The Soft-Landing Fallacy and Consumer Debtors

Barry E. Adler*
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AND CONSUMER DEBTORS

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In their article, But Can She Keep the Car? Some Thoughts on Collateral Retention in Consumer Chapter 7 Cases, 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. Culhane & White target in particular provisions for a consumer debtor’s retention of collateral. 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.” 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. Culhane & White recommend alternative reform, including a debtor’s “ride-through” option. “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.”

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

2. Id. at 474-75.
3. Id.
4. Id. at 475-76.
5. Id.
6. Id. at 491-92.
7. Id. at 497-98.

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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. 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. 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. 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.” 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

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8. See Barry E. Adler et al., Regulating Consumer Bankruptcy: A
9. See Eric A. Posner, Should Debtors be Forced Into Chapter 13, 32 LOY.
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.\(^2\) In addition, where creditors frequently use deceptive practices to extract payments from debtors, as Culhane & White believe they do,\(^3\) 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.

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Notes & Observations