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Joseph L. Raia

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opinion of the Fifth Circuit has a limiting effect on the protections afforded by the first and fourteenth amendments. Because of this limiting effect, it is suggested that the Court should have granted certiorari and reversed the case.

RONALD D. POLTORACK

Fisher v. First National Bank of Chicago: 12 U.S.C. Section 85 Is Granted Automatic Extraterritorial Effect

This note discusses the operation of the Seventh Circuit's holding that pursuant to 12 U.S.C. section 85 a national bank located in Illinois may apply that state's interest rates in any other state. Through an economic analysis, the author argues that this operation is essentially sound but should be modified to permit the consideration of conflicts of law principles. The operation of the exception to this general rule is also considered. Specific attention is given to the application and effects of the words "located" and "existing" as used in section 85.

Fisher, an Iowa resident,[1] brought an action against the First National Bank of Chicago, chartered in Illinois, alleging that the interest charged in connection with its bank credit cards was usurious under Iowa law. In *Fisher v. First National Bank of Chicago*[2] the Seventh Circuit Court of Appeals affirmed the decision of the District Court for the Northern District of Illinois[3] to dismiss the

1. In June, 1969, plaintiff Fred Fisher ("Fisher"), a resident of Iowa, received a credit card from The First National Bank of Chicago ("Bank"), a national banking association located in Chicago, Illinois. Fisher accepted the card and used it numerous times to obtain credit from the Bank pursuant to the terms of the agreement that was enclosed with the card when he received it.

Brief for appellee at 2. (References to appendix omitted.)

2. 538 F.2d 1284 (7th Cir. 1976), *cert. denied*, 97 S. Ct. 786 (1977).

3. This action . . . was originally filed in the United States District Court for the Southern District of Iowa on September 3, 1971. . . .

On May 9, 1972, on the Bank's motion, the district court dismissed the complaint for lack of subject matter jurisdiction. Fisher requested reconsideration of that ruling and also sought leave to file an amended complaint. . . .

On June 14, 1972, the district court denied Fisher's motion for reconsideration, and, on July 5, 1972, denied his motion for leave to amend the complaint. On appeal, the district court's jurisdictional ruling was reversed (6-2) by the Court of Appeals for the Eighth Circuit sitting en banc, and the case was remanded with instructions that Fisher be allowed to file his amended complaint. 479 F.2d 26 (8th Cir. 1973).

On remand, the district court took up the Bank's motion for a change of venue pursuant to Section 94 of the National Bank Act, 12 U.S.C. § 94, and on February 14,

action for failure to state a claim upon which relief can be granted. The Seventh Circuit held that where a national bank is located in Illinois and charging interest in Iowa, the allowable rate of interest under 12 U.S.C. section 85[4] is provided by Illinois law.

I. INTRODUCTION

First National Bank of Chicago is located in Illinois but offers its credit card services in Iowa through local correspondent banks. In so doing, the bank charges the eighteen percent annual interest allowed by the Illinois Revolving Credit Act.[5] Iowa law, however, allows interest rates ranging between twelve percent and thirty-six percent for small loan companies[6] but only twelve percent for state banks.[7] Fisher brought a class action on behalf of himself and all other persons within the state of Iowa who were customers of defendant's First Card and Bank Americard plans and who had unpaid balances in their accounts within two years of the filing of his complaint. The complaint alleged that the eighteen percent interest rate of defendant's revolving credit card plan was usurious under the Iowa law which allows state banks only twelve percent. The statutory basis of the complaint was two sections of the National Bank Act, 12 U.S.C. section 85[8] and section 86.[9]

Section 85 sets forth the allowable rate of interest for national banks and provides in pertinent part:

> Any association may take, receive, reserve, and charge on any loan or discount made, or upon any notes, bills of exchange, or other evidences of debt, interest at the rate allowed by the laws of the State, Territory, or District where the bank is located . . . *except* that where by the laws of any State a different rate is limited for banks organized under State laws, the rate so limited shall be allowed for associations organized *or existing* in any such State under this chapter. (Emphasis added).

1974, the court granted the motion and ordered the case to be transferred to the Northern District of Illinois.

Brief for appellee at 3, 4. (References to appendix omitted.)

12 U.S.C. § 94 (1970) is the venue provision of the National Bank Act, and provides that suits against national banking associations "may be had in any district . . . court of the United States held within the district in which such association may be established, or in any State . . . court in the county or city in which said association is located. . . ."

4. (Supp. V 1975). *See* note 8, *infra*.

5. ILL. REV. STAT. ch. 74, § 4.2 (1973). "The rate charged by the Bank . . . was 1 1/2% per month of the average daily unpaid balance of the principal of Fisher's debt during the billing cycle. . . ." Brief for appellee at 7.

6. IOWA CODE ANN. § 536.13(4)(5) (West 1970).

7. IOWA CODE ANN. § 524.906(1)(b) (West 1970).

8. This section establishes the rates of interest a national bank may charge.

9. This section fixes the penalty for usury.

The intendment of this section is to limit a national bank's interest rate to that of the state in which it is located. Hence, the importance of Fisher rests with its determination of which interest rate a national bank may charge in a state where it is not located.

The Seventh Circuit's interpretation of section 85 applies the section's general rule that the state in which a national bank is located provides the interest rate the bank may charge.[10] According to the *Fisher* court, this rule applies even when national banks charge interest, or make loans, in states where they are not located. On the other hand, the exception to the rule provides that when a national bank "exists" in a state, it may charge the rate that state allows to banks chartered under its laws. Therefore, the Seventh Circuit held that the First National Bank of Chicago may charge the eighteen percent Illinois rate in Iowa because it is located in Illinois.[11] Furthermore, the court indicated that if the defendant bank had existed in Iowa it could charge the interest rate applicable to the Iowa state banks, should that rate be higher than the Illinois rate.[12]

This note will first analyze the effects and implications of the Seventh Circuit's holding. It then will proceed to explore the peculiar problems raised by the court's treatment of the terms "located" and "existing." In this regard, one will observe that the court's application of section 85 hinges upon the recognized, but still undefined, distinction between the aforementioned terms. As the language of the section indicates, the operational effect of the general rule depends upon the definition of "located" whereas the exception's effect depends upon the meaning ascribed to "existing."

II. *Fisher's* General Rule: Its Problems and Implications

Fisher's general rule is derived from a literal interpretation of the section's broad language. As mentioned previously, section 85

10. 538 F.2d at 1291.

11. This holding rejects the positions of both the district court below and the district court in Meadowbrook National Bank v. Recile, 302 F. Supp. 62 (E.D. La. 1969) *vacated,* No. 67-341 (E.D. La. Nov. 24, 1969). The Northern District of Illinois had asserted that the borrower's state should limit the chargeable interest rate, but it justified the defendant's eighteen percent rate with the "most favored lender" doctrine. The court found that since Iowa law applied, and the amount loaned Fisher never exceeded $1,000, the defendant bank's eighteen percent interest rate was permitted by the Iowa small loan act. 539 F.2d 1287-88. In *Meadowbrook,* the court asserted that the borrower's state should provide the allowable interest rate because the National Bank Act "fixes the rate of interest chargeable by a national bank only as to loans made in the state where the bank is located." 302 F. Supp. at 75. *Meadowbrook* has been criticized in Shanks, *Special Usury Problems Applicable to National Banks,* 87 Bank. L.J. 483, 491 n.14 (1970).

12. 538 F.2d at 1291 (Dictum).

states that the law of the state where the bank is located shall provide the allowable rate of interest on "any loan."[13] Thus, it is not inconsistent to interpret "any loan" as including loans made either in other states or made in-state but to out-of-state residents.

Although deciding that the broad statutory language supported its holding, the court neglected to discuss the implications that would result. This is an especially curious aspect of *Fisher* in view of the extraterritorial effect granted Illinois' interest rates, which raises three principle considerations. First, providing extraterritorial effect to the interest rates of one forum may offend the interest policies of another forum. In *Fisher*, for example, the Illinois interest rate, when applied in Iowa, subverted the Iowa policy that no one shall borrow from a bank at more than twelve percent interest. As interpreted by the Seventh Circuit, however, a national bank may always have this option of charging the interest rate allowed by the state in which it is located, regardless of the policies of other affected forums.

Next, the question arises whether or not Illinois national banks gain an unfair competitive advantage over Iowa state banks. It is submitted herein, that when an Illinois national bank charges eighteen percent in Iowa, there accrues no competitive advantage over Iowa state banks which are limited to twelve percent.[14] Briefly, this assertion rests with the view that, in this situation, national and state banks are functioning in different markets, and therefore are not competing. As will be demonstrated, economic analysis will justify this statement.

It is commonly understood that interest rates and the amount of money sought to be borrowed are inversely proportional. As a general rule, when interest rates rise the demand for loans will decrease and, conversely, more loans will be demanded as interest rates decline. Although more people will want to borrow at lower interest rates, banks will not necessarily lend to all who wish to borrow. The interest rate at which a bank will lend depends, *inter alia*, on the risks[15] a particular borrower presents. A twelve percent usury law limits the bank's operational market by permitting it to compete for only those borrowers whose risks require no more than a twelve percent rate. The bank is prohibited by law from competing

13. *See* text following note 9.

14. A national bank's ability to charge higher interest rates may provide a greater opportunity for success and profits. This does not affect, however, the existence of competitive advantage. Throughout this article competitive advantage shall refer to the comparative ability of different money lenders to supply the same market.

15. A. ALCHIAN & W. ALLEN, UNIVERSITY ECONOMICS, 470-72 (3d ed. 1972).

for higher risk borrowers who can only obtain loans at eighteen percent interest.[16]

Markets are defined by this conjunction of borrowers' risks and usury laws. Because of the bank's desire to earn profits, it is precluded from making loans to higher risk borrowers at lower interest rates.[17] Therefore, in the principal case, Iowa state banks are not competing in that market where borrowers' higher risks justify interest rates from twelve percent to eighteen percent. Higher risk borrowers who can only borrow at greater than twelve percent must either borrow from a non-Iowa bank or do without the loan. Notwithstanding this division of markets, Illinois national banks, doing business in Iowa, would be competing with Iowa banks for those borrowers whose risks justify no more than twelve percent. In this competitive situation, Iowa banks will have a competitive advantage since they will not incur the higher transaction costs caused by lending money in foreign markets.[18]

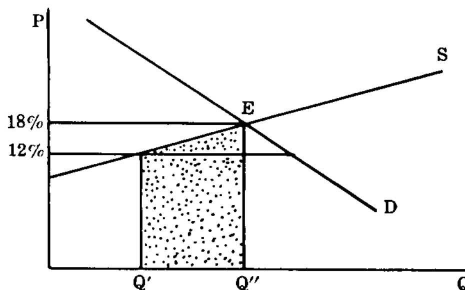
Illinois national banks will only be able to lend at interest rates greater than twelve percent if one of two conditions precedent are met. First, the higher risk Iowa residents must demand loans, in other words, the market for loans at interest rates greater than twelve percent must exist.[19] Second, Iowa banks must have loaned out all their assets, thereby leaving out-of-state banks as the only source of loans. This resultant scarcity of money would cause inter-

16. *Id.*

17. *Id.* at 466-67.

18. "A law restricting the class of borrowers to whom banks can lend, or the interest they can charge, does not prevent banks from competing with each other in other cost-incurring services in order to lend." *Id.* at 471.

19. This condition and the general point being asserted can be illustrated on a graph.



P represents the interest rate, and Q, the amount of loans demanded at each P. D is the demand curve for loans of Iowa residents. S is the supply curve of loans made available by Iowa and Illinois banks. In this example, there is a demand for loans at an interest rate greater than twelve percent which is not being met because of Iowa usury law. Since this demand is not met, a market exists for Illinois banks to charge eighteen percent interest. At the twelve percent rate, Q' represents the amount of money loaned. Q" represents the amount loaned at eighteen percent. The difference between Q" and Q' (the shaded area) represents the amount of money loaned to those borrowers whose risks require an interest rate greater than twelve percent. Only if the supply and demand curves intersect above the twelve percent interest rate will the Illinois banks have a market for loans over twelve percent.

est rates to rise independently of individual borrowers' risks.[20] Thus, given either of these two conditions, *Fisher* guarantees Illinois national banks a new market in Iowa contrary to Iowa policy, but not to the detriment of Iowa banks.

The third consideration raised by the extraterritorial operation of Illinois usury law is the automatic effect given the Illinois eighteen percent rate by the Seventh Circuit. The court held that "Illinois' 18% per annum statute applies to *all* loans made by the defendant Illinois national banking association, whether made in Illinois or elsewhere. . . ."[21] It is submitted that this holding is unnecessarily broad.

Section 85 provides that a national bank may charge interest "at the *rate allowed by the laws* of the State . . ." where it is located.[22] The word "laws" is not limited to a state's statutory usury law. In *First National Bank in Mena v. Nowlin*,[23] it was argued that the interest rates allowed to national banks were provided only by the numerical rate of interest permitted by state statute and did not include the state case law construing that statute. The court dis-

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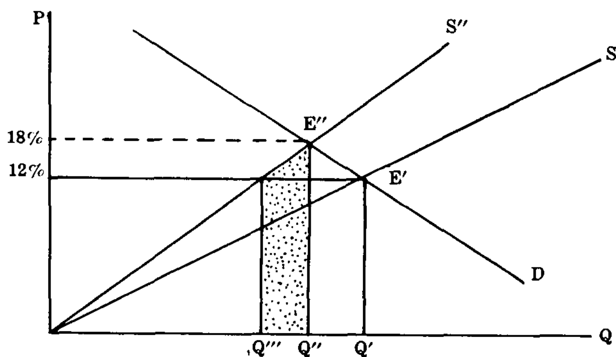
20. This condition can be illustrated on a graph depicting the resultant shift in the supply curve.



P represents the interest rates, and Q the amount of loans demanded at each P. D is the demand curve for loans of Iowa residents. S' is the supply curve of loans made available by Iowa and Illinois banks where the banks of both states have sufficient excess reserves to meet the demand of lower risk Iowa residents. As in this example, however, if the excess reserves of the Iowa banks decrease, *ceteris paribus*, the supply curve will shift upward and to the left, thereby establishing a new equilibrium point (E"). At the old equilibrium point (E') there was no demand by low risk Iowa residents for loans at interest rates greater than twelve percent. After the shift in the supply curve, however, Illinois banks will be able to make loans to low risk Iowa residents at interest rates greater than twelve percent. The difference between Q" and Q"' (the shaded area) represents the amount of such loans. The interest rate charged (P in this example) can be as high as eighteen percent, and the increase is unrelated to individual borrowers' risks.

21. 538 F.2d at 1291. (Emphasis in original).

22. 12 U.S.C. § 85 (Supp. V 1975). (Emphasis added).

23. 509 F.2d 872 (8th Cir. 1975).

agreed, and held that where state case law has declared that it is usurious for a state association to discount interest rates it is also usurious for a national bank to engage in such discounting. The Eighth Circuit replied that section 85 "adopts the entire case law of the state interpreting the state's limitations on usury. . . ."[24] This decision sought to avoid a situation where although both state and national banks are limited by the same statutory rate, national banks could have obtained a higher "effective rate" or "yield" by discounting.[25] The result essentially was founded upon the stated policy of maintaining competitive equality between state and federal lending associations.[26]

The Middle District of Alabama has also articulated this notion of competitive equality in *Partain v. First National Bank.*[27] Therein the court interpreted the "most favored lender" doctrine first articulated in *Tiffany v. First National Bank of Missouri.*[28] In *Tiffany,* Missouri allowed two interest rates: ten percent for persons generally and eight percent for state banks. The First National Bank of Missouri charged nine percent and it was argued that this rate was usurious since national banks were limited by the rate established for state banks. The Court disagreed and held that national banks were not limited by the rate provided exclusively for state banks. National banks may charge the highest rates allowed by the state to its most favored lenders; since persons generally could charge ten percent, national banks may charge up to ten percent. The Court reasoned that otherwise national banks could be placed at a competitive disadvantage in relation to state most favored lenders.[29] As discussed previously,[30] this is an inaccurate characterization. There is no competitive disadvantage to national banks if nonbanking persons may charge ten percent whereas national banks are limited to eight percent. In this situation the two lenders cannot compete

24. *Id.* at 876.

25. When interest is discounted, the stated interest rate is deducted from the amount borrowed before the borrower receives the loan. The borrower then repays the face amount of the loan. Discounting results in a higher than stated interest rate. For example, if $100 is borrowed for one year at 5 percent interest, at the end of the year $100 plus 5 percent, or $5, would be repayed. However, if the 5 percent were discounted, the borrower would receive $95 and repay $100 in one year. In the first case, the borrower is paying $5 for the use of $100; but in the second case, he is paying $5 for the use of $95. When the $5 is discounted, the interest rate exceeds 5 1/4 percent annually.

26. 509 F.2d at 879-80.

27. 336 F. Supp. 65 (M.D. Ala. 1971), *rev'd on other grounds,* 467 F.2d 167 (5th Cir. 1972).

28. 85 U.S. 409 (1873).

29. *Id.* at 412-13.

30. See text accompanying notes 14 to 20.

for those borrowers whose risks require interest rates from eight to ten percent. *Tiffany's* most favored lender doctrine more accurately may be viewed as promoting competition between national banks and nonbank state lending institutions. In order to compete with the state's most favored lenders, national banks may charge the interest rates allowed these lenders. This characterization is helpful in understanding the subsequent decisions of the *Partain* and *Nowlin* courts.

In *Partain*, it was held that a national bank may charge the thirty-six percent rate allowed to small loan companies even though the bank did not fulfill the statutory requirements for such companies.[31] However, the bank was permitted only to apply the small loan rate to small loans—those defined by the statute as less than three hundred dollars. The court reasoned that national banks may charge as much as competing institutions, but only for those types of loans which competing institutions are permitted to make. Thus, a necessary evolution of the most favored lender doctrine occurred. Whereas *Tiffany* allows national banks to compete with most favored lenders by charging the higher most favored lender interest rates, *Partain* limits the doctrine to its intended purpose of competitive equality. Thus, a more accurate statement of the policy would be that national banks may only use most favored lender rates to compete with lenders permitted to charge those rates.

Both *Nowlin* and *Partain* state that the foundation for their decisions is competitive equality. Their analytical frameworks focus on the existence of competitive advantages. In both cases the courts took limitations on state lenders and applied them to federal lenders in order to prevent the federal lenders from effectively charging higher interest rates. It is suggested that this does not literally maintain competitive equality or competitive advantage but rather the *existence of competition.* When only national banks are permitted to charge high interest rates, they are the only lenders operating in those markets composed of high risk borrowers.

In *Nowlin*, if national banks could discount the maximum interest rate, they could lend to higher risk borrowers because state lenders, prohibited from discounting, would be unable to compete. A similar situation existed in *Partain*. If national banks could charge thirty-six percent on any loan, they could function in innumerable high risk markets foreclosed to all other state lenders. *Partain* and *Nowlin* would not interpret section 85 to allow a national bank higher interest rates than *every* state lender. Implicit in

31. 336 F. Supp. at 67. *See also* 538 F.2d at 1288.

this prohibition is the requirement that for every interest rate allowed to national banks there exist state lenders who are also allowed those rates. It is submitted that when determining "the rate allowed by the laws of the state . . ." the courts should analyze whether or not the rate in question will result in national banks operating as the only lenders in the given market. Any rate which allows national banks to operate in a market absent the competition of state lenders should not be "the rate allowed by the laws of the State . . ."[32] as permitted by section 85. Thus, the *Nowlin-Partain* notion of competitive equality should be characterized as the opportunity for the lenders organized under the laws of the state where the national bank is located, to compete with that national bank. In essence, this statement is simply the converse of the principle set forth in *Tiffany;* that is, national banks may compete with all state lending institutions.

Given this perspective of section 85, the automatic nature of the rule provided by the *Fisher* court can be analyzed. The Seventh Circuit's opinion could be interpreted as stating that national banks may charge in any state, the rate allowed by the state where it is located. This interpretation is undesirable because it would produce a result rejected by the *Nowlin* and *Partain* courts. Thus, a national bank could make loans at rates prohibited to all state lenders rather than simply at rates forbidden to state banks. This effect would be caused by the failure to consider conflict of laws principles which, though non-uniform in their approach, govern the rates a state bank may charge when lending in a foreign forum.[33]

The Restatement (Second) of Conflict of Laws[34] provides a liberal principle. A rate of interest will not be found usurious if it is permitted by a state to which the contract has a substantial relationship, and if the rate is not greatly in excess of the rate permitted by the otherwise applicable law. Leflar concurs with the Restatement: "The courts tend to apply the law of whatever state, substantially connected with the transaction, will sustain the contract, unless the contract somehow violates the forum's strong public policy."[35] Ehrenzweig finds that this liberal principle applies to contracts generally but does not ordinarily apply to usurious con-

32. 12 U.S.C. § 85 (Supp. V 1975).

33. *See* Seaman v. Philadelphia Warehouse Co., 274 U.S. 403 (1927); Speare v. Consolidated Assets Corp., 367 F.2d 208 (2d Cir. 1966); Clarkson v. Finance Co., 328 F.2d 404 (4th Cir. 1964).

34. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 203 (1971).

35. R. LEFLAR, AMERICAN CONFLICTS OF LAW § 153 at 378-79 (1968). Both Leflar and the Restatement, *supra* note 34, comment (c) find support for this proposition in 2 BEALE, CONFLICT OF LAWS, 1241-42 (1935), and GOODRICH, CONFLICT OF LAWS, 216-19 (4th ed. 1964).

tracts.[36] Stumberg[37] notes and approves what is in substance the Restatement rule. He further catalogs three other principles: (1) the law where the contract was made controls; (2) the law of the place of performance controls; and (3) the contract will not be usurious if it is sustained under the law of the place of making or the place of performance.

Depending on which conflict of laws principle a particular forum applies, a state bank doing business in another state may or may not be guilty of usury. If the rule in *Fisher* is automatic, however, national banks may charge the rates allowed by the state where they are located for all loans regardless of this consideration. Therefore, it is merely fortuitous that a state bank will have the same access as national banks located in its state, with respect to potential out-of-state markets. This is precisely the result the *Nowlin* and *Partain* courts sought to avoid — national banks operating by themselves in a particular market.

This problem can be avoided if future interpretations of section 85 ("rate allowed by the laws of the State . . .") consider the word "laws" to include state conflicts of law rules.[38] In this respect, *Nowlin* can easily be read as supporting this contention.[39] By subjecting national banks to state conflicts law, we mitigate the effect of the two problems mentioned above, which are created by the *Fisher* court's automatic general rule. First, state and national banks located in the same state will be subject to the same constraints on their ability to compete in out-of-state markets. This would comport with the notions of competition set forth in *Nowlin* and *Partain*. Second, conflicts principles may also allow the courts to give some consideration to a state whose policies may otherwise be subordinated. As specifically permitted by the Restatement,[40] and noted by Leflar,[41] a more liberal rate will not be allowed in a state whose strong public policy is offended. If in *Fisher* a strong Iowa policy was manifest, conflicts rules would not have subordinated that policy so as to permit Illinois law to control the transaction. To the extent conflicts principles are uncertain or unpredictable, however, they may cause higher transaction costs when operating in foreign markets.[42]

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36. A. EHRENZWEIG, CONFLICT OF LAW, § 182 (1962). He does note, however, exceptions where the liberal law of another state has been used to uphold an otherwise usurious contract.

37. G. STUMBERG, PRINCIPLE OF CONFLICTS OF LAW, at 237-39 (3d ed. 1963).

38. Shanks, *supra* note 11 at 489.

39. *See* text accompanying notes 23 & 24.

40. *See* note 34 and accompanying text *supra*.

41. *See* note 35 *supra*.

42. The value of property rights depends upon their legal enforceability. As people come

Conflicts principles should apply as long as the general rule, controls. When the "exception clause" is invoked the national bank should be permitted to charge the higher rate allowed by the state in which it exists. Unlike the general rule, the operation of the "exception clause" does not defeat any policy considerations. The higher rate is endorsed by the state where the national bank exists and it will be competing with that state's lenders.

A. *Problems with Location*

In order to apply *Fisher's* general rule, the location of the national bank must be determined. A large body of case law has developed through 12 U.S.C. section 94, the venue provision of the National Bank Act, for determining where national banks are located. The Seventh Circuit relied on cases interpreting section 94 in its finding that the defendant bank was located in Illinois for the purposes of section 85.[43] In this regard, the general rule relied on by the court is that a national bank is located where it is established[44] and it is established at the location of its main branch as specified in its charter or organization certificate.[45] Until recently, this rule was unqualified by almost every federal court and it still remains the majority position.[46] Only one state court has dissented from this position.[47]

If the majority definition of location continues to prevail and is applied to section 85, an interesting effect will result. A national bank located in Illinois with branches in several states which have lower interest rates will be permitted to charge Illinois interests rates because of the location of the main branch. Certainly, such a practice would be inconsistant with the notions of competitive equality discussed previously. Although these branches would have no competitive advantage over a lending association chartered by the state where they exist and do business,[48] they would have competitive advantages over state institutions chartered by the state

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to expect the uncertainty of a right's legal enforcement, its value will decline. ALCHIAN & ALLEN, *supra* note 15, at 141-44.

43. 538 F.2d at 1289.

44. *Id.* at 1286.

45. *Id.*

46. First Nat'l Bank v. United States Dist. Ct., 468 F.2d 190 (9th Cir. 1972). Leonardi v. Chase Nat'l Bank, 81 F.2d 19 (2d Cir. 1936), *cert. denied,* 298 U.S. 677; Odette v. Shearson, Hammill & Co., 394 F. Supp. 946 (S.D.N.Y. 1975); General Elec. Credit Corp. v. James Talcott, Inc., 271 F. Supp. 699 (S.D.N.Y. 1966); International Refugee Organization v. Bank of America Nat'l Trust & Sav. Ass'n., 86 F. Supp. 884 (S.D.N.Y. 1949).

47. Holson v. Gosnell, 264 S.C. 619, 216 S.E.2d 539 (1975).

48. See text accompanying notes 14 to 20.

where their main branch is located. A branch existing in a state will incur smaller costs per loan than a bank located in another state and trying to do business across state lines. An Iowa resident whose credit-worthiness requires an over twelve percent loan might have incurred the costs of going to Illinois to borrow from either a state or national bank. Under the *Fisher* rule, however, this Iowa resident can go to a branch of an Illinois national bank in Iowa—therein lies the competitive advantage.

III. THE EXCEPTION TO THE GENERAL RULE: PROBLEMS AND IMPLICATIONS

Fisher's interpretation of the "exception clause"[49] assures national banks the option of charging the highest possible interest rate. Provided it exists or is located in a state, it may charge the rate allowed to that state's banks. This exception will become relevant when the state in which the national bank exists permits higher interest rates than the state in which it is located.

A. *The Problem of "Existing"*

First National Bank of Chicago was operating a credit card service in Iowa through local correspondent banks. Such credit card systems are found throughout the United States.[50] Consumers enter into contracts with the credit card issuer, who has previously entered into contracts with various merchants.[51] When the consumer purchases an item with the card he does not pay the merchant; instead, the merchant tenders the sales slip to the issuer and it bills the consumer.[52] In the instant case the system involved more than three parties. Here the merchants tender the sales slips to local corresponding banks, which in turn forward the sales slips to the card issuer in Illinois.

The ability of the defendant bank to charge a higher Iowa rate would depend on whether or not the bank exists in Iowa. The *Fisher* court found it unnecessary to make this determination but stated

49. The "exception clause" of section 85 provides: "[E]xcept that where by the laws of any State a different rate is limited for banks organized under State laws, the rate so limited shall be allowed for associations organized or existing in any such State under this chapter." See text accompanying note 53.

50. *See generally* Brandel and Leonard, *Bank Charge Cards: New Cash or New Credit*, 69 MICH. L. REV. 1033 (1971); Davenport, *Bank Credit Cards and the Uniform Commercial Code*, 1 VAL. U. L. REV. 218 (1967); Note, *Regulation of Installment Credit Cards*, 35 U. CIN. L. REV. 424 (1966); Comment, *The Tripartite Credit Card Transaction: A Legal Infant*, 48 CAL. L. REV. 459 (1960).

51. Brandel and Leonard, *supra* note 50 at 1035; Comment, *supra* note 50 at 464.

52. Brandel and Leonard, *supra* note 50 at 1035.

"the defendant bank appears to exist in Iowa."[53] "Existing" was defined as "the fact, or state, of being or living"[54] but was neither explained nor applied to the facts. Thus, a narrow interpretation of the Seventh Circuit's suggestion that the First National Bank of Chicago exists in Iowa is that the act of an Iowa resident possessing and using that bank's credit card, and the existence of the processing system among merchants, corresponding banks and card issuer, are sufficient to find that the card issuer exists in Iowa.

A narrower definition of "existing" would serve to limit the ability of national banks to implement the higher interest rates of other states. Some limitation upon the effect of this term is necessary since it is susceptible to broad interpretation in two contexts. First, in any loan situation possibly five different forums may become relevant: lender's state, borrower's state, state where the contract is entered into, state where the contract is to be performed, and state(s) where negotiations occur. In a credit card situation the potential forums are limited by the number of states where the cards are honored. Every such state will contain an interchange system[55] of corresponding banks which transfers sales slips from merchants to card issuers. Hence, a bank, especially a credit card issuer, can possibly "exist" in many states under *Fisher's* analysis. Merely doing business in a state would be a threshold requirement for existence, but it should not be a necessary or sufficient criteria. The residency of one party to the transaction, for example, may provide an appropriate limit. In the instant case Fisher's Iowa residency conjoined with the credit card system could be sufficient to find that defendant bank existed in Iowa. On the other hand, if Fisher merely had used his card in Indiana, the Illinois bank should not be found to exist there simply because a system for processing credit card transactions operates in the state.

Furthermore, the "exception clause" imposes no limitation on its own general effect. If any state provides a different rate for state banks, then that rate is allowed to national banks existing in the state. A literal interpretation would permit a national bank to charge the higher rate allowed by the state where it exists to all other transactions without regard to who the parties are, or where the transaction is negotiated, consummated and performed. For example, an Illinois national bank existing in Iowa could charge a higher Iowa rate in Illinois and anywhere else it existed. Since Iowa

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53. 538 F.2d at 1291.

54. *Id.* at n.12.

55. Brandel and Leonard, *supra* note 52 at 1036.

banks could be charging the higher rates in these states under conflicts law, an Illinois national bank might argue that it should be able to implement the Iowa rates in order to compete with Iowa banks in these out-of-state markets. As is apparent, at this point the "exception clause" would begin to swallow the general rule of section 85 and tend to defeat the notion that the state where the national bank is located shall provide allowable interest rates.

B. *The "Exception Clause" and the "Most Favored Lender" Doctrine*

Strict adherence to the general rule, as set forth by the Seventh Circuit, would allow an Illinois national bank to charge Illinois "most favored lender" rates on any appropriate loan no matter where it was made. The language of the "exception clause" would not support the use of higher Iowa "most favored lender" rates by Illinois national banks, even if they existed in Iowa. The exception clause provides in pertinent part: except that where "a different rate is limited for *banks* organized under state law . . ."[56] the rate so limited shall be allowed to national banks. (Emphasis added). Hence, the limited "exception clause" literally applies to limited rates set for banks only, not carte blanche to all lending institutions. It has no application to rates established for nonbank lending associations.

This apparent inconsistency in federal policy may not be explicable. As originally passed, the exception clause read: "[E]xcept that where by the laws of any state a different rate is limited for banks of issue organized under state laws, the rate so limited shall be allowed for associations organized in any such state under this act."[57] This is exactly as the clause reads today except that the words "or existing" were subsequently inserted between "organized" and "under".[58] During the Congressional debates concern was expressed that if the interest rates allowed national banks were left to state law, individual states may attempt to discriminate against national banks by providing one rate for them and a higher rate for state banks.[59] Subsequent to that debate, section 85 was rewritten and enacted as described above.[60] It must be more than

56. 12 U.S.C. § 85 (Supp. V 1975).

57. National Bank Act, Ch. 106, § 30, 13 Stat. 99 at 108 (1864).

58. 538 F.2d at 1289.

59. Remarks of Senators Sherman and Grimes, *Cong. Globe*, 38th Cong., 1st Sess. 2124-25 (1864).

60. Remark of Senator Sherman, *Id.* at 2145.

coincidental that the exception clause, as originally enacted, remedied the stated apprehension.

The "exception clause" was quoted by the Supreme Court in its original form until 1875.[61] The words "or existing" first appeared in the Revised Statutes of 1878 section 5197 and were first cited in 1881.[62] This amendment enabled the Seventh Circuit in *Fisher,* to give national banks the option of charging the higher interest rates provided by the states where they exist. Until the amendment, the exception clause only applied to the state where the national bank was organized.

Since there does not appear to be any legislative history for this amendment, its purpose is left to conjecture. Apparently, it was intended to increase the number of situations where the "exception clause" applies. It is not clear whether or not the amendment occurred prior to, or after *Tiffany's* promulgation of the "most favored lender" doctrine.[63] If the amendment preceded *Tiffany,* it could be argued that the "exception clause" could not possibly embrace the "most favored lender" doctrine because it did not exist at the time of amendment. If, however, the amendment followed *Tiffany,* it could be argued that since the language only mentions banks there was an intention to exclude the "most favored lender" doctrine from the operation of the exception clause.

There are several good reasons why the "most favored lender" doctrine should operate within the "exception clause." Allowing national banks access to one state rate and not the others is inconsistent and arbitrary. In order to defend this result one would have to argue that Congress intended to protect a state's "most favored lenders" from the competition of out-of-state national banks. This is a weak position as it has never been the intent of Congress to shield any state institutions from the competition of national banks. Moreover, the underlying intent of the "most favored lender" doctrine is to permit national banks to compete with nonbank state lending institutions.[64] An Illinois national bank implementing the

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61. 538 F.2d at 1291 n.11.

62. *Id.*

63. The amendment occurred between June 3, 1864, the day the National Bank Act passed, and March 2, 1877, the current date of the Revised Statutes of 1878. Furthermore, it has been noted that many errors were made in the compilation of the Revised Statutes. Recently, Justice Blackman argued this possibility in a dissenting opinion involving section 91 of the National Bank Act. Third National Bank in Nashville v. Impac Limited, Inc., 97 S.Ct. 2307 (1977).

64. *E.g.,* Tiffany v. National Bank of Missouri, 85 U.S. 409 (1873); First Nat'l Bank in Mena v. Nowlin, 509 F.2d 872 (8th Cir. 1975); Partain v. First Nat'l Bank, 336 F. Supp. 65 (M.D. Ala. 1971) *rev'd on other grounds,* 467 F.2d 167 (5th Cir. 1972).

higher rates allowed to Iowa "most favored lenders" would not offend Iowa public policy. It would be charging rates endorsed by the state. The resulting competition between out-of-state national banks and local "most favored lenders" may benefit local consumers by reducing interest rates. Therefore, in order to give effect to Congressional policy, at no expense to state policy, the literal provisions of section 85 should be read to permit the implementation of "most favored lender" rates through the "exception clause."

V. CONCLUSION

The Seventh Circuit has formulated the most tempting of all rules — one that is simple and straightforward to apply. Two potential problems may be anticipated, however, because the words "located" and "existing" are susceptible to broad interpretations. Serious policy considerations will arise if some limitation is not placed on their operational effect for the purposes of section 85.

One may criticize *Fisher's* general rule on two grounds. An automatic application of Illinois law may create inconsistency with the *Nowlin/Partain* notion of competitive equality. This difficulty may be circumvented, however, through the application of conflicts principles. In order to derive its general rule, the court found support in the literal interpretation of the statute. Specifically, full effect was given to the language "any loans." An analogous effect should be derived from the literal interpretation of "laws of the state . . . ." This interpretation should include state conflicts law.

Those parts of section 85 which have been discussed above read substantially the same as they were first enacted in 1864. One might suspect that the section is an anachronism, ripe for amendment. It is submitted that by implementing conflicts law a reasonable vehicle for dealing with the extraterritorial operation of national banks will arise.

JOSEPH L. RAIA