Seventh Circuit Strikes Down Indiana Law Aimed at Car Title PAWNS

The Indiana version of the Uniform Consumer Credit Code (UCCC) requires lenders to be licensed to make consumer loans and it prohibits the charging of interest beyond certain specified rates. A lender who fails to comply with these rules is subject to a variety of administrative and civil sanctions. Most notably, the failure to obtain a license voids any loan made, with the result that the borrower need not repay even the principal.

In 2007, Indiana amended its UCCC in an effort to stem what it considered to be predatory lending to its residents by businesses outside the state. The amendment made the Code applicable to any lender who "enters into a consumer

sale, lease, or loan transaction" with an Indiana resident if the lender "has advertised or solicited sales, leases, or loans in Indiana by any means, including by mail, brochure, telephone, print, radio, television, the Internet, or electronic means."

In January, the Seventh Circuit ruled in *Midwest Title Loans, Inc. v. Mills*, __F.3d__, 2010 WL 308967 (7th Cir. 2010), that the 2007 amendment was unconstitutional because it interfered with interstate commerce. That is, the law violated the Negative Commerce Clause. The decision is a setback to states who wish to protect their residents from predatory lending, but Indiana may have a way around the decision to prevent the particular abusive lending practices involved in the case. If you are a car title lender or payday lender, of course, the decision is very favorable.

The Facts. Midwest Title Loans, Inc., makes consumer loans to Indiana residents at annual percentage interest rates almost 10 times higher than the maximum permitted by the Indiana UCCC. The loans have a maturity of 12 to 24 months, are secured by the borrower's motor vehicle, and are for no more than half the vehicle's estimated wholesale value. The loans are made in person at Midwest's offices in Illinois. Each borrower is required to provide Midwest with keys to the car at closing to enable Midwest to repossess the car in the event of a default. This enables Midwest to avoid judicial action to enforce its lien. (In this respect, title lending is like a pawnbroker transaction, hence the name "car title pawns.") Apparently bringing a lawsuit to enforce the lien would be infeasible because of the small size of the loans relative to the costs of litigation.

Midwest advertises on Indiana television and through direct mailings to Indiana residents. In 2006, Midwest made more than 2,000 loans to Hoosiers. Shortly after the 2007 amendment, Indiana's Department of Financial Institutions advised Midwest of the change in the law. Midwest ceased lending to Indiana residents and brought an action to enjoin application of the amended law, claiming it violated the Commerce Clause. The district court entered the injunction and Indiana appealed.

Seventh Circuit Analysis: Indiana Statute Violates Commerce Clause. The court began by discussing the state's interest in protecting its residents from predatory lending. It noted the extensive literature on payday loans, facially short-term transactions that are often rolled over and thus become long-term commitments. The court noted how Midwest's car title pawns resemble payday loans. Although some commentators defend payday lending as "fringe banking," the court readily conceded that the state had an interest in protecting its residents. However, this interest does not, the court concluded, permit Indiana to violate the Commerce Clause.

The Commerce Clause gives Congress the power to regulate interstate commerce. The Supreme Court has long held that an implicit corollary to this federal power is that states may not establish barriers to trade across state lines. This corollary is variously referred to as the Negative Commerce Clause or the Dormant Commerce Clause.

Of course, not all state regulation of commerce is unconstitutional. The Negative Commerce Clause prohibits only those state laws that discriminate against nonresidents, those that produce consequences felt mostly in other states, and those that purport to regulate activities in other states. Judge Posner, writing for the court, readily acknowledged that Indiana was not discriminating against nonresident lenders; all lenders were subject to the licensing requirement and interest rate limitations. He also concluded that the Indiana law was not one whose consequences would be primarily felt elsewhere. The law is unlike a severance tax on raw materials that are almost entirely exported to other states, such that the incidence of such a tax would fall on the consumers in other states.

However, the court concluded that the Indiana amendment did seek to regulate activities in other states. Quoting the Supreme Court's decision in *Healy v. Beer Institute*, 491 U.S. 324, 337 (1989), Judge Posner noted that "no state may force an out-of-state merchant to seek regulatory approval before undertaking a transaction in another state." Here, Midwest's transactions with Indiana residents were all conducted in Illinois. If Midwest sued one of its Indiana borrowers in the Hoosier State, the Indiana court might be justified in applying Indiana law because Indiana had more intimate contacts with the transaction, or because Indiana's interest in protecting its residents might be sufficiently strong to allow its courts to disregard an Illinois choice-of-law provision. On these points, Judge Posner relied on the Restatement (Second) of Conflict of Law § 187(2)(b) (law selected in contract to govern will not be applied if it would be "contrary to a fundamental policy" of the forum state and the forum state's law would apply in the absence of an effective choice of law by the parties). A strong state interest that might justify disregarding a contractual choice of law, however, is not sufficient to justify state regulation of interest commerce. If it were, there would be little left of the Negative Commerce Clause.

Circumventing the Decision. The Seventh Circuit was clearly right. Indiana attempted to regulate transactions entered into by an Illinois merchant in Illinois. That is precisely the type of legislation that the Negative Commerce Clause prohibits. Nevertheless, there may be a way for Indiana to achieve its objectives.

Indiana could respond by amending its version of Uniform Commercial Code § 9-609 to prohibit self-help repossession in connection with any loan above a specified interest rate. Such a law of general applicability would not discriminate

for or against out-of-state residents. Its consequences would be felt primarily in Indiana, not in other states. And most important, it would regulate activity that by its nature occurs only in Indiana. It is worth noting that several of the Native American Tribes that have enacted a secured transactions law have declined to authorize repossession without the debtor's post-default consent or a judicial order. Indeed, that is the position taken in § 9-609 of the Model Tribal Secured Transactions Act. Such a law would therefore seem not to run afoul of the Negative Commerce Clause. It would, however, force lenders such as Midwest to go to court in Indiana to obtain the collateral, where traditional conflict-of-law rules might lead to the application of Indiana usury law. If, as the Seventh Circuit also suggested, it would be uneconomical for Midwest to pursue judicial remedies after a default, Midwest and other similar lenders would either have to alter their lending model or discontinue lending to Indiana residents. In essence, a nonuniform amendment to the Indiana UCC might be an indirect way to shut down Midwest's predatory lending to Indiana residents.

Of course, states should not blithely enact variations from the official text of the UCC. The UCC in general — and Article 9 in particular — have facilitated commerce by standardizing commercial practices, and they have been able to do this only because states have adopted it on a largely uniform basis. Accordingly, the legislature and the state bar should carefully consider whether the problems resulting from the lending practices of Midwest and others really justify non-uniformity and whatever attendant problems it may bring.

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