than other states' banks.[23]

B. Marquette National Bank *and the Emergence of the Exportation Principle*

At the time of the National Bank Act and *Tiffany*, "the activities of a national bank were restricted to one particular location" in one particular state.[24] As a result, when disputes arose under section 85, states had little trouble protecting consumers from interest charged by national banks. The Act subjected national banks to the laws of their home state, which included not only the location where all their business was transacted, but where the vast majority of their customer base resided.[25] By the 1970s, through the use of credit cards and the convenience of mail, national banks could solicit potential customers nationwide without branching outside their original state of operations.[26]

In *Marquette National Bank of Minneapolis v. First of Omaha Service Corp.*,[27] the Supreme Court decisively ushered in the era of interest rate exportation.[28] The Court ruled that a national bank organized in one state was permitted to charge its out-of-state customers the periodic percentage interest rate allowed in the *bank's* home state, regardless of whether this interest rate exceeded the amount allowed in the state where the customer resided.[29]

The *Marquette National Bank* Court acknowledged that permitting a national bank to "export" its home state's interest rate could have two separate effects.[30] First, section 85 could provide a distinct competitive advantage for national banks within a particular state.[31] The Court,

---

[23] *Id.* at 412-13.

[24] Mazaika v. Bank One, Columbus, N.A., 653 A.2d 640, 648-49 (Pa. Super. Ct. 1994) (citing Citizens & S. Nat'l Bank v. Bouqas, 434 U.S. 35, 42-43 (1977)). Congress did not permit national banks to have branches until ratifying the McFadden Act in 1927. *Id.* at 649. Even then, national banks were subjected to branch banking restrictions created by the laws of the bank's home state. *Id.*

[25] *Id.* at 648-49.

[26] Marquette Nat'l Bank of Minneapolis v. First of Omaha Serv. Corp., 439 U.S. 299, 318-19 (1978).

[27] 439 U.S. 299 (1978).

[28] *Id.* at 318.

[29] *Id.* at 301.

[30] *Id.* at 314, 318-19.

[31] *Marquette Nat'l Bank*, 439 U.S. at 314. Marquette National Bank claimed that they were forced to charge their customers a $10 annual fee to compensate for their interest rate restriction under Minnesota law, which adversely affected their ability to compete with First of Omaha Service Corporation, an out-of state national bank. *Id.* at 304.

relying heavily on the "most favored lender status" provided to national banks in section 85 under *Tiffany*,[32] concluded that the Act intended for national banks to be equally competitive and, potentially, to acquire a competitive advantage over their state counterparts.[33] Additionally, after reviewing the Congressional record to determine the framers' intent,[34] the Court believed that the Civil War Congress was cognizant of an interstate banking system that could create this type of competitive advantage.[35]

Second, the "exportation" of interest rates creates a preemptive power that could have a significantly detrimental effect on the usury and consumer protection laws in other states.[36] However, the *Marquette National Bank* Court deduced that this potential inequity was implied when the Act was constructed, "since citizens of one State were [always] free to visit a neighboring State to receive credit at foreign interest rates."[37] The Court recognized that the emergence of interstate credit card applications could accentuate the potential for preemption of state laws.[38] However, the Court concluded that this subject was "an issue of legislative policy, and any plea to alter [section] 85 to further that end [was] better addressed to the wisdom of Congress than to the judgment of this Court."[39]

C. *The Drafting of the Depository Institutions Deregulation and Monetary Control Act of 1980*

Two years after *Marquette National Bank*, Congress implicitly responded to the Supreme Court's invitation to modify the meaning of section 85. With the Depository Institutions Deregulation and Monetary Control Act of 1980 (D.I.D.A.),[40] Congress not only decided to retain the text of section 85 of the National Bank Act, it practically *copied* its

---

[32]*See supra* note 18 and accompanying text.

[33]*Id.* at 314 (reiterating the rationale of the *Tiffany* Court).

[34]*Id.* at 314-18. The Court believed that the senatorial debates "portray[ed] a banking system of great regional interdependence." *Id.* at 316. Additionally, the Court pointed to its discussion in Bank of Augusta v. Earle, 38 U.S. 519 (1839), decided 25 years prior to the National Bank Act, as evidence that the Civil War Congress was not "oblivious to the existence" of interstate banking. *Id.* at 317-18.

[35]*Id.* at 318.

[36]*Marquette Nat'l Bank*, 439 U.S. at 318.

[37]*Id.*

[38]*Id.*

[39]*Id.* at 319.

[40]Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132 (1980).

original language to create Section 521 of D.I.D.A.[41]

Congress created D.I.D.A. in response to the staggering inflation of the late 1970s, when interest rates rose dramatically.[42] State lending institutions were crippled with interest rate ceilings imposed by state usury laws which made lending financially impractical.[43] Moreover, state banks faced the added burden of becoming noncompetitive against national banks, which, under section 85, were able to increase their interest rates to correspond with rising federal discount rates.[44] D.I.D.A. helped maintain a competitive balance between qualifying state banks and national banks, since it allowed state-chartered insured depository institutions to have the same advantages previously available only to national banks.[45]

When Congress borrowed the language of section 85 for D.I.D.A., it, in effect, adopted prior judicial interpretations of section 85 (including *Marquette National Bank*'s exportation principle) within the new act.[46] From D.I.D.A.'s formation until *Smiley v. Citibank (South Dakota), N.A.*,[47] these parallel provisions served as persuasive authority for one another in discovering the meaning of the term "interest."[48]

---

[41]Greenwood Trust Co. v. Massachusetts, 971 F.2d 818, 827 n.7 (1st Cir. 1992) ("Although there are niggling variations, the key phraseology is substantially identical."). Section 1831d(a) states in part:

> In order to prevent discrimination against State-chartered insured depository institutions . . . such State bank or insured branch of a foreign bank . . . may . . . take, receive, 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 or such insured branch of a foreign 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(a) (1994).

[42]*Greenwood Trust*, 971 F.2d at 826.

[43]*Id.*

[44]*Id.*

[45]*Id.*

[46]Greenwood Trust Co. v. Massachusetts, 971 F.2d 818, 827 (1st Cir. 1992).

[47]116 S. Ct. 1730 (1996).

[48]In determining the scope of the statutory term "interest," § 85 of the National Bank Act was interpreted as the appropriate law in several cases. *See* Smiley v. Citibank (S.D.), N.A., 900 P.2d 690 (Cal. 1995), *aff'd*, 116 S. Ct. 1730 (1996); Copeland v. MBNA Am. Bank, N.A., 883 P.2d 564 (Colo. App. 1994), *aff'd*, 907 P.2d 87 (Colo. 1995), *cert. denied*, 116 S. Ct. 2496 (1996); Mazaika v. Bank One, Columbus, N.A., 653 A.2d 640 (Pa. Super. Ct. 1994); Tikkanen v. Citibank (S.D.), N.A., 801 F. Supp. 270, 274 (D. Minn. 1992); Sherman v. Citibank (S.D.), N.A., 668 A.2d 1036, 1040 (N.J. 1995), *vacated*, 116 S. Ct. 2493 (1996). However, several cases relied upon § 521 of the D.I.D.A. *See* Greenwood Trust Co. v.

D. *The Era of Deregulation and Reregulation in Banking*

The Supreme Court's decision in *Marquette National Bank* and Congress's creation of D.I.D.A. were expected to promote an era of deregulation that would significantly alter banking during the 1980s, particularly in the credit card industry.[49] However, the actual result of these changes was mixed.[50] The exportation principle did encourage the expansion of interstate retail banking.[51] National banks, now armed with the laws of their home state, could conveniently charge one periodic percentage interest rate to all customers nationwide, effectively preempting the usury laws and corresponding consumer protection laws of every other state in the country.[52]

Legislatures in several less populated states, notably bank-friendly South Dakota and corporate-friendly Delaware, interpreted federally approved banking deregulation as an opportunity to entice national banks to relocate within their borders.[53] These states, seeking increased tax revenues and employment opportunities, raised or eliminated usury ceilings and softened consumer protection regulations in order to permit national banks even greater economic advantage under their states' preemptive powers.[54] The potential benefits available through relocation caused national banks in less-responsive jurisdictions to place increased pressure on their home states' legislatures to join in the deregulatory movement or risk losing their retail banking industry.[55]

Conversely, many states did not share in the competitive euphoria created by exportation and deregulation.[56] They responded by passing

---

Massachusetts, 971 F.2d 818 (1st Cir. 1992), *cert. denied*, 506 U.S. 1052 (1993); Hunter v. Greenwood Trust Co., 668 A.2d 1067, 1069 (N.J. 1995), *vacated*, 116 S. Ct. 2493 (1996). Still other courts applied both statutes. *See* Spellman v. Meridian Bank (DE) (full argument on file with *The Delaware Journal of Corporate Law*) (summary on file with No. 94-3203, 1995 U.S. App. LEXIS 37149, at *20-21 (3d Cir. Dec. 29, 1995)).

[49]*See generally* Helen A. Garten, *Devolution and Deregulation: The Paradox of Financial Reform*, 14 YALE L. & POL'Y REV. 65, 80 (1996) (discussing the practical effects of the exportation principle).

[50]*Id.*

[51]*Id.*

[52]*Id.*

[53]Garten, *supra* note 49, at 80; Kevin G. Toh, Note, *Are Credit-Card Late Fees "Interest"? Delineating the Preemptive Reach of Section 85 of the National Bank Act of 1864 and Section 521 of the Depository Institutions Deregulation and Monetary Control Act of 1980*, 94 MICH. L. REV. 1294, 1296 (1996).

[54]Douglas H. Ginsberg, *Interstate Banking*, 9 HOFSTRA L. REV. 1133, 1370 (1981); Toh, *supra* note 53, at 1296.

[55]Toh, *supra* note 53, at 1296.

[56]*See* Garten, *supra* note 49, at 80. The desire of state legislatures to prevent

tougher consumer protection regulations, which, in many cases, were more restrictive than the federal regulations that they replaced.[57] These states, including California, responded to their inability to shield their citizens from percentage-based interest rate exportations by passing new legislation that prohibited out-of-state banks from imposing additional types of credit card charges.[58] Among these state-imposed restrictions were late fees.[59]

E. *The Role of the OCC: From Interpretive Letters to Informal Rulemaking*

The Office of the Comptroller of the Currency (OCC), positioned within the Department of the Treasury,[60] is the administrative agency responsible for supervising banks under section 85.[61] Based on the authority delegated to it under the National Bank Act, the OCC granted permission to the national banks to create credit card operations, in addition to assistance with the design of its interstate credit programs.[62]

As credit card interest rate exportations exploded during the 1980s, both the states (fearing infringement of their consumer protection laws) and the banking industry (seeking uniformity in its credit charges nationwide) turned to the Comptroller to interpret the meaning of "interest" under section 85. Not surprisingly, in view of Congress's ongoing push for deregulation, the OCC penned several interpretive letters supporting the broader interpretation of section 85's text, which included

---

deregulation in order to protect their citizens lasted until *Smiley*'s high Court hearing when "[m]ore than 25 states . . . urged the Supreme Court to side with Smiley and uphold the power of the states to limit the late fees charged consumers." *Card Issuer's Home State's Rules Apply: Ruling to Have Little Effect in Texas*, HOUS. CHRON., June 6, 1996, at 3.

[57]Garten, *supra* note 49, at 68.

[58]*Id.* at 80.

[59]*Id.*

[60]Section 1 states, in relevant part:

> There shall be in the Department of the Treasury a bureau charged with the execution of all laws passed by Congress relating to the issue and regulation of a national currency . . . the chief officer of which bureau shall be called the Comptroller of the Currency, and shall perform his duties under the general directions of the Secretary of the Treasury. . . . The Secretary of the Treasury may not delay or prevent the issuance of any rule or the promulgation of any regulation by the Comptroller of the Currency.

12 U.S.C. § 1 (1994).

[61]Copeland v. MBNA Am. Bank, N.A., 907 P.2d 87, 92 (Colo. 1995), *cert. denied*, 116 S. Ct. 2496 (1996).

[62]*Id.*

late fees.[63]

When litigation pertaining to the scope of section 85 began, the OCC attempted to diffuse any speculation about its interpretation by addressing various courts as *amicus curie* on behalf of the national banks.[64] However, as the issue became a national concern, the Comptroller recognized the need for informal rulemaking procedures in order to construct a definitive OCC position. In March 1995, the OCC began a period of notice and public comment to formulate an official agency stance.[65] In February 1996, the OCC issued its regulation, which defined "interest" as "any payment compensating a creditor . . . for an extension of credit, making available . . . credit, or any default or breach by a borrower of a condition upon which credit was extended."[66] Moreover, the OCC regulation specifically itemized which charges commonly associated with credit card lending should and should not be included within that definition.[67] Again, the Comptroller placed late fees within the preemptive scope of section 85.[68]

---

[63]*See, e.g.*, Letter from Julie L. Williams, OCC Chief Counsel, to John L. Douglas, Alston & Bird (Feb. 17, 1995), *available in* LEXIS, Interpretive Letter No. 670 (stating that annual fees, overlimit charges and *late charges* constitute interest under § 85 of the National Bank Act); Letter from William P. Bowden, Jr., OCC Chief Counsel (Feb. 4, 1992), *available in* 1992 WL 136390 (stating that "interest" under § 85 expressly includes dishonored check fees, *late payment fees*, and charges associated with exceeding credit limitations); Letter from Robert B. Serino, Deputy Chief Counsel (OCC Interpretive Letter No. 452), [1988-89 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,676, at 78,064 (Aug. 11, 1988) (listing *late fees*, nonsufficient funds charges, and cash advance fees as "interest" under § 85); *see also* Garten, *supra* note 49, at 80.

[64]*See* Smiley v. Citibank (S.D.), N.A., 116 S. Ct. 1730, 1733 (1996).

[65]*See* Charging Interest at Rates Permitted Competing Institutions; Charging Interest to Corporate Borrows, 60 Fed. Reg. 11,924, 11,940 (1995) (to be codified at 12 C.F.R. pts. 7, 31) (charging interest to corporate borrowers).

[66]12 C.F.R. § 7.4001(a) (1996).

[67]Section 7.4001(a) states, in relevant part, that:

> ["interest"] includes, among other things, the following fees connected with credit extension or availability: numerical periodic rates, *late fees*, not sufficient funds (NSF) fees, overlimit fees, annual fees, cash advance fees, and membership fees. It does not ordinarily include appraisal fees, premiums and commissions attributable to insurance guaranteeing repayment of any extension of credit, finders' fees, fees for document preparation or notarization, or fees incurred to obtain credit reports.

12 C.F.R. § 7.4001(a) (1996) (emphasis added).

[68]*Id.*

F. Greenwood Trust *and Beyond: A Jurisdictional Jumble in Interpreting "Interest"*

In August 1992, in *Greenwood Trust Co. v. Massachusetts*,[69] the First Circuit of the United States Court of Appeals, applying the language of D.I.D.A., became the first court to decide that "interest" should be broadly construed to include late fees associated with credit card transactions.[70] As a result of this ruling, not only were out-of-state national banks within the First Circuit allowed to export periodic percentage interest rates from their home states, as in *Marquette National Bank*, they could also export the definition of "interest" from their home state banking statutes.[71]

Two months later, the District Court of Minnesota was asked to resolve the same issue under section 85 in *Tikkanen v. Citibank (South Dakota), N.A.*[72] Relying heavily on *Greenwood Trust*'s interpretation under the parallel language of D.I.D.A., the court ruled that "interest" extended to both late fees and overlimit charges.[73] For the next three years, this interpretation was upheld; however, a contrary trend was in the winds.[74]

In December 1994, the Pennsylvania Superior Court became the first appellate court in the nation to reject the expansive application of section 85 in *Mazaika v. Bank One, Columbus, N.A.*[75] This decision restricted section 85 exclusively to percentage-based interest rates.[76] In doing so, it enabled Pennsylvania citizens who entered into out-of-state credit card agreements to retain the protective shield provided by the state's usury and consumer protection regulations.[77]

The initial rulings in 1995 presented *Mazaika* as nothing more than

---

[69]971 F.2d 818 (1st Cir. 1992).

[70]*Id.* at 831.

[71]*Id.* at 829.

[72]801 F. Supp. 270 (D. Minn. 1992).

[73]*Id.* at 279.

[74]Mazaika v. Bank One, Columbus, N.A., 653 A.2d 640, 650-51 (Pa. Super. Ct. 1994).

[75]653 A.2d 640 (Pa. Super. Ct. 1994).

[76]*Id.* at 648.

[77]*Id.* at 650. The Pennsylvania Supreme Court granted appeal in Bank One, Columbus, N.A. v. Mazaika, 659 A.2d 557 (Pa. 1995), but decided to suspend their hearing of oral arguments upon learning of the United States Supreme Court's grant of *certiorari* to Smiley v. Citibank (S.D.), N.A., 116 S. Ct. 806 (1996). *See also* Leonard A. Bernstein, *N.J. Supreme Court Bounces Credit Card Issuers*, 113 BANKING L.J. 391, 391 (1996) (discussing the relevance of the 1995 New Jersey decisions which delivered a blow to the banking industry by holding that out-of-state bank credit card issuers could not charge late fees to New Jersey cardholders).

an aberration by a lower court. September brought the California Supreme Court's allowance of late charges in *Smiley*, albeit only in a 5-2 decision.[78] The Colorado Supreme Court followed suit in November with *Copeland v. MBNA America Bank, N.A.*[79] However, just one week after *Copeland*, the New Jersey Supreme Court supplied the most devastating blow to judicial uniformity by restricting credit card interest to numerical rates under both section 85 *and* section 521 of D.I.D.A. in *Sherman v. Citibank (South Dakota), N.A.*[80] and *Hunter v. Greenwood Trust Co.*,[81] respectively.[82]

Even though the Third Circuit Court of Appeals ended the year by following the pre-1995 decisions in *Spellman v. Meridian Bank (Delaware)*,[83] the country faced the prospect of continued fragmentation within the state and federal courts. The Supreme Court responded by granting Smiley's request for certiorari in January 1996.[84]

III. ANALYSIS

In *Smiley v. Citibank (South Dakota), N.A.*,[85] the Supreme Court responded to the confusion of the lower courts across the nation. As *Smiley* had proceeded through the California courts, the division of opinion and corresponding arguments mirrored other jurisdictions, with justices performing extensive historical examinations in an effort to unlock the unexpressed intent of the Civil War Congress when drafting section 85. While the Supreme Court concurred with the California Supreme Court and the majority of other lower courts, its decision marked a completely different approach.[86] The Court settled the 132 year old "exportation" riddle by deferring to a regulation that was four months old.

A. *The Factual and Procedural History*

Plaintiff Barbara Smiley (Smiley), a resident of California, brought

---

[78]Smiley v. Citibank (S.D.), N.A., 900 P.2d 690, 692, 708, 716 (Cal. 1995).

[79]907 P.2d 87 (Colo. 1995).

[80]668 A.2d 1036 (N.J. 1995).

[81]668 A.2d 1067 (N.J. 1995).

[82]*See* Bernstein, *supra* note 77, at 391.

[83]Full argument on file with *The Delaware Journal of Corporate Law* (summary on file with No. 94-3203, 1995 U.S. App. LEXIS 37149 (3d Cir. Dec. 29, 1995)).

[84]Smiley v. Citibank (S.D.), N.A., 116 S. Ct. 806 (1996).

[85]116 S. Ct. 1730 (1996).

[86]*Id.*

action against defendant Citibank (South Dakota), N.A. (Citibank), who had assessed late payment charges on both her Preferred Visa and MasterCard credit card accounts.[87] Smiley sought compensatory and punitive damages, in addition to injunctive relief, by claiming that the late fees were impermissible under California law.[88]

Citibank, a national bank chartered by the Comptroller of the Currency, maintained its credit card operations from its sole location in South Dakota.[89] In accordance with South Dakota law[90] and the terms expressly stated in its credit card agreements, Citibank can levy up to fifteen dollars in late charges against all customers who fail to submit a minimum portion of their outstanding balances by a specified payment date.[91] This late fee is assessed without regard for the balance on the customer's credit card.[92]

After the United States District Court for the Central District of California remanded this action to state court,[93] the trial court held that section 85 of the National Bank Act of 1864 permitted Citibank to export late fee charges from its home state.[94] This ruling effectively preempted

---

[87]Smiley v. Citibank (S.D.), N.A., 900 P.2d 690, 692-93 (Cal. 1995), *aff'd*, 116 S. Ct. 1730 (1996).

[88]Smiley v. Citibank (S.D.), N.A., 32 Cal. Rptr. 2d 562, 563 (Cal. App. 1994), *aff'd*, 900 P.2d 690 (Cal. 1995), *aff'd*, 116 S. Ct. 1730 (1996). Smiley claimed that Citibank used unfair business practices under CAL. BUS. & PROF. CODE § 17200 (West 1987), and petitioned to have the late fees in her credit card agreement deemed invalid under CAL. CIV. CODE § 1671 (West 1985). *Smiley*, 32 Cal. Rptr. 2d at 563 n.1.

[89]*Smiley*, 32 Cal. Rptr. 2d at 563.

[90]Section 54-3-1 states in part: "Interest is the compensation allowed by law for the use, or forbearance, or detention of money or its equivalent, including without limitation . . . charges for unanticipated late payments . . . as an incident to or as a condition of the extension of credit." S.D. CODIFIED LAWS ANN. § 54-3-1 (1990).

Section 54-3-1.1 reads: "Unless a maximum interest rate or charge is specifically established elsewhere in the code, there is no maximum interest rate . . . if [the parties] establish the interest rate or charge by written agreement." S.D. CODIFIED LAWS ANN. § 54-3-1.1 (1996).

[91]*Smiley*, 900 P.2d at 692-93. Smiley's MasterCard late fee amounted to $15 for each month that she failed to make the minimum payment during the 25 day payment period. *Smiley*, 116 S. Ct. at 1732. The preferred Visa card assessed Smiley a $6 late charge if her minimum balance was not received within fifteen days and an additional charge of $15 or 0.65% of her outstanding balance, if the minimum had not been submitted by the next payment period. *Id.*

[92]*Smiley*, 900 P.2d at 693.

[93]Smiley v. Citibank (S.D.), N.A., 863 F. Supp. 1156, 1165 (C.D. Cal. 1993).

[94]*Smiley*, 32 Cal. Rptr. 2d at 563-64. The trial court initially rejected Citibank's motion to dismiss the action. *Smiley*, 900 P.2d at 693. Citibank subsequently filed a writ of mandate with the Court of Appeal, Second Appellate District, which ordered the trial court to vacate its decision denying the motion or show cause why this should not be required. *Id.* Upon this order, the trial court granted the defendant's motion to dismiss. *Id.*

any similar California law pertaining to late fee payments and dismissed all of Smiley's state law-based contentions.[95]

B. *The California Court of Appeals Decision*

The court of appeals upheld the trial court's decision that late fees are considered "interest" under section 85.[96] The court justified this ruling, in part, by referring to the federal limitation on lending charges imposed on national banks under section 85.[97] Additionally, since intrastate credit cards were a readily available alternative, the Court noted that consumers had the option of removing the potential for late charges by avoiding national banks.[98] This position was supported by referencing similar holdings from other jurisdictions[99] and by deferring to the "OCC's longstanding interpretation that . . . late fees are governed by section 85."[100]

C. *The California Supreme Court Decision*

In a 5-2 decision, the Supreme Court of California affirmed the judgments of the two lower courts, believing that "the National Bank Act should be construed to cover late payment fees, if such fees are allowed by a national bank's home state."[101] The majority, like the court of appeals, referred to the decisions of the other jurisdictions and the stance of the OCC, but also provided textualist and originalist arguments in favor of an expansive meaning of "interest."[102] First, the court, while acknowledging that the wording of section 85 provided no insight, offered nineteenth century dictionary definitions and judicial connotations existing during the era surrounding the statute as evidence that the plain meaning of the word supported a more inclusive application.[103]

Next, the court determined that the Congressional intent behind the National Bank Act was better served by adopting an expansive meaning

---

[95] *Smiley*, 32 Cal. Rptr. 2d at 563-64.

[96] *Id.* at 566.

[97] *Id.* at 565.

[98] *Id.*

[99] *Smiley*, 32 Cal. Rptr. 2d at 566. The court stated that, at the time of this opinion, 24 separate courts, including *Greenwood Trust* and *Tikkanen*, had held that late fees were within the scope of "interest" under § 85. *Id.*

[100] *Id.*

[101] *Smiley*, 900 P.2d at 700.

[102] *Id.* at 699-700.

[103] *Id.* at 699.

of "interest" in section 85.[104] The court, relying heavily on the "most favored lender" analysis constructed in *Tiffany*,[105] determined that the statute was designed to protect national banks from potentially unfriendly litigation that could result in a competitive disadvantage or a financially impractical existence.[106] The majority reasoned that if "interest" were interpreted narrowly to include only periodic percentage rates, then states could still discriminate against national banks and frustrate the statutorial purpose by setting periodic percentage rates for all banks at artificially low levels, while allowing only state banks to assess the late payment charges necessary to make banking profitable.[107] Finally, the court pointed to Congress's decision not to elaborate on the meaning of the term, despite its efforts to amend and codify the language in the statute over the ensuing years, as evidence that the courts have applied the language properly.[108]

The majority acknowledged that this decision extended the role of the exportation principle beyond merely allowing an interest rate to cross over state lines.[109] This decision delegated the power to define "interest" to the national bank's home state.[110] As a result, the court created the "immanent threat" that national banks could use the usury laws of their home states to effectively override consumer regulations established in other states to protect their citizens.[111] The court reasoned that, despite the fact that interstate credit card solicitations have compounded the potential consumer protection problem, "this displacement of the usury laws of sister states has always been implicit in the structure of the National Bank Act, since residents of one state have ever been free to visit another to receive credit subject to the latter's usury law, even when that law permits unlimited interest."[112] The court ultimately deferred to the wisdom of Congress to amend section 85 if it was dissatisfied with the banking industry's current application and the corresponding judicial interpretation.[113]

---

[104] *Id.* at 700.

[105] *Smiley*, 900 P.2d at 700-01 n.9 (citing Tiffany v. National Bank of Mo., 85 U.S. (18 Wall.) 409 (1873)).

[106] *Id.* at 700 n.9.

[107] *Id.*

[108] *Id.* at 699-701.

[109] *Smiley*, 900 P.2d at 707.

[110] *Id.*

[111] *Id.*

[112] *Id.* (citing *Marquette Nat'l Bank*, 439 U.S. at 310).

[113] *Smiley*, 900 P.2d at 707.

Justices Arabian and George each filed a dissenting opinion.[114] Justice Arabian adopted a more formalistic position when discussing the language of the statute and the legislative intent.[115] The Justice observed that "interest" was always connected to the term "rate" in the text of the National Bank Act, thus signifying Congress's unambiguous intent to limit its use to a periodic percentage calculation.[116] Next, Justice Arabian offered a contrasting interpretation of *Tiffany* from that which the majority had used as its historical and legal basis for an expansive application. Utilizing the chaotic state of American banking during the state banking era[117] and the Union's need for a centralized system to finance its Civil War operations as a backdrop, the Justice concluded that:

> [a] fair reading of the opinion in *Tiffany* . . . demonstrates that the high court . . . alluded not to Congress's fear of the specter of discriminatory rate setting against *national* banks by the states, but to its concern that state legislatures might abolish *all banks*, state *and* federal . . . .
>
> . . . .
>
> [The National Bank Act] was thus to induce state banks to convert their charters and to protect the future of *banking* itself.[118]

Furthermore, Justice Arabian noted that neither the *Tiffany* Court nor the Civil War Congress had the knowledge of interstate banking required to implicitly permit the broad exportation of "interest," because both operated in "the context of a banking industry geographically confined within a single state and operating through single outlets."[119] The Justice added that the capability to foresee the modern interstate banking system did not arise until twenty years ago, when, in *Marquette National Bank v. First of Omaha Service Corp.*,[120] the Supreme Court

---

[114]*Id.* at 708, 716.

[115]*Id.* at 709.

[116]*Id.* Justice Arabian also quoted from senatorial debates during the crafting of the National Bank Act as evidence that "Congress had in mind a notion of interest that was linked ineluctably to rates." *Id.* at 710.

[117]*Smiley*, 900 P.2d at 711-12.

[118]*Id.*

[119]*Id.* at 714.

[120]439 U.S. 299 (1978).

applied the exportation principle solely to interest rates.[121]

Finally, Justice Arabian argued that, even if an historical analysis did not definitively point to the narrow interpretation, the language in section 85 was clearly ambiguous and, therefore, failed to establish the "clear and manifest" Congressional intent required to allow a federal preemption of state law.[122] The Justice believed that "an especially restrictive standard of preemption" was required to uphold federal preemption in the banking industry, in light of Congress's traditionally "generous deference to state banking laws" and "the long history of the dual banking system."[123]

Justice Arabian's conclusion evidences an obvious disdain for the recent actions of national banks, particularly Citibank, to manipulate legal constraints in banking.[124] While the accepted trend may be towards deregulating the banking industry, "it has not been the result of deliberate policy initiatives on the part of the legislative or executive branches,"[125] but through an unholy marriage between national banks, who seek to circumvent state consumer protection laws, and "small or sparsely populated states that have deregulated consumer credit in an attempt to attract the interstate credit card operations of large national banks."[126]

Justice George's dissent, while raising several of the same arguments as Justice Arabian's dissent,[127] has two additional criticisms of

---

[121]*Smiley*, 900 P.2d. at 714.

[122]*Id.* at 715 (citing Cipollone v. Liggett, 505 U.S. 504, 516 (1992)). The majority had held that the issue of whether § 85 provided preemptive powers had already been decided in *Marquette National Bank* and the sole purpose of this case was to determine the *scope* of the preemption. *Id.* at 696-97.

[123]*Id.* at 715.

> More commonly, it has been left to the courts to delineate the proper boundaries of federal and state supervision. The judicial test has been a tolerant one. [National Banks'] right to contract, collect debts, and acquire and transfer property are all based on state law. . . . Thus the rule is that state laws apply.

Id. (citations omitted) (alterations in original).

[124]*Id.*

[125]*Smiley*, 900 P.2d at 716 (quoting Geoffrey P. Miller, *Interstate Banking in the Court*, 1985 SUP. CT. REV. 179, 180 (1985)).

[126]*Id.* at 708. The court expressly referred to the relocation of retail banking created by the efforts of the Delaware and South Dakota legislatures, who "[i]n return for jobs and taxes . . . have traded local entry rights and powers." *Id.* at 708 n.1 (quoting Ginsberg, *supra* note 54, at 1370).

[127]Justice George offered similar arguments regarding Congress's historical deference to the states in banking matters, the limited application of *Marquette National Bank*, and a textualist interpretation that the language in § 85 consistently associated "interest" with "rates." *Id.* at 716-17.

the expansive application of section 85.[128] First, Justice George distinguished between financial reimbursements that are considered "interest" and those within the realm of "penalty" or "liquidated damages."[129] The Justice then categorized late fees as "fixed dollar amount[s]" which are "unrelated either to the amount of the loan or the time period for which funds are advanced, and that [are] assessed only if the borrower fails timely to make a required payment."[130] According to Justice George, the question of whether a payment is "interest" "must be determined as of the time of the transaction."[131] As historical support, the Justice noted that mid-nineteenth century Supreme Court decisions held that any "conditional or contingent" charges which were either attached to the borrower's nonperformance of a contractual obligation or were undeterminable at the loan's origination were not considered interest.[132]

Second, Justice George disputed the majority's reliance on *Tiffany* for proof that section 85 was designed to prevent state discrimination of national banks.[133] Since the Supreme Court had ruled in *McCulloch v. Maryland*[134] that states did not have the power to discriminate against federal instrumentalities, the Justice believed that such protection would be redundant.[135] *McCulloch* aside, if Congress had actually intended section 85 to provide the regulation needed to avoid discriminatory practices, the states could have easily frustrated this intent by exercising a variety of police powers.[136]

D. *The Supreme Court*

In a unanimous decision, the Supreme Court held that the statutory term "interest" under section 85 encompassed late fees.[137] In doing so, the Court allowed out-of-state national banks to export their states' late charges without regard for the usury laws in the states where their

---

[128] *Id.* at 717-18.

[129] *Smiley*, 900 P.2d at 717.

[130] *Id.* at 717.

[131] *Id.* at 718 (quoting First Am. Title Ins. & Trust Co. v. Cook, 90 Cal. Rptr. 645, 647 (Cal. App. 1970) (alterations in original)).

[132] *Id.*

[133] *Smiley*, 900 P.2d at 719.

[134] 17 U.S. (4 Wheat.) 316 (1819).

[135] *Smiley*, 900 P.2d at 719.

[136] *Id.* Such police powers include the authority to issue building permits, set the minimum wage, and establish health and safety requirements. *Id.*

[137] Smiley v. Citibank (S.D.), N.A., 116 S. Ct. 1730, 1736 (1996). Justice Scalia filed the unanimous opinion of the Court. *Id.* at 1731.

customers reside.[138]

The Court stated that its grant of *certiorari*[139] was prompted by the dissenting opinions of Justices Arabian and George in *Smiley*'s California Supreme Court decision[140] and the subsequent opposing opinion registered by the New Jersey Supreme Court in *Sherman v. Citibank (South Dakota), N.A.*[141] The Court's brief summary of the fractured condition of lower court opinions regarding the scope of the term "interest"[142] provided proof that Congress's statutory construction in section 85 was ambiguous.[143] The Court, citing *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*,[144] stated that its policy with regard to ambiguous expressions of law was to defer to the reasonable judgments of the appropriate agency, "because of a presumption that Congress . . . understood that the ambiguity would be resolved, first and foremost, by the agency, and desired for the agency (rather than the courts) to possess whatever degree of discretion the ambiguity allows."[145] The Court noted that, in this case, the prescribed deference should be provided to the Comptroller of the Currency since he "is charged with the enforcement of banking laws to an extent that warrants the invocation of [the rule of deference] with respect to his deliberative conclusions as to the meaning of these laws."[146] Specifically, the Court's deference attached to the Comptroller's provision created through section 553[147] rulemaking,[148] that

---

[138]*Id.* at 1736.

[139]Smiley v. Citibank (S.D.), N.A., 116 S. Ct. 806 (1996).

[140]*Smiley*, 116 S. Ct. at 1732.

[141]668 A.2d 1036 (N.J. 1995).

[142]*Smiley*, 116 S. Ct. at 1732 n.2.

[143]*Id.* at 1732-33.

[144]467 U.S. 837 (1984). In *Chevron*, the Supreme Court created a method for judicial review when confronted with an administrative agency's construction of a Congressional statute. *Id.* at 842-43. This two-part test has become known as the "*Chevron* two-step":

> First, always, is the question whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress. If, however, the court determines Congress has not directly addressed the precise question at issue, the court does not simply impose its own construction on the statute, as would be necessary in the absence of an administrative interpretation. Rather, if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute.

Id. (citations omitted).

[145]*Smiley*, 116 S. Ct. at 1733 (quoting *Chevron*, 467 U.S. at 843-44).

[146]*Smiley*, 116 S. Ct. at 1733 (quoting NationsBank of N.C., N.A. v. Variable Annuity Life Ins. Co., 115 S. Ct. 810, 813 (1995) (alterations in original)).

[147]5 U.S.C. § 553 (1994).

expressly concluded that the definition of "interest" under section 85 contained late fees.[149]

The Court maintained its deference to the Comptroller despite Smiley's four contentions.[150] First, the Court dismissed Smiley's contention that the Comptroller's regulation was issued nearly 130 years after the original statute was created and, even then, only in response to the recent surge of related litigation, in which the Comptroller showed an expressed bias toward the banking industry.[151] The Court dismissed the relevance of the intermission between the statute and the regulation or the possibility that litigation spawned the development of the related regulation.[152] With regard to the agency's potential bias, the Court found comfort in "a full dress regulation . . . adopted pursuant to the notice-and-comment procedures of the Administrative Procedure Act designed to assure due deliberation."[153]

Second, the Court rejected Smiley's claim that the OCC's regulation created an arbitrary distinction between charges labeled "interest" and those considered "noninterest."[154] The Court found a rational basis for drawing the line between "'payment[s] compensating a creditor or prospective creditor for an extension of credit, making available . . . a line of credit, or any default or breach by a borrower of a condition upon which credit was extended' and . . . all other payments."[155]

Third, the Court discarded the argument that the Comptroller was

---

[148]Section 7.4001(a) states in full:

> The term "interest" as used in 12 U.S.C. 85 includes any payment compensating a creditor or prospective creditor for an extension of credit, making available of a line of credit, or any default or breach by a borrower of a condition upon which credit was extended. It includes, among other things, the following fees connected with credit extension or availability: numerical periodic rates, *late fees*, not sufficient funds (NSF) fees, overlimit fees, annual fees, cash advance fees, and membership fees. It does not ordinarily include appraisal fees, premiums and commissions attributable to insurance guaranteeing repayment of any extension of credit, finders' fees, fees for document preparation or notarization, or fees incurred to obtain credit reports.

12 C.F.R. § 7.4001(a) (1996) (emphasis added).

[149]*Smiley*, 116 S. Ct. at 1733.

[150]*Id.* at 1733-35.

[151]*Id.* at 1733.

[152]*Id.*

[153]*Smiley*, 116 S. Ct. at 1733 (citing Thompson v. Clark, 741 F.2d 401, 409 (D.C. Cir. 1984)).

[154]*Id.*

[155]*Id.* at 1734 (quoting 12 C.F.R. § 7.4001(a) (1996)).

not entitled to deference, because this regulation conflicted with prior agency rulings.[156] Although noting that a contradictory change in agency position does not make the change arbitrary per se,[157] the Court found no vacillation between the OCC's notice-and-comment rulemaking and its recent interpretative letters.[158] The Court dismissed Smiley's examples of prior agency positions as insufficient to establish any definitive agency position, thus further justifying the promulgation of its current stance to prevent future uncertainties.[159]

Finally, the Court rejected Smiley's argument, based on *Cipollone v. Liggett*,[160] that section 85 raises the issue of federal preemption, which, in turn, removes the agency's *Chevron*-like deference and requires the Court to decide the matter *de novo*.[161] The Court stated, as did the majority in the California Supreme Court decision,[162] that "[t]his argument confuses the question of the substantive *meaning* of a statute with the question of *whether* a statute is pre-emptive."[163] The Court pointed to the *Marquette National Bank* holding as evidence of the preemptive effect of the statute, which rendered *Cipollone* inapplicable in this decision.[164]

Having determined that the Comptroller of the Currency was entitled to deference because of the ambiguity of section 85, the Court's next step was to evaluate whether this statutorial interpretation was reasonable in light of its historical basis.[165] The Court, in concluding that the interpretation was "obviously" reasonable,[166] was careful to note that its judicial review was not intended to scrutinize the OCC's regulation in order to determine whether the Comptroller selected the best interpretation possible.[167]

In reaching this decision, the Court performed an historical review to determine the common meaning and judicial application of the terms "interest" and "rate."[168] The court, citing several nineteenth century dictionaries and the Supreme Court's holding in *Brown v. Hiatts*,[169]

---

[156] *Id.*

[157] *Smiley*, 116 S. Ct. at 1734 (citing Motor Vehicles Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Automobile Ins. Co., 463 U.S. 29, 46-57 (1983)).

[158] *Id.*

[159] *Id.*

[160] 505 U.S. 504 (1992).

[161] *Smiley*, 116 S. Ct. at 1735.

[162] *Smiley*, 900 P.2d at 697.

[163] *Smiley*, 116 S. Ct. at 1735 (citations omitted).

[164] *Id.*

[165] *Id.*

[166] *Id.*

[167] *Smiley*, 116 S. Ct. at 1735.

[168] *Id.* at 1735-36.

rejected Smiley's (and Justice George's) contention that "interest" was traditionally related to "the payment owed" or "the time period of delay."[170]

The Court also dismissed the petitioner's textualist contention that section 85's repetitive use of the word "rate" also supported the theory that interest "charges [must] be expressed as functions of time and amount ow[ed]."[171] The Court, adopting a functionalist position, found nothing magical about percentage-based interest.[172] To substantiate this position, the Justices reasoned that flat charges had received judicial acceptance, were an established denotative meaning of the term,[173] and could easily be converted back into percentage-based amounts.[174]

The Court then rejected Smiley's argument that late fees are actually *penalties* charged for failing to comply with the terms specified in the credit card agreement, which separates them from "interest."[175] Penalties, the Court held, are simply a subclassification of "interest" and using this specific term only serves to distinguish this area of interest from "interest which is exacted as commercial compensation."[176]

IV. EVALUATION

Smiley v. Citibank (South Dakota), N.A.[177] effectively removes the state-imposed barriers created to frustrate Congress's intent to deregulate the banking industry, specifically in the area of consumer credit.[178] The Supreme Court's ruling permits national banks to expand their exportation beyond the realm of periodic percentage rate interest charges and into related credit card charges associated with the consumer lending process.[179] In doing so, national banks, backed by the banking laws of their home states, are now empowered to potentially override the usury

---

[169]82 U.S. (15 Wall.) 177 (1872) (defining interest as "the compensation allowed by law, or fixed by the parties, for the use or forbearance of money, or for damages for its retention").

[170]*Smiley*, 116 S. Ct. at 1735.

[171]*Id.* at 1736.

[172]*Id.* at 1735-36 (citing Hollowell v. Southern Bldg. & Loan Ass'n, 26 S.E. 781 (N.C. 1897)).

[173]*Id.* at 1736 (citing JOHN BOUVIER, A LAW DICTIONARY 421 (6th ed. 1856); NOAH WEBSTER, AMERICAN DICTIONARY OF THE ENGLISH LANGUAGE 910 (1849)).

[174]*Smiley*, 116 S. Ct. at 1736.

[175]*Id.* at 1735-36.

[176]*Id.* at 1736.

[177]116 S. Ct. 1730 (1996).

[178]*Id.* at 1736.

[179]*Id.*

ceilings and consumer protection regulations of every state in America.

This section will examine the Supreme Court's approach in resolving this issue and will also project the effect that this decision will have on the individual states, the national banks, and, perhaps most importantly, on credit card consumers. With regard to the Court's decision, this section will specifically address its heavy reliance on the Comptroller's position, its obvious avoidance of *Tiffany v. National Bank of Missouri*[180] or any related discussion suggesting continued favoritism towards national banks, and its rejection of lower court arguments that credit card interest rates are strictly formula-driven calculations.

A. *The Reliance on* Chevron: *"Two-Stepping" Around the Question*

Superficially, *Smiley* appears to ask a very simple legal question — what does the word "interest" mean in the text of section 85 of the National Bank Act? However, this seemingly simple issue, when attached to *Marquette National Bank*,[181] the father of interstate interest rate exportation, suddenly touches upon the central nerve of a nation founded as a dual sovereignty. In an argument that dates back to the founding of the First National Bank over 200 years ago, the proponents of a strong centralized banking system continue to grapple with the advocates of states' rights for control of our banking industry. Compounding this problem is the notion that national banks have traditionally received special privileges,[182] even though banking and consumer protection laws have been historically acknowledged as state concerns.[183]

Faced with this potential political powder keg, it appeared rather anticlimactic, albeit consistent with prior Supreme Court[184] and lower court rulings[185] involving the National Bank Act, when the Court defused this debate by deferring to the OCC in *Smiley*. The Court's reliance on

---

[180]85 U.S. (18 Wall.) 409 (1873).

[181]439 U.S. 299 (1978).

[182]*Tiffany*, 85 U.S. (18 Wall.) at 413.

[183]Toh, *supra* note 53, at 1310.

[184]In NationsBank of N.C., N.A. v. Variable Annuity Life Ins. Co., 115 S. Ct. 810, 817 (1995), the Court deferred to the Comptroller's reasonable interpretation of the National Bank when ruling that national banks may serve as agents for the sale of annuities.

[185]*See, e.g.*, NoDak Bancorporation v. Clarke, 998 F.2d 1416, 1420 (8th Cir. 1993) (applying *Chevron* when deferring to the Comptroller's authority with regard to the National Bank Act since the statute was ambiguously constructed and the Comptroller provided a reasonable interpretation); American Land Title Ass'n v. Clarke, 968 F.2d 150, 154-55 (2d Cir. 1992), *cert. denied*, Chase Manhattan Bank v. American Land Title Ass'n, 508 U.S. 971 (1993) (same).

the Comptroller's section 553 regulation,[186] under what is commonly regarded as the "*Chevron* two-step,"[187] significantly lowered the evidentiary threshold required to adopt the expansive meaning of "interest" and sidestepped many of the textualist and originalist arguments supplied by the lower courts in attempting to definitively categorize the statute either broadly or narrowly.[188]

Employing the *Chevron* analysis, the Court will always find Congressional intent if Congress has "directly spoken to the precise question at issue."[189] This required the *Smiley* Court to determine whether the meaning of "interest" under section 85 was unambiguously expressed by Congress. The Court looked no further than the fragmentation among state and federal lower courts to gain sufficient proof that the statute was textually opaque.[190] This conclusion removed the Court's ability to rule on the application of section 85 as a strict question of law, and required the Court to use the second and more important step in the *Chevron* analysis.

With an ambiguous text, the Court will not "simply impose its own construction on the statute,"[191] but will defer to the authorized administrative agency's position if the Court determines that its interpretation was reasonable.[192] The judicial threshold is lowered because, as the Court noted, this deference applies even when the Court believes that there were other plausible or even more probable interpretations available.[193] This lower standard enabled the Court to show that the OCC's interpretation was reasonable merely because an expansive meaning of "interest" existed in dictionaries and judicial rulings of the mid-nineteenth century.[194]

It is also important to note, when distinguishing the Supreme Court's opinion from those in the California courts, that the OCC's informal rulemaking position[195] was not finalized until February 1996, which was five months after the California Supreme Court ruled in

---

[186]5 U.S.C. § 553 (1994).

[187]Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984).

[188]For examples of the textualist and originalist arguments used to define the statute, see the dissenting opinions by Justices Arabian and George in *Smiley*, 900 P.2d at 708, 716.

[189]*Chevron*, 467 U.S. at 842.

[190]*Smiley*, 116 S. Ct. at 1732-33.

[191]*Chevron*, 467 U.S. at 843.

[192]*Id.*

[193]*Smiley*, 116 S. Ct. at 1735.

[194]*Id.* at 1735-36.

[195]12 C.F.R. § 7.4001(a) (1996).

Smiley. Thus, while the Supreme Court based its ruling on the OCC's regulation, the regulation was not in effect when the California courts decided the *Smiley* case.

Part of the reason for the general disagreement and detailed interpretive arguments in California and other jurisdictions was that lower courts were only aided by the OCC's interpretive letters and the Comptroller's *amicus curie* participation instead of being bound by a final regulation. By comparison, section 553 rulemaking has traditionally received greater deference than other forms of agency policy making. As discussed in *National Petroleum Refiners Association v. Federal Trade Commission*:[196]

> The Administrative Procedure Act's rule-making procedures . . . provide an agency about to embark on legal innovation with all relevant arguments and information . . . . [U]tilizing rule-making procedures opens up the process of agency policy innovation to a broad range of criticism, advice and data that is ordinarily less likely to be forthcoming in adjudication. . . . Furthermore, under the Administrative Procedure Act the public, including all the parties in the industry who might be affected, are given a significant opportunity prior to promulgation of a rule to ventilate the policy and empirical issues at stake through written submissions, at a minimum . . . or more. . . . Any fears that the agency could successfully use rule-making power as a means of oppressive or unreasonable regulation seem exaggerated in view of courts' general practice in reviewing rules to scrutinize their statement of basis and purpose to see whether the major issues of policy pro and con raised in the submissions to the agency were given sufficient consideration.[197]

The Court's deference implied that it was satisfied that the agency's informal rule was both procedurally and substantively sound.

In effect, the Court took a similar posture as the *Marquette National Bank* Court eighteen years prior by deferring to the wisdom of Congress to adopt the appropriate laws concerning the banking industry.[198] In *Smiley*, the deference came indirectly, via an agency. The

---

[196]482 F.2d 672 (D.D.C. 1973), *cert. denied*, 415 U.S. 951 (1974).

[197]*Id.* at 683, 692.

[198]Marquette Nat'l Bank of Minneapolis v. First of Omaha Serv. Corp., 439 U.S. 299,

Court reasoned that Congress intended the OCC, and not the judicial branch, to resolve any ambiguities resulting from its pronouncements.[199] Additionally, agencies have greater expertise with the specific issues at hand and are more likely to be in tune with the desires of Congress.[200]

Judicial deference to the legislative branch is normally welcomed by those favoring majoritarian law ruling.[201] Those subscribing to this belief would rather have Congress, which is elected by the people and represents the interests of the individual states, create their laws.[202] Ironically, the Court's deference in *Smiley* may have accomplished the opposite effect. While the OCC accurately represented Congress's desire to deregulate banking, it appears possible that Congress was not representing the wishes of its constituents, since over half of the states petitioned the Supreme Court on behalf of *Smiley*.[203] Time will determine whether Congress will be forced to modify its deregulatory position, particularly as it affects each state's ability to provide consumer protection for its citizens.

B. *The Avoidance of* Tiffany

Nearly all the major opinions leading up to the Supreme Court's ruling on this matter, including the California Supreme Court's majority[204] and two minority opinions[205] in *Smiley*, reexamined *Tiffany v. National Bank of Missouri* in order to construe the meaning of section 85 of the

---

318 (1978).

[199]Smiley v. Citibank (S.D.), N.A., 116 S. Ct. 1730, 1733 (1996).

> We accord deference to agencies under *Chevron*, not because of a presumption that they drafted the provisions in question, or were present at the hearings, or spoke to the principal sponsors; but rather because of a presumption that Congress, when it left ambiguity in a statute meant for implementation by an agency, understood that the ambiguity would be resolved, first and foremost, by the agency, and desired the agency (rather than the courts) to possess whatever degree of discretion the ambiguity allows.

Id.

[200]*See id.*

[201]*See generally* ROBERT H. BORK, THE TEMPTING OF AMERICA: THE POLITICAL SEDUCTION OF THE LAW (1990) (discussing the problems of counter majoritarianism in an activist court).

[202]*Id.* at 130.

[203]*See Card Issuer's Home State's Rules Apply Ruling to Have Little Effect in Texas*, *supra* note 56, at 3.

[204]Smiley v. Citibank (S.D.), N.A., 900 P.2d 690, 697-98 (Cal. 1995).

[205]*Id.* at 709-11, 719. Justice George's dissent counterargued the majority's reliance on *Tiffany*'s most favored lender status without expressly referring to the case by name. *Id.* at 719.

National Bank Act. Surprisingly, the Supreme Court not only failed to mention the case by name anywhere in its ruling, but it also averted any reference to *Tiffany*'s doctrine of favoritism towards national banks or any of the discriminatory tactics that the *Tiffany* court believed the statute attempted to prevent.[206]

While it is impossible to be certain, the following are three plausible reasons why the Supreme Court may have elected to avoid *Tiffany*. First, as noted in the prior section, the Court's decision to defer to the agency only required a showing that the OCC's interpretation was reasonable, not definitive.[207] With this lower threshold, the Court may have elected to focus solely on proof provided in the text of dictionaries and judicial decisions. If so, this implies that the Court must have been uncertain about *Tiffany*'s interpretation of section 85. One ambiguity may have been whether the statute intended to provide national banks with an advantage or simply provide them with a competitive equilibrium with their state counterparts. Additionally, the Court might have been unclear whether the Civil War Congress possessed the vision to create a statute that factored in the modern developments in interstate banking.

A second theory is that the Supreme Court may have been uncomfortable relying on *Tiffany*'s second-hand interpretation of the Congressional policy behind section 85. The Court limited its review to readily accessible information regarding the meaning of the term "interest," which was presumably known to the framers drafting the text. Reconciling *Tiffany* with the *Smiley* decision could create a separation of powers dilemma stemming from the recognition that the Court elected to resolve the ambiguity of the text with prior judicial interpretation, instead of truly deferring to the agency's judgment.

Finally, perhaps the Court recognized that the favoritism supposedly implied in the language of the National Bank Act has been disputed by recent changes that show a more patent Congressional desire to place national banks and state banks on equal footing. The duplication of section 85 in D.I.D.A.[208] now provides state-chartered insured lending institutions with the same exportation opportunities that were previously available only to national banks.

---

[206] *See* Smiley v. Citibank (S.D.), N.A., 116 S. Ct. 1730, 1730 (1996).
[207] *Id.* at 1735.
[208] 12 U.S.C. § 1831d(a) (1994).

C. *The Contingency Distinction with Credit Card Interest*

Throughout the precursors to *Smiley*, courts[209] and legal commentators[210] favoring the more restrictive definition of "interest" preferred to limit its application to a calculation based on the length of time and amount owed. Justice George's dissenting opinion for the California Supreme Court distinguished late charges from "interest" because they are not based on such a formula and are "conditional or contingent" on the borrower's failure to make a required payment within the period noted in the credit card agreement.[211] The Justice separately classified late charges as "penalty" and not "interest" by concluding that when a transaction "is not usurious [at] its inception [it] cannot become so by reason of the borrower's subsequent default."[212]

The Supreme Court dismissed this distinction in two ways. First, the Court refused to accept the rigid formula suggested for calculating interest.[213] The Court cited nineteenth century decisions permitting the substitution of flat sum interest for percentage-base interest rates, so long as the state usury ceilings were not exceeded.[214] Practically speaking, the Court found nothing magical about a variable-driven interest rate calculation that could not be equally accomplished through a fixed charge, if a bank so elected.[215] Second, the Court rejected a distinction between "interest" and "penalty" by contending that the latter term is merely a descriptive subclassification of the former.[216]

The Court's position accurately depicted the one expressed by the Office of the Comptroller of the Currency, as evidenced in its interpretive letters.[217] The OCC recognized that credit card lending differs

---

[209]*See Smiley*, 900 P.2d at 717-18; Mazaika v. Bank One, Columbus, N.A., 653 A.2d 640, 654-55 (Pa. Super. Ct. 1994) (Cirillo, J., concurring) (excluding late fees from "interest" because they were contingent on future events); *but see* Spellman v. Meridian Bank (DE), No. 94-3203, 1995 U.S. App. LEXIS 37149, at *61 n.32 (3d Cir. Dec. 29, 1995) (rejecting the argument that interest cannot be derived from contingent charges).

[210]Toh, *supra* note 53, at 1306 ("Late fees are penalties, and they are charged only on contingent events of borrower default. Although agreeing to terms governing late-fee payments is a prerequisite for loan extensions, actual *payment* of such contingent default charges is not.").

[211]Smiley v. Citibank (S.D.), N.A., 900 P.2d 690, 718 (Cal. 1995).

[212]*Id.*

[213]Smiley v. Citibank (S.D.), N.A., 116 S. Ct. 1730, 1735 (1996).

[214]*Id.* at 1735-36.

[215]*Id.* at 1736.

[216]*Id.*

[217]Letter from Julie L. Williams, *supra* note 63, at 23-24 ("Many charges, including the regular monthly percentage finance charges on a credit card account, are 'contingent' . . . but they are still recognized as 'interest'.").

significantly from other types of banking loans.[218] With credit card loans, a consumer will never be required to pay any interest — periodic percentage-based or otherwise — unless they fail to repay their full purchase amount within the specified period.[219] Therefore, all interest is considered contingent since, at the time of the loan's inception, the consumer never knows when (or if) they will ever be forced to compensate the bank for the credit extension.

Under this contingency argument, all charges related to the nonpayment of the credit card loan would need to be lumped together as "interest," which is precisely what the OCC did in its informal rulemaking regulation when it included "any default or breach by a borrower of a condition upon which credit was extended" along with other charges realized at the loan's inception.[220]

D. *After* Smiley: *Who Wins and Who Loses?*

The battle lines in *Smiley* appeared to be fairly well drawn between the federal banks and the individual states working to protect their in-state cardholders. However, the winners and losers may not be so easily discernable since many of the parties in these three groups could be either positively or adversely affected.

1. The States

The obvious winners under expansive exportation are corporate-giant Delaware[221] and lesser-known South Dakota, who lured credit card kingpin Citibank[222] to relocate its operations within South Dakota borders. After *Marquette National Bank*, both of these states had the foresight to capitalize on the far-reaching preemptive powers available to the states under section 85. They enticed national banks by passing legislation that

---

[218] *Id.* For example, with a personal loan, the borrower is obligated to pay interest as well as principal throughout the life of the loan. Interest payments are guaranteed and begin calculating at the time the loan is commenced.

[219] See generally any credit card application which explains the terms and conditions of the agreement.

[220] 12 C.F.R. § 7.4001(a) (1996).

[221] Five of the ten largest credit card issuers in the nation are located in Delaware, namely Discover (second), MBNA America (third), First USA (fifth), First Chicago (sixth), and Advanta (ninth). Joan Biskupic, *Banks Win Court Ruling on Credit Card Late Fees*, WASH. POST, June 4, 1996, at C1.

[222] Citibank has emerged as "the dominant credit card issuer in the interstate market" with $35 billion in billings. Smiley v. Citibank (S.D.), N.A., 900 P.2d 690, 716 (Cal. 1995).

not only increased percentage rates, but loosened other restrictions involving usury and consumer protection laws.[223] In turn, Delaware and South Dakota reaped the benefits of tax revenues and employment.[224]

Other states that fought deregulation by tightening state restrictions are now faced with the difficult task of playing catch-up. Most certainly, the elected officials in other states will face intense pressure from national banks that still remain within their borders to provide banking-friendly legislation or face the revenues and employment reductions stemming from their exodus. If these previously regulated states intend to join the competition for national banks, the states will be forced to not only exceed the opportunities currently available, but to exceed by a margin that justifies the sizable expense of moving an entire banking operation. Clearly, the states that presently house the large national banks will possess a significant advantage as this process unfolds.

It should be noted that deregulation did not remove consumer protection, but only the ability of every state to enforce its own rules. The OCC regulation provides restrictive guidelines and examples of what may be considered "interest."[225] Also, the national bank's home state may offer further protection to consumers by limiting the availability of certain forms of interest. Even those states seeking the economic advantage created by banking must balance the benefit against the erosion of protection to their own constituents.

2. The National Banks

Banks have discovered that credit card operations can reap returns that are three to five times greater than the overall profit rate in banking.[226] This potential for profitability, combined with a saturation of solicitations to consumers nationwide,[227] will be the catalyst for increased competition within the banking industry. Banks have already responded by increasing their marketing expenses to attract consumers.[228] The early 1990s have also resulted in a permanently reduced usage of annual fees.[229]

---

[223]Garten, *supra* note 49, at 68; Ginsberg, *supra* note 54, at 1370.

[224]Ginsberg, *supra* note 54, at 1370.

[225]12 C.F.R. § 7.4001(a) (1996).

[226]Lawrence M. Ausubel, *The Failure of Competition in the Credit Card Market*, 81 AM. ECON. REV. 50, 56 (1991); *see Competition*, *supra* note 1 (asserting that credit cards are now the "star performers of banking").

[227]*See* Biskupic, *supra* note 2, at 10A.

[228]*Competition*, *supra* note 1.

[229]*Id.*; Stark, *supra* note 3, at 33.

Late fees have been an answer to the credit card industry's narrowing profits created by the reductions in percentage rates and enrollment charges and the increased expenditures associated with persuading their target audience.[230] By 1993, late fee charges generated about as much income for banks as annual fees.[231] Today, nearly all the large and mid-sized issuers charge late fees,[232] with many of them raising their amounts[233] and shortening their grace periods[234] in order to generate more revenue. Banks have been able to raise these rates without suffering a competitive disadvantage because many consumers have not yet grown sensitive to the impact of late charges.[235] Even if consumers are cognizant of late fees, many may dismiss this factor from the equation when choosing a card, because of the prevailing, and often erroneous, belief that they will be able to pay the required minimum balance for each payment period.[236] Only increased resistance to late fees by potential cardholders, as they have shown with percentage rates and annual fees, will compel banks to reduce these charges. Therefore, national banks should receive greater profit margins created by late fees, at least until competitive pressures require banks to lower these charges and explore other credit revenue methods.

Additionally, *Smiley*'s expansion of the exportation principle will turn state boundaries into national boundaries, where credit card banking will be extracted from the burden and expense associated with adjusting credit card programs to comply with different requirements imposed by each state's legislature.[237] Banks will now be able to offer uniform programs nationwide with concern only for the laws of state in which they reside, thereby saving a great deal of operating expense. This, too,

---

[230]*Competition, supra* note 1; Henry Gilgoff, *Pay Now or Pay Later, With Late Fees*, NEWSDAY, Jan. 22, 1993, at 49.

[231]*See Competition*, supra note 1 (stating that by 1993, annual fees had dropped to 5.5% of all credit card revenues, while late fees had increased rapidly to 5.3%).

[232]*See* Stark, *supra* note 3, at 33 (noting that in 1996, 94% of all such issuers charge late fees).

[233]*Id.* The most common late fee today is $15, up from $10 in 1990. Some credit cards issuers have raised their charges to as high as $20. *Id.*

[234]*Id.* Traditionally, credit card grace periods were between 10 and 15 days. However, many national banks are now trimming these time extensions to a fraction of their former lengths or are completely eliminating them. *Id.*

[235]*See* Stark, *supra* note 3, at 33 (offering consumer protection strategies to help combat the increased use of late fees); *see also* Biskupic, *supra* note 2, at 10A (advising credit card consumers to look at the address of the credit card lender to determine if their bank is in a deregulated state such as Delaware or South Dakota).

[236]Stark, *supra* note 3, at 33.

[237]*See Card Issuer's Home State's Rules Apply Ruling to Have Little Effect in Texas, supra* note 56, at 3.

will increase the national banks' profit margin.

3. The Cardholders

Based on the appeals of the individual states in *Smiley*, it would seem that consumers would be the biggest losers. However, that appears to be an overly broad assessment. True, as the individual states argued, citizens will lose the protection provided from the usury and consumer laws of their jurisdictions. But, depending on the habits of each cardholder, *Smiley* may represent a significant victory.

If Barbara Smiley had been successful, national banks would have been unable to charge late fees in states with tighter consumer protection laws. That decision would have created inequitable results for consumers nationwide. Cardholders who fail to make their minimum payments within time periods specified in their credit agreements are greater default risks and generate higher expenses than customers who comply with their contractual obligations.[238] If card companies were not able to collect these charges from the offenders directly, the additional costs would be allocated to *all* cardholders, either through higher periodic percentage rates or increased annual fees.[239] Is it fair that everyone should pay higher charges to subsidize the actions of a limited number of customers in regulated states? Allowing this type of consumer protection burdens many for the benefit of a few.[240] Even worse, states opting for stricter regulations not only protect their citizens from the additional cost associated with breaching their economic responsibilities, but also dump much of this expense over state lines. Legalized late fee charges allow banks to directly target the appropriate parties and, in doing so, insure fairer treatment to all cardholders and an equal impact on every state.

Deregulation in the credit card industry appears to have won the day. With the downfall of related state consumer protection laws, consumers will have to protect themselves when choosing a credit card. States will need to turn their attention towards insuring that citizens are provided with the necessary information to make educated economic decisions. Requiring banks to issue standardized solicitations that conspicuously disclose potential charges in simplistic language may be a start.

---

[238] *Legal Issues: The Supreme Court Gives Issuers a Penalty Fee Victory*, CREDIT CARD NEWS, July 1, 1996, *available in* 1996 WL 8385838.

[239] *Id.*

[240] *Id.*

V. CONCLUSION

In *Smiley v. Citibank (South Dakota), N.A.*, the Supreme Court's deference to the Comptroller of the Currency shifted the balance of power in the credit card industry away from the individual states and mandated the deregulatory practices which Congress had sought since the early 1980s. Deregulation should have an immediate impact within the credit card industry by intensifying already fierce competition in two distinct ways.

First, banks appear positioned for heightened revenues attributable not only to the removal of state restrictions, but by more states offering banking-friendly laws to bring national banks within their borders. Second, cardholders should see decreases in annual fees and lower periodic percentage-based interest rates, since card companies can directly assess additional charges to consumers who breach their contractual obligations.

Stephen G. Stroup