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Preemption **demy**stified

By Ed Winn III

This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any thing in the constitution or Laws of any State to the Contrary notwithstanding. — UNITED STATES CONSTITUTION, ARTICLE VI, CLAUSE 2

The debate over federal regulation of rental-purchase transactions in the last Congress devolved from a debate over how best to regulate the industry at the federal level to debates over preemption, the doctrine of federalism and states' rights. Most rental dealers are conversant by now with their industry's disclosure and consumer protection issues. Their eyes may glaze over, however, when the discussion turns to constitutional issues, particularly preemption. This article will summarize the debate to date and explain why the issue persists at the federal level.

Preemption as a legal doctrine allows a superior legislative body to override the otherwise lawful enactments of inferior legislative bodies. Under the U.S. political framework, the federal government has the power to preempt the acts of state government under certain circumstances. This is so because of the Supremacy Clause in the constitution cited above. Likewise, most state constitutions empower their state executive and legislative branches to preempt local governments.

When the country was founded, it was not at all clear what the relationship would be between the new federal government and the sovereign states. The constitution acknowledges the final supremacy of federal over state law in order to create a cohesive union of states, but it also acknowledges the integrity and independence of the states in the 10th Amendment:

“...the powers not delegated to the United States by the Constitution, not prohibited by it to the states, are reserved to the states respectively, or to the people.”

And so, the federal government cannot preempt the states in all things, much as it might like to do so. The U.S. Congress can only exercise the powers granted it in the Constitution. Only the federal government can, for example, make treaties with foreign nations. For the purpose of legislating controls on rental-purchase transactions, Congress looks to its powers granted under the commerce clause which gives Congress authority to regulate interstate commerce, generally. That means highways, train tracks, air space and, over the years, the commerce clause has been very broadly interpreted to include most kinds of businesses that Congress has seen fit to regulate. With the size and breadth of the rental-purchase industry today, no serious argument can be made that the rental-purchase industry is beyond the reach of Congressional power.

As the size of the federal government grew during the 20th century, preemption became an increasingly important issue in the courts. According to the U.S. Advisory Commission on Intergovernmental Relations, as of 1992, 50 percent of all federal preemptions were enacted since 1970. The trend has continued since then as the federal government has inserted itself into most areas of American life.

Insofar as the rental-purchase bills are concerned, the federal Truth In Lending Act has a limited preemption standard for disclosures in consumer credit transactions. Passed in the 1970s, TILA was an attempt to standardize how interest rates are disclosed to consumers, since prior to its enactment there were several inconsistent ways of doing so,

which some lenders used to take advantage of consumers. Under TILA, state consumer credit laws are preempted if they are “inconsistent with the federal law, and then only to the extent of the inconsistency.”

Previous versions of proposed rental-purchase legislation going all the way back to 1981 adopted this language with the intent of allowing the states to continue regulating rental-purchase transactions as they saw fit with a federal “floor” of disclosures that rental dealers must make to ensure adequate consumer protections.

In the late 1990s, court decisions in Minnesota and Wisconsin and the attorney general’s rule in Vermont called into question whether the TILA “inconsistency” preemption standard would work to keep states from re-characterizing rental-purchase transactions as credit sales, which is what the industry has always wanted from a federal law. The Minnesota Supreme Court ruled that in spite of a comprehensive rental-purchase statute, arguably the most restrictive such statute in the country at the time, the transactions were still credit sales and therefore subject to the state usury law limit of 8 percent.

Wisconsin courts of appeal have ruled that there is no way to structure a rental-purchase transaction in that state that will not be considered to be a consumer credit transaction under the Wisconsin Consumer Act. The Vermont attorney general has decreed that even though the state legislature enacted a law declaring rental-purchase transactions to be leases and not credit sales, state rental dealers must nonetheless disclose an “effective annual percentage rate” by pretending that the difference between the cash price of the rental property and the total rental-purchase price is all interest.

In the face of these kinds of aberrant rulings in the states, the industry has sought language in more recent federal bills that would ensure consistent treatment of the transaction everywhere. Here is the language in H.R. 996 and S.B. 884 that has been added to the TILA “inconsistency” language:

“...this title shall supersede any State law, to the extent that such law (1) regulates a rental-purchase agreement as a security interest, credit sale, retail installment sale, conditional sale, or any other form of consumer credit, or that imputes to a rental-purchase agreement the creation of a debt or extension of credit; or (2) requires the disclosure of a percentage rate calculation, including time-price differential, an annual percentage rate, or an effective annual percentage rate.” (S.B. 884, sec. 1018(b))

While the issue is debated as being federal preemption of state law, in fact, this language would not overrule any state legislative enactments concerning rental-purchase transactions. This language would overrule state court decisions in Minnesota, Wisconsin, New Jersey and the attorney general’s rule in Vermont. This is a distinction with a difference. State legislatures are political entities far more sensi-



To some extent, the merits of the rental-purchase bills have become hostage to the larger political issue of preemption. Rental dealers have a duty to protect their businesses by understanding how the preemption issue affects movement of rental-purchase legislation at the federal level and to be able to discuss the issue persuasively with their representatives.

tive to the will of the people in the state than are state judges, who are not supposed to try to implement political agendas from the bench, but often do. It should cause members of Congress, even those with strong states’ rights beliefs, less concern to “preempt” a state judge’s ruling in the interest of national consistency than to overrule the enactments of a state legislature, subject as those enactments are to the tug and pull of state politics.

Last fall, in the previous Congress, it was no particular surprise to industry watchers when most of the House members from Minnesota, Wisconsin, New Jersey and Vermont voted against the Jones bill, not on its merits as consumer protection legislation, but because they were championing their own state’s rights—in this case to be able to regulate rental-purchase transactions any way they wanted. What was surprising was that a number of other Republican House members who generally would have supported the bill since the industry supported it, also voted “nay” on states’ rights grounds.

If the rental-purchase bills in the Congress today are preemptive, they are barely so. State legislatures remain specifically free to continue to regulate rental-purchase transactions as they see fit. They can regulate disclosures and they can regulate the economics of the transaction if they so choose. They can limit fees. They can set cash prices. They can limit the total rental-purchase price. They can dictate early-purchase option formulas. They can regulate anything about the relationship between the rental dealer and the consumer, except that they cannot call the transaction a credit sale or impose interest rate disclosures or limitations on the transaction.

Beyond the rental-purchase bills, preemption is currently a hot issue in Washington. The doctrine is at play in local smoking ordinances, gun control, environmental laws at every level, local zoning and building code laws, Internet taxation, workplace and employment rules, consumer credit, payday lending, and the list goes on and on. To some extent, the merits of the rental-purchase bills have become hostage to the larger political issue of preemption. Rental dealers have a duty to protect their businesses by understanding how the preemption issue affects movement of rental-purchase legislation at the federal level and to be able to discuss the issue persuasively with their representatives. It is important that the true merits of the proposed legislation, which are significant for all concerned, not get lost in the brouhaha over preemption. ■

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