

Fordham Journal of Corporate & Financial Law

Volume 7, Number 2

2002

Article 12

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THE SOFT-LANDING FALLACY AND CONSUMER DEBTORS

*Barry E. Adler**

In their article, *But Can She Keep the Car? Some Thoughts on Collateral Retention in Consumer Chapter 7 Cases*,¹ Marianne Culhane and Michaela White argue, in essence, that bankruptcy law should provide consumer debtors with a soft landing, at least a softer landing than proposed by the House and Senate versions of the still pending Bankruptcy Reform Act of 2001.² Culhane & White target in particular provisions for a consumer debtor's retention of collateral.³ The problem, according to Culhane & White, is that the proposed retention provisions "would increase creditor control and raise the price of retention in Chapter 7."⁴ Any such increase, according to the authors, would further impede the debtor's fresh start, already compromised, in their view, by the current law on retention.⁵ Culhane & White recommend alternative reform, including a debtor's "ride-through" option.⁶ "These proposals," Culhane & White conclude, "would facilitate retention of collateral in Chapter 7 with much less danger to the fresh start, and still return more to secured creditors than they could obtain by repossession."⁷

There is little doubt that *any* creditor collection from an individual debtor in bankruptcy impedes the debtor's fresh start. It

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1. Marianne B. Culhane & Michaela M. White, *But Can She Keep the Car? Some Thoughts on Collateral Retention in Consumer Chapter 7 Cases*, 7 FORDHAM J. CORP. & FIN. L. 471 (2002).

2. *Id.* at 474-75.

3. *Id.*

4. *Id.* at 475-76.

5. *Id.*

6. *Id.* at 491-92.

7. *Id.* at 497-98.

does not follow, however, that enhanced creditor collection is in debtors' collective interest. At least if the credit market is competitive and transparent, any increase in ex post creditor collection translates to more favorable loan terms, such as a lower interest rate, for a debtor ex ante. Thus, it is plausible to assume that debtors would *prefer* a retention process favorable to creditors ex post, as I have argued in the past with my co-authors Ben Polak and Alan Schwartz.⁸ Similar arguments have been made, by Eric Posner, for example, that debtors may be better off if they can effectively bind themselves to file for Chapter 13 instead of Chapter 7 and thus promise to pay with future income some of their otherwise dischargeable pre-bankruptcy debts.⁹ In the same vein, with Polak and Schwartz, I have argued that the current debtor's option, ex post, to file either under Chapter 7 or Chapter 13 disserves debtors who would prefer to waive this option in exchange for more favorable loan terms.¹⁰ Put simply, anything that makes it easier for a creditor to collect ex post may make it easier for a debtor to borrow ex ante, and vice versa.

It is not a complete response, moreover, simply to observe, as do Culhane & White, that because debtors who receive a fresh start are likely to be more productive contributors to society, the benefits of a fresh start "extend beyond the immediate parties to the economy as a whole."¹¹ First, to say that there are positive externalities from a fresh start does not imply that these positive externalities outweigh the direct ex ante costs borne by debtors. Second, an extensive mandatory fresh start may impose on society the loss of other positive externalities, those that debtors would have generated with the proceeds of loans not taken because the best available interest rate was too high. (Consider, for example, the positive effects of a home improvement loan in a marginally deteriorating neighborhood.)

This is not to say that the Culhane & White policy

8. See Barry E. Adler et al., *Regulating Consumer Bankruptcy: A Theoretical Inquiry*, 29 J. LEGAL STUD. 585, 601-05 (2000).

9. See Eric A. Posner, *Should Debtors be Forced Into Chapter 13*, 32 LOY. L.A. L. REV. 965 (1999).

10. Adler et al., *supra* note 8, at 607.

11. Culhane & White, *supra* note 1, at 475.

recommendations are wrong. Positive externalities from a fresh start *could* be a determinant factor. Moreover, there is some debate over whether the consumer credit market is in fact competitive. And as I have argued before, in my article with Polak and Schwartz, where a creditor is a monopolist, retention does disadvantage borrowers with little bargaining power.¹² In addition, where creditors frequently use deceptive practices to extract payments from debtors, as Culhane & White believe they do,¹³ a bankruptcy system that facilitates such practices is undesirable, or potentially undesirable, on too many grounds to mention.

My point, then, is not that permitting aggressive creditor collection necessarily enhances social welfare. Rather, my point is that it may. The question is harder than Culhane & White sometimes make it seem.

12. Adler et al., *supra* note 8, at 604.

13. Culhane & White, *supra* note 1, at 491.

Notes & Observations