RILEY v. NORTHERN COMMERCIAL:
COMMERCIAL RATIONALE TRIUMPHS OVER
STATUTORY INTERPRETATION

I. INTRODUCTION

In Riley v. Northern Commercial Co.,¹ the Alaska Supreme Court interpreted a promissory note providing for “interest after maturity at the highest lawful contract rate.”² The note did not specify an actual interest rate, but the court found that the parties had entered into an express interest rate agreement. In reaching this conclusion, the court refused to apply the legal rate of interest³ and upheld the superior court’s award of prejudgment interest at the highest rate sanctioned by Alaska law under the variable interest rate formula.⁴ Throughout this note, as well as in the court’s opinion,

2. Id. at 966.
3. ALASKA STAT. § 45.45.010(a) (1980) (“The rate of interest in the state is 10.5 percent a year and no more on money after it is due except as provided in (b) of this section.”).
4. ALASKA STAT. § 45.45.010(b) (1980) now provides:
   No interest may be charged by express agreement of the parties in a contract or loan commitment dated after June 4, 1976 which is more than five percentage points above the annual rate charged member banks for advances by the 12th Federal Reserve District that prevailed on the 25th day of the month preceding the commencement of the calendar quarter during which the contract or loan commitment is made. A contract or loan commitment in which the principal amount exceeds $100,000 is exempt from the limitation of this subsection.

At the time the contract was executed ALASKA STAT. § 45.45.010(a) stated, in pertinent part: “The [legal] rate of interest in the state is six percent a year and no more
legal rate refers to that rate of interest provided by law to accrue on any obligation not specifying an interest rate; the variable rate is a legislatively sanctioned level of interest, higher than the legal rate, available to parties who agree expressly in their obligations that a rate higher than the legal rate will apply. The variable rate sets the uppermost level for interest; any level of interest higher than the variable rate will be deemed usurious. The court considered it unpersuasive that the parties had executed their note in 1975 and the legislature had expressly provided that the amended variable interest formula, which raised the allowable interest ceiling, was to apply only to contracts made after June 4, 1976.5

II. FACTS

On December 12, 1975, John Riley executed a promissory note for $51,209.20 in favor of Northern Commercial. The note was given to liquidate his account for supplies and services previously rendered by Northern Commercial. Riley defaulted on the note after making one payment. On November 3, 1978, Northern Commercial filed suit against Riley to collect on the unpaid promissory note. Riley denied owing the full indebtedness and filed a counterclaim for recovery of amounts allegedly due him in an unrelated transaction. He failed, however, to timely respond to requests for admission and the superior court granted Northern Commercial summary judgment on both the promissory note and the contractual counterclaim. On appeal, the supreme court sustained the summary judgment rulings and also upheld the superior court’s award of prejudgment interest at the highest rate obtainable under Alaska’s amended variable interest rate formula.

III. APPLICABLE INTEREST RATE PROVISION

Justice Compton, writing for the majority, began his discussion of the prejudgment interest award by observing that contracts not containing express interest rate agreements carry prejudgment interest at the legal rate (which at the time was six percent). Although parties may be bound by the legal rate of interest either by incorporating it or by leaving an interest rate out of their contract altogether,6 Justice Compton noted that those parties not wishing to be

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5. 648 P.2d at 968.
6. ALASKA STAT. § 45.03.122(d) (1980) provides that unless an instrument states otherwise, interest on commercial paper runs at the rate provided by law for a judgment. See id. § 45.45.010(a). See generally 45 AM. JUR. 2D Interest & Usury § 68 (1969).
so bound may agree on the applicable rate of interest as long as such a rate does not exceed the variable interest rate formula.\footnote{7}

The court found that Riley and Northern Commercial entered into an express interest agreement even though the promissory note did not state a particular rate of interest or refer specifically to any statutory interest rate provision. As a logical matter, the court stated that the term “highest lawful rate” was not equivalent to “legal interest” because the former “means any rate of interest up to that fixed by statute as the maximum rate at which interest can be contracted for.”\footnote{8} Since the legal interest rate was not the highest rate obtainable under the Alaska statutory interest scheme, the court concluded that the legal interest rate did not apply but the variable interest rate formula did. The court reached this conclusion under the appropriate standard of review, treating the contractual provision as a matter of law since neither party alleged the surrounding circumstances to be in dispute.\footnote{9} One wonders, though, whether the contractual interpretation is as simple as the court’s logic indicates.

As the court later observed: “This is not a case where the parties attempted to negotiate a cost of credit.”\footnote{10} The court’s assumption that the parties, who were not professional lenders, were familiar with the statutory interest scheme — especially the variable interest rate formula — seems unwarranted and unsubstantiated. Indeed, the opposite seems far more plausible; that is, it is probable that the parties were not aware of the variable provisions or that those provisions might be changed in such a way as to affect their contract. By contrast, an assumption that the parties were aware of the legal interest rate provisions seems more likely. Thus, the court’s interpretation is perhaps not as neat as first impression indicates. Indeed, when confronted with the same question, a Massachusetts court found that “highest lawful rate” meant interest was due at the legal rate.\footnote{11}

Even if one does not fault the court’s presumption that the parties had a detailed knowledge of the statutory interest scheme,\footnote{12} the

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\item \footnote{7}{648 P.2d at 966-67.}
\item \footnote{8}{Id. at 967 (quoting 45 AM. JUR. 2D Interest & Usury § 2, at 16-17 (1969)).}
\item \footnote{9}{648 P.2d at 967; see also Wessells v. State, 562 P.2d 1042, 1046 n.9 (Alaska 1977); Day v. A & G Constr. Co., 528 P.2d 440, 443 (Alaska 1974).}
\item \footnote{10}{648 P.2d at 968.}
\item \footnote{11}{Universal C.I.T. Credit Corp. v. Ingle, 347 Mass. 119, 124, 196 N.E.2d 847, 851 (1964) (interest rate applicable to promissory note after maturity, which provided for interest after maturity at highest lawful rate, was that provided by statute in absence of any other agreement for interest rate).}
\item \footnote{12}{See 648 P.2d at 967 (“The purpose of contract interpretation is to ascertain and effectuate the reasonable expectations of the parties.”) (citing Wright v. Vickaryous, 598 P.2d 490, 497 (Alaska 1979); Stordahl v. Government Employees
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rationale behind its holding is still questionable. The court justified its decision with a non sequitur by explaining that its holding was required in an era of interest rate instability, otherwise the ability of commercial parties to allocate the risk of nonperformance would be unduly impaired. But the allocation of commercial risk was only tangentially involved in the question before the court. The court was required to interpret a contract provision which already allocated the risk of nonperformance, since Riley was required to pay the highest lawful contract rate after maturity. If the court had decided that the parties had not reached an express interest agreement because of ambiguous language and had applied the legal rate instead of the variable formula, it would not have disturbed other commercial parties who provided for specific interest rates in their contracts. The only parties who would be affected by a decision that the clause was ambiguous are those who have written similarly ambiguous clauses; those who write clear interest clauses would be unaffected by this case. Taken at face value, the court's opinion is tantamount to stating that in any case involving a vague interest clause the creditor must receive the highest interest possible under any method of interpretation or the commercial process will be impaired. Potential litigants would be better served if the court had handled the matter by construing the particular contract clause rather than by attempting to universalize, under an untenable rationale, discrete litigation problems. If the court meant what it said, it is easy to foresee lenders writing clauses with a studied ambiguity hoping to achieve higher interest rates should the legislature improve upon the present statutory scheme.

The court concluded that the interest rate provision in the promissory note was unambiguous. This conclusion seems ludicrous. Indeed, if the contractual provision was so clear one wonders why it required such extensive litigation. Assuming that there was ambiguity, the court should have applied the normal rule of contract-
tual interpretation, that any ambiguity is construed against the draftsman.\textsuperscript{16} Had the court applied this rule, Riley would have paid less interest.

IV. RETROACTIVE EFFECT OF THE VARIABLE FORMULA

After deciding that the variable interest formula applied to the note, the court had to wrestle with a more problematic question. The legislative amendment which raised the interest rate ceiling stated that the higher rates were to be applied only to contracts made after June 4, 1976. The amendment on its face was intended to operate only prospectively, not retroactively. Ignoring the statutory language, the court circumvented the express legislative intent in a neat end run. The majority began by deciding that the parties probably intended to be bound in their contract by whatever rate changes the legislature enacted.\textsuperscript{17} The court supported this interpretation by finding that the parties undoubtedly intended the interest provision to operate as an indemnification for Riley's failure to perform.\textsuperscript{18} With relish, the court adopted the argument that Riley could have avoided paying any interest had he performed.\textsuperscript{19} It is submitted that the court answered a needless question about the parties' intention, albeit probably correctly. Evidently not entirely satisfied with its reading of the parties' intention, the court returned to its commercial rationale by saying that it would be "anomalous to adopt a rule which, due to rising interest rates, rewards Riley for failing to perform, and, more generally, creates an incentive for debtors to default."\textsuperscript{20}

The court stated that the language of the statute limiting the higher interest formula to contracts signed after June 4, 1976 did not apply in this case because it did not prevent parties from agreeing to be bound by a higher interest rate should the legislature allow it. In reasoning which virtually ignored the legislative language, the court argued that the legislature meant only to prohibit the subsequent validation of previously usurious interest rate provisions. Having set up this straw man, the court knocked it down by observing that the contract in question was not usurious since it did not specify any interest rate at all. Therefore, the statutory limitation did not apply and Riley was required to pay the higher rate even though his con-

\textsuperscript{16} See 3 A. Corbin, Corbin on Contracts § 559 (1960); 4 S. Williston, Williston on Contracts § 621 (3d ed. 1961).
\textsuperscript{17} 648 P.2d at 968.
\textsuperscript{18} Id.
\textsuperscript{19} Id.
\textsuperscript{20} Id.
tract was written six months before the legislature adjusted the rate upward.

While the court cited the black letter rule that "a statutory amendment of the legal interest rate will not be applied retroactively if it alters the rights and duties under an existing contract," it never applied this rule in the case at bar. Indeed, if the parties had an express interest agreement in the court's eyes on December 12, 1975, which vested at the highest rate then available, was not their contract finalized at that point? The court seemingly answered no; the parties agreed to be bound by a higher rate if the legislature saw fit to raise the interest ceiling. If the legislature had lowered the interest ceiling, would the court then have reduced the interest rate for which Riley would be responsible? It seems obvious that the answer would be no. The court could not lower the interest rate because it would impair the rights of Northern Commercial under the contract. At issue is the point at which the contract's interest agreement was finalized — when the contract was signed, or when a judgment was issued. The lender cannot have it both ways. If the rates can be applied retroactively on the way up, they should be applied retroactively on the way down. Yet, the overwhelming weight of authority states that a legislative enactment lowering interest rates can have no such effect because it would disturb vested contract rights.

But the most important question raised by the court's discussion of interest rates was never asked, let alone answered. Even Justice Rabinowitz — who in his dissent agreed with the majority's finding of an express interest agreement and the application of the variable interest rate formula, but parted company over its retroactive application — failed to fully articulate the question, although he did reach the correct conclusion. The important question is: even if the parties saw fit to provide for a higher interest rate should the legislature allow it, did the legislature in fact allow it?

The Michigan Court of Appeals confronted this question in Campbell v. Gawart. The question before the Campbell court concerned a land contract which provided for a maximum interest rate. The contract also included a clause allowing a higher interest rate if the legislature raised the rate ceiling. The court said that such an interest agreement may be valid, but its effect was to be controlled by the way in which the legislature changed the law.

23. 648 P.2d at 970 (Rabinowitz, J., dissenting in part).
25. Id. at 531-32, 208 N.W.2d at 609.
If the Legislature clearly manifests an intent that only contracts executed after a certain date may bear a higher interest rate, a contractual provision to the contrary is of no force or effect . . . .

What that future law will be is the prerogative of the Legislature. If the Legislature changes the law in a way that is wholly prospective the old maximum rate applies and this is not an impairment of contract. 26

Accordingly, clear language calling for only prospective application required the court to apply the variable interest rate in effect at the time the parties signed their contract.

A long line of Alaska cases support the impropriety of awarding prejudgment interest for the full period at the higher rate permitted by a statutory amendment after the date of an accident but prior to the judgment. The supreme court has frequently held that the proper course is to award the prior rate of interest until the date of the amendment, then to award the higher rate for the period until judgment. 27 Thus, it seems the court adopted the logic it first espoused in State v. Phillips, 28 and later articulated in City of Juneau v. Commercial Union Insurance Co., 29 that "prejudgment interest is a substantive right of an injured party, to allow that party to recover for economic loss occasioned by his inability to use the award of damages between the injury and judgment." 30

Apparently, the Riley court became tangled in a commercial rationale before it answered the question of what was permitted by the legislative language. As a result, the court incorporated the compensatory purpose rationale from the Phillips and Juneau cases, which discussed the amendment of the legal prejudgment interest statute, into the Riley decision. "We conclude that at least where the interest provision is intended to establish compensatory damages for the detention of money, the statutory language does not preclude parties to a contract from agreeing to be bound by future modifications in the statutory formula." 31 In reaching this conclusion the court, in its zeal to compensate Northern Commercial for the use of the money to which the court believed it was entitled, ignored the statutory mandate that the new interest rate not apply retroactively.

By focusing on the compensation the court felt was due to commercial parties, rather than on the legislature's prospective language, the court retroactively applied a statute which clearly was intended

26. Id. at 532, 208 N.W.2d at 609 (emphasis added).
30. Id. at 959.
31. 648 P.2d at 968 (emphasis added).
to operate only prospectively. In so doing, the court violated both the positive command of the legislature that "[n]o statute is retro-
spective unless expressly declared therein," and its own established
rule of construction that "‘in the absence of a clear expression to the
contrary a law is presumed to operate prospectively only.'"

V. CONCLUSION

Probably uppermost in the justices’ minds was a fear that
"‘[f]ailure to award prejudgment interest creates a substantial
financial incentive for defendants to litigate even where liability is so
clear and the jury award so predictable that they should settle.’" If
so, such a concern was misplaced for three reasons. First, Northern
Commercial was going to be awarded interest; the only question was
how much. Second, the interest rate differential in the instant case
was small; it was only one percentage point (as Justice Rabinowitz
pointed out). Third, the court should not penalize one party by
engaging in a plausible, yet less than probable, construction of his
contractual promise in order to achieve what the court believes to be
a socially desirable policy. Controverting an express legislative pol-
icy that a statute should operate only prospectively is not a judicial
task. The interests of society and litigants are better served by a less
activist reading of otherwise clear statutory language.

Accordingly, prejudgment interest should have been assessed at
the rate in force at the time Riley gave his note to Northern Com-
cerial. As a matter of contractual interpretation, interest should
have been assessed at the legal rate because of the black letter propo-
sition that ambiguous language is construed against the draftsman.
It is also submitted that an application of the legal interest rate
would be more in keeping with the probable expectations of the
parties.

C. Mark Baker

32. ALASKA STAT. § 01.10.090 (1982).
   1979) (per curiam) (quoting Hill v. Moe, 367 P.2d 739, 742 (Alaska 1961)).
34. Drickersen v. Drickersen, 604 P.2d 1082, 1087 n.8 (Alaska 1979) (quoting
35. 648 P.2d at 970 (Rabinowitz, J., dissenting in part).