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# THE APPROPRIATE ROLE OF SECURITY INTERESTS IN CONSUMER TRANSACTIONS

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Consumer protection, a growth industry in the early 1970's, has seemed moribund over the past seven or eight years, save only the working out of the important nuances of the Bankruptcy Code.<sup>1</sup> In this article, I return to the scene of old battles<sup>2</sup> and consider once again the regulation of security interests in consumer transactions. I am prompted by the Federal Trade Commission's (FTC) adoption of a credit practices rule that severely restricts the use of wages and household goods as collateral for consumer loans,<sup>3</sup> and by Professor Alan Schwartz' two articles critiquing arguments that the Commission and others have advanced favoring regulation of security interests.<sup>4</sup>

My analysis in this article is premised on the proposition that our nonbankruptcy collection law normally makes coercive execution on tangible personalty encumbered by a security interest less costly to the creditor than any form of coercive execution available to an unsecured creditor. Most importantly, repossession under a security interest in personalty is less expensive than wage garnishment. The basis for this conclusion should be quite evident to all familiar with the field. Repossession of personalty can often be accomplished by self-help,<sup>5</sup> and in other circumstances an ex parte court procedure will

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<sup>1</sup> See, e.g., LoPucki, "Encouraging" Repayment Under Chapter 13 of the Bankruptcy Code, 18 Harv. J. Legis. 347 (1981); Note, The Transformation Rule Under Section 522 of the Bankruptcy Code of 1978, 84 Mich. L. Rev. 109 (1985).

<sup>2</sup> See Grau & Whitford, The Impact of Judicializing Repossession: The Wisconsin Consumer Act Revisited, 1978 Wis. L. Rev. 983; Whitford & Laufer, The Impact of Denying Self-Help Repossession of Automobiles: A Case Study of the Wisconsin Consumer Act, 1975 Wis. L. Rev. 607.

<sup>3</sup> FTC Credit Practices Rule, 16 C.F.R. §§ 444.1 - 444.5 (1986). The validity of this credit practices rule was recently upheld in *American Fin. Servs. Ass'n v. FTC*, 767 F.2d 957 (D.C. Cir. 1985), cert. denied, 106 S. Ct. 1185 (1986).

<sup>4</sup> Schwartz & Wilde, Imperfect Information in Markets for Contract Terms: The Examples of Warranties and Security Interests, 69 Va. L. Rev. 1387 (1983) [hereinafter cited as Imperfect Information]; Schwartz, The Enforceability of Security Interests in Consumer Goods, 26 J.L. & Econ. 117 (1983) [hereinafter cited as Security Interests].

<sup>5</sup> U.C.C. § 9-503 (1978). All citations to the Uniform Commercial Code ("UCC") are to the 1978 Official Text, unless otherwise noted. This provision permits self-help repossession by a creditor whenever this can be accomplished without committing a breach of the peace. The

suffice.<sup>6</sup> Wage garnishment, on the other hand, requires prior court approval, given only after notice and opportunity for a hearing.<sup>7</sup> Even when successful, in many jurisdictions the net proceeds per garnishment judgment are typically small.<sup>8</sup>

Partly as a consequence of this relative cost differential, I believe that consumer credit has been channelled into the secured form.<sup>9</sup> More importantly, creditors holding delinquent secured debt are encouraged to turn to repossession and resale of tangible collateral rather than to execution on cash resources, particularly wages. These consequences are unfortunate. I will argue that the total social costs of repossession of tangible collateral are commonly greater than the parties realized in formulating the transaction and exceed the necessary costs of execution on cash resources. The implications of this position are that execution on cash resources, particularly wages, should be facilitated, and that regulation should discourage execution on tangible collateral.

In the first section of this article, I will develop the argument that the total social cost of coercive execution on tangible collateral is greater than the comparable costs of execution on cash resources. The next section will detail the law reform implications of this analysis in a situation where a debtor has sufficient cash resources—most likely wages—to make cash execution feasible. The third section will develop an argument for severe regulation of security interests in tangible personalty even in situations in which the debtors' circumstances

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constitutionality of such procedures has been upheld on the ground that they do not involve state action. See *Flagg Bros. v. Brooks*, 436 U.S. 149 (1978) (foreclosure sale under warehouseman's lien not state action).

<sup>6</sup> *Mitchell v. W.T. Grant Co.*, 416 U.S. 600 (1974), upheld the constitutionality of an *ex parte* procedure for seizing collateral subject to a security interest. This case requires that issuance of a writ be under judicial supervision and that the defendant be provided an immediate postseizure opportunity to be heard on any defenses to the seizure. *Id.* at 609-10. Typical state statutes authorizing *ex parte* court procedures for repossession of collateral by legal process include: N.Y. Civ. Prac. Law § 7102(c) (McKinney 1980); Ill. Ann. Stat. ch. 110, ¶ 19-106 (Smith-Hurd 1984).

<sup>7</sup> See *Sniadach v. Family Fin. Corp.*, 395 U.S. 337 (1969).

<sup>8</sup> See, e.g., N.Y. Civ. Prac. Law § 5231(b) (McKinney 1978) (permits a judgment creditor to garnish a maximum of 10% of the debtor's wages per week, provided that the debtor earns more than \$85 per week).

<sup>9</sup> Of course, there are other reasons for security interests in consumer credit transactions. For instance, they offer the creditor some protection in the event of bankruptcy. See *White, Efficiency Justifications for Personal Property Security*, 37 Vand. L. Rev. 473, 487 (1984). I believe, however, that obtaining access to inexpensive methods of coercive execution is an underappreciated reason for the prevalence of security interests. A recent paper advances a similar rationale for the existence of security interests in commercial loan transactions. *Scott, A Relational Theory of Secured Financing*, Working Paper Series #4, Legal Stud. Workshop, U. Va. Sch. L. (1985).

do not allow for cash execution.<sup>10</sup> The FTC's rule prohibiting non-possessory security interests in household goods, other than purchase money security interests, will be defended. In the final section of the article, I will comment on a proposed regulation, not adopted by the Commission, to restrict the availability and size of deficiency judgments.

## I. THE RELATIVE COSTS OF PROPERTY AND INCOME EXECUTION

The social costs of execution on tangible property derive largely from what I have called the "lost value" that commonly accompanies such execution.<sup>11</sup> Lost value refers to the difference between the costs and benefits of repossession to the debtors—essentially the use value of the goods less the debt retired as a consequence of the creditor's action. There are two primary sources of lost value in the repossession of consumer goods.

One source is the transaction costs of repossession and resale. These include the cost of forcibly depriving the debtor of the goods' possession. However, this cost may not be great given the frequent availability of self-help repossession or expedited *ex parte* replevin procedures. More substantial in most instances is the cost of locating a new owner. Retail markups range as high as 100% for furniture and other consumer goods which are often the subject of security interests.<sup>12</sup> These large markups do not reflect noncompetitive market conditions as much as the high costs for these retail businesses. Goods of this type tend not to be standardized—they frequently vary in color and styling, for example—and consequently many consumers shop extensively before buying. Retailers tend to respond to such consumer behavior by stocking large inventories, to be able to satisfy a variety of tastes. However, this raises the costs of doing business, and accounts for much of the substantial difference between the retail cost of an item purchased new and the amount realized only a few months later when the same item, now a used good, is sold at wholesale.<sup>13</sup> Yet it is these wholesale prices that the repossessioning creditor

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<sup>10</sup> Such circumstances would occur if the debtor were unemployed, or his wages were less than the amount exempt from garnishment.

<sup>11</sup> I first developed the "lost value" thesis in Whitford, *A Critique of the Consumer Credit Collection System*, 1979 Wis. L. Rev. 1047, 1060. Schwartz has critiqued my thesis as earlier developed. *Security Interests*, *supra* note 4, at 139-48. In this part, I respond to that critique.

<sup>12</sup> A conversation with an anonymous New Jersey retailer of furniture and other durables indicated that markups for such goods are frequently as high as 75 to 100%.

<sup>13</sup> Wholesale and retail prices of used goods are also depressed because of what is known as the "lemon" effect. Prices are set on the assumption that the goods being sold are of less than average quality with respect to characteristics not easily observed. Were this not the case,

typically realizes on resale,<sup>14</sup> and hence that largely determine the amount of debt retired as a result of the property execution.

The other primary source of lost value in repossession and resale of consumer goods derives from the special relationship a debtor frequently has with the goods repossessed. A debtor may have acquired special knowledge about peculiarities of the goods that gives them a higher use value to the debtor than they will have for any other potential owner. For example, a debtor may have learned how instantaneously to adjust the vertical control on a television set, a feat that may take a new owner months to duplicate. An involuntary change of ownership results in loss of that use value; there is no practical way to recover its value through transfer for a price.<sup>15</sup> Another reason a debtor may have a special relationship to the goods is because people in our culture are encouraged to and do develop special feelings for possessions, particularly possessions like furniture or cars that can be readily distinguished from similar items owned by others.<sup>16</sup> A debtor who refuses voluntarily to surrender collateral to a creditor in return for whatever debt reduction surrender will provide may have such feelings about the goods. A new owner may also develop a special attachment to the goods, of course, but development of such feelings may take time. Thus, forceable repossession can cause loss of some of the goods' emotional use value.

Professor Alan Schwartz has criticized the view that repossession

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there would be an incentive for owners of less than average quality goods to reap a windfall gain by reselling. See *Security Interests*, *supra* note 4, at 145-46.

That debtors realize a lower amount from repossession because of the lemon effect cannot be considered a true social cost of repossession. Although the lemon effect may cause the debtor to realize less than the goods are worth to him—assuming the goods are truly of higher quality than the market presumes—that loss will be gain, in approximately the same amount, to the new owner. The same cannot be said for the transaction cost losses to the debtor that are discussed in the text. These losses do not directly benefit the new owner of the goods. See *infra* notes 23-28 and accompanying text.

<sup>14</sup> For an excellent analysis of creditor practices in reselling cars, see White, *Consumer Repossessions and Deficiencies: New Perspectives From New Data*, 23 *B.C.L. Rev.* 385 (1982). Some have argued that if a repossessing creditor in fact resells at retail, the retail price should control for purposes of fixing the deficiency. Schwartz has criticized this position, and on this point I agree with him for the reasons he gives. See *Security Interests*, *supra* note 4, at 131 n.36.

<sup>15</sup> Arthur Leff first identified this source of lost value in an insightful article that spawned many of my ideas about regulation of consumer credit. Leff, *Injury, Ignorance and Spite—The Dynamics of Coercive Collection*, 80 *Yale L.J.* 1, 12-13 (1970). Schwartz acknowledges this source of lost value, but he dismisses it as a basis for regulation because it is "trivial" in amount. *Security Interests*, *supra* note 4, at 147. This quantitative estimate is based solely on Schwartz' intuitions. My intuitions differ: I believe Leff identified a very important source of lost value.

<sup>16</sup> See Radin, *Property and Personhood*, 34 *Stan. L. Rev.* 957 (1982).

of consumer goods causes the goods to lose use value.<sup>17</sup> That there are unrecoverable costs to repossession and resale does not in itself establish that this procedure causes goods to move from a higher to lower use, since at the time of repossession, the debtor's life circumstances may be such that the goods have a relatively low use value in his hands. For example, a debtor who has recently changed jobs and accepted one closer to his home may have no substantial need for a second car, even if he is the person most familiar with the car's peculiar operating characteristics and has developed an emotional attachment to it.

Schwartz seizes this possibility. He argues that if a debtor values the goods to be repossessed at a value higher than that which the creditor can realize upon resale, then we should expect the debtor to offer the creditor a sufficient amount to induce the latter to forego repossession. It would be a classic bargain: each party would be in a better position. Since repossession occurs when the debtor does not offer the creditor a sufficient amount, Schwartz concludes that the debtor's use value for the goods is less than the benefits of repossession to the creditor.<sup>18</sup>

My basic response to this critique of the lost value hypothesis is one that Schwartz anticipates.<sup>19</sup> Explanation may be facilitated if I introduce some symbols.

Let  $V_1$  = the direct benefits to the creditor from repossession and resale—to wit, the resale price less the costs of repossession and resale.

Let  $V_2$  = the value of the goods to the debtor.

Let  $V_3$  = the amount still owing by the debtor on the underlying obligation.

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<sup>17</sup> Security Interests, *supra* note 4, at 139-48 (conceptualized in economic terms, repossession cannot be shown to impose harm to the debtor, but if "psychic" costs are considered, loss to the debtor from repossession may not be offset by gains elsewhere).

<sup>18</sup> It is tempting, of course, to respond to this analysis by stating that debtors frequently lack the financial resources to keep creditors from repossessing the goods. However, such a response ignores the fact that creditors frequently accept a debtor's agreement to pay an increased amount over time in lieu of immediate repossession. More importantly, this argument requires a subjective, interpersonal comparison of utilities. We can no longer use the seemingly "objective" test of asking who will pay more in order to determine the highest use value of goods.

I firmly believe that money has different utilities to different people, and that it is often appropriate to conclude that a poor person has a higher use value for goods than someone less poor, even though the latter is willing to pay more. However, because this approach requires such subjective judgments, my analysis will proceed along more traditional lines. I presume that normally the highest bidder has the highest use value, and I will demonstrate that even on this presumption, there is substantial lost value in property execution.

<sup>19</sup> See *infra* notes 23-28 and accompanying text.

At first glance it would seem that if  $V_2 > V_1$ , as the lost value hypothesis would suggest, the debtor would surely offer the creditor something exceeding  $V_1$  to forego repossession and the creditor would surely accept. The law, however, permits the creditor to repossess unless the debtor tenders  $V_3$ . In the consumer area,  $V_3$  commonly exceeds  $V_1$ , and probably  $V_2$  as well.

If all parties had perfect information, a creditor's interest in being able credibly to threaten repossession unless the debtor pays  $V_3$  would extend only to situations in which  $V_2$  exceeds or equals  $V_3$ . If the latter condition did not hold, a debtor would prefer to suffer repossession rather than pay  $V_3$ ; realizing this, the creditor would accept a settlement for any amount in excess of  $V_1$ .

In the real world, however, a creditor can only guess at the value of  $V_2$ . Moreover, because creditors are usually engaged in collecting many delinquent debts, they must always be concerned about how their actions in a particular case will affect judgments that others, particularly debtors, make about their behavior in future cases. It would be foolhardy to gain a reputation for relying solely on the debtor's statements about the value of the goods to the debtor ( $V_2$ ). Otherwise, debtors for whom  $V_2 > V_3$  would be encouraged to resist payment of  $V_3$ , with the expectation that ultimately the creditor would accept the debtor's protestations that some lesser amount, still greater than  $V_1$ , was all they would pay to forestall repossession. Consequently, it is quite plausible to assume that creditors, for strategic reasons, often insist on payment of  $V_3$  as the price of foregoing repossession. Even where they do not insist on  $V_3$ , creditors are likely to demand more than debtors' estimates of  $V_2$ , thus leading frequently to bargaining impasses. If these assumptions about creditor collection strategies are correct, then it is also plausible to assume that with some frequency  $V_3 > V_2 > V_1$ , yet the creditor will refuse to forego repossession except for payment of  $V_3$ , or some other amount greater than  $V_2$ .<sup>20</sup>

This analysis implicitly assumes that deficiency judgments are not available to the creditor, either for legal or practical reasons. If deficiency judgments are available and uniformly collected, it would be sensible for the debtor to offer a creditor any amount up to  $V_3$  to

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<sup>20</sup> In considering these different values and payments that a debtor might make to forego repossession, it should be understood that they need not necessarily be lump-sum payments. The settlement of a delinquent consumer debt frequently takes the form of a promise to make payments over an extended period of time. The analysis described above can be applied to such a settlement by assuming that the present value of the promised payments—taking account both of the time value of money and of the risk that the particular debtor will fail to make all the promised payments—must equal whichever of the values ( $V_3$ ,  $V_2$ , or  $V_1$ ) the creditor demands.

forego repossession in every case in which  $V_2 > V_1$ . Since, in any event, the debtor is ultimately going to pay  $V_3$ , the only issue is whether it is better to pay the amount entirely in cash, or partly in goods (through repossession) and the balance ( $V_3 - V_1$ ) in cash. Whenever  $V_2 > V_1$ , payment entirely in cash would be in the debtor's interest.

However, for a number of practical reasons, it is well known that deficiencies are not uniformly collected even when legally available.<sup>21</sup> While the possibility of deficiency judgments requires some technical modifications of the analysis on the preceding page, so long as collection of deficiencies is partial, the basic conclusions stand.  $V_2$  can exceed  $V_1$ , yet the debtor will not offer the creditor enough to stave off repossession because the creditor will insist on a payment exceeding repossession's cost to the debtor.<sup>22</sup>

As I indicated, Professor Schwartz anticipates this response to his basic critique of the lost value hypothesis. However, he suggests that this response is inadequate because any value lost by the debtor in repossession will be more than compensated by gains to the creditor and to the new owner of the goods.<sup>23</sup> Schwartz argues that if the new owner has the same use value for the goods as the debtor ( $V_2$ ), then the debtor's loss equals the new owner's gain.<sup>24</sup> This analysis presumes the new owner pays only an amount equal to the part of the debt discharged by the repossession ( $V_1$ ). In fact, the new owner pays an amount that exceeds  $V_1$  because of the considerable transaction costs of repossession and resale.

In another part of his article, Schwartz goes to some lengths to maintain that creditors who repossess will maximize their proceeds on resale, a point with which I generally agree.<sup>25</sup> Hence it is fair to as-

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<sup>21</sup> Deficiency claims are, by their nature, unsecured. Exemption laws may protect the debtor's unencumbered assets from execution. Unsecured debts can also be discharged in bankruptcy, and there is always the possibility that a suit for a deficiency judgment will incite the debtor to seek such relief. A creditor who initiates a suit for a deficiency judgment and fails to collect it cannot even recover the costs of maintaining the suit. For these reasons, creditors frequently forego such suits.

<sup>22</sup> It will be in the debtor's interest to suffer repossession where the price demanded by the creditor to waive both its rights in the collateral and any further claim in the debt exceeds  $V_2$  plus  $p$  times ( $V_3 - V_1$ ), where  $p$  is the probability that the deficiency ( $V_3 - V_1$ ) will be collected after repossession. In those circumstances, repossession will be less costly to the debtor than satisfying the creditor's demand. Since, as stated earlier in the text, creditors must consider the deterrent effects that repossession will have on future debtors, creditors will often demand  $V_3$  as the price of foregoing repossession, even assuming the uncollectability of many deficiency claims.

<sup>23</sup> Security Interests, *supra* note 4, at 143-44.

<sup>24</sup> *Id.* at 146.

<sup>25</sup> *Id.* at 125-29.



sume the new owner has paid something approximating the goods' market price. On this assumption, if the new owner's use value for the repossessed goods exceeds the price he pays, he presumably would have bought similar goods at a similar price, thereby reaping this gain, even if the debtor had not defaulted. Thus, the new owner's gain cannot be considered a product of repossession which compensates for the debtor's lost value.<sup>26</sup>

It is true that a creditor receives a gain from repossession in the sense that losses from credit delinquencies are reduced. However, the direct debt reduction is in the amount of  $V_1$ , an amount often considerably less than  $V_2$  for reasons argued above. Schwartz seems to argue that in reselling, the creditor makes a profit above and beyond any debt reduction.<sup>27</sup> His point makes little sense. Normally, a creditor is required to account to the debtor for any amount by which the resale proceeds exceed the outstanding debt.<sup>28</sup>

To establish my basic propositions in this article, I need to establish not only that there is lost value in property execution, but also that this social cost exceeds the inherent social costs of most forms of income execution, particularly wage garnishment.<sup>29</sup> It should be obvious that the principal sources of lost value in property execution are not present in income execution. A major transaction cost in property execution flows from the difficulty in finding a new owner for the repossessed goods. However, cash is the ultimate fungible commodity; once seized by a creditor, it is essentially costless to a creditor to find another appropriate use for it. Another primary source of lost value in property execution relates to a debtor's special relationship to the goods repossessed. Debtors do not form the same emotional attachment to currency as they do to personal property.

There is still lost social value associated with income execution, particularly as it is practiced today in its most common form—wage garnishment. Since the Supreme Court's decision in *Sniadach v. Family Finance Corp.*,<sup>30</sup> a prior judicial order, entered only after notice

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<sup>26</sup> At one point in the course of his argument that the debtor's lost value from repossession will be the new owner's gain, Schwartz has in mind lost value resulting from the lemon effect. See *supra* note 13. Schwartz' argument is correct with respect to lost value resulting from the lemon effect, but incorrect with respect to lost value from other sources.

<sup>27</sup> For the bulk of this argument, see *Security Interests*, *supra* note 4, at 143.

<sup>28</sup> U.C.C. § 9-504(2).

<sup>29</sup> For a brief description of wage garnishment, see Note, *Garnishment Payments: Voidable Preferences in Bankruptcy?*, 7 *Cardozo L. Rev.* 309, 311-13 (1985). Generally, in wage garnishment the creditor obtains a court order requiring the debtor's employer to pay a portion of the debtor's wages to the creditor.

<sup>30</sup> 395 U.S. 337 (1969). It may seem anomalous that the Constitution has been interpreted to require more rigorous procedural prerequisites for wage garnishment than for property exe-

and an opportunity for a hearing, has been constitutionally required before wage garnishment can commence. Most state legislation requires a prior judgment on the merits of the underlying debt before an action for wage garnishment can be commenced.<sup>31</sup> These procedures are costly, particularly if they force creditors to retain attorneys to effectuate wage garnishment, as they often do.<sup>32</sup>

A different set of transaction costs is imposed on the employer in wage garnishment. Upon receipt of a writ of garnishment, he must adjust his payroll, paying the exempt portion of the wages to the employee and the nonexempt portion to the court or garnishor. In many jurisdictions, this adjustment must be made on short notice. Moreover, exemption laws are often complicated,<sup>33</sup> and in most jurisdictions it is the employer's burden to calculate the amount to be turned over to the court or garnishor. Over a decade ago, it was estimated that the average cost to an employer of complying with a garnishment order was approximately \$22.<sup>34</sup> The rule in most jurisdictions—that a wage garnishment order applies only to a single pay period—further increases the transaction costs of debt collection through garnish-

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tion. It is my overall thesis that, normally, wage garnishment is less harsh to the debtor than repossession. Nonetheless, in establishing relatively lenient procedural prerequisites for property execution, the Supreme Court has avoided questioning the validity of *Sniadach's* holding respecting wage garnishment. *North Georgia Finishing, Inc. v. Di-Chem, Inc.*, 419 U.S. 601 (1975); *Mitchell v. W.T. Grant Co.*, 416 U.S. 600 (1974).

<sup>31</sup> E.g., Cal. Civ. Proc. Code § 487.020(c) (West 1979 & Supp. 1986); Wis. Stat. Ann. § 812.02(2)(a) (West 1977 & Supp. 1985).

<sup>32</sup> The procedures may also delay the creditors' ability to effectuate wage garnishment, creating opportunity losses for creditors. But if creditors respond to these procedural obstacles by initiating the procedures earlier than they would if the delays were not present, opportunity losses do not exist. Reliable data on whether creditors have so responded is not available. Moreover, whatever opportunity losses creditors may suffer could be balanced by the benefits to debtors of having use of their cash for longer periods. In this instance, such losses may not be true social losses.

<sup>33</sup> Federal law sets a ceiling on available wage garnishment equal to 25% of an individual's "disposable" earnings or the amount by which disposable earnings per week exceeds 30 times the federal minimum hourly wage, whichever is less. 15 U.S.C. § 1673(a) (1982). States frequently set higher exemptions. Wisconsin probably has as complicated a system as any. Where the debt sought to be satisfied through garnishment arose in a "consumer credit transaction," subject to some exceptions, the exempt amount is the greater of 75% of earnings "after all deductions required by law to be withheld," or \$15 per dependent plus 40 times the federal minimum hourly wage (for each week in the pay period). Wis. Stat. Ann. § 425.106(1)(a) (West 1977 & Supp. 1985).

I once heard an anecdote about a Wisconsin employer who, frustrated at trying to calculate the exempt amount for a garnished employee, paid the entire amount owing to the creditor in a lump sum. He then deducted the amount, in installments, from the employee's subsequent paychecks. The employee chose not to object that the amount being withheld from his paycheck exceeded the amount allowed under the exemption laws, and the employer was freed from court supervision. I do not know if the employer charged the employee interest for what amounted to an advance.

<sup>34</sup> D. Caplovitz, *Consumers In Trouble* 237 n.10 (1974).

ment.<sup>35</sup> Given current exemption laws, the creditor's recovery for a single pay period will be less than the amount owing for all but the smallest debts. Nevertheless, most of the transaction costs described above will be reincurred if the creditor attempts further collection through garnishment of a second paycheck.

A striking feature of these costs is that they are largely a product of the procedures used to implement wage garnishment. Many of these costs could and should be avoided by adoption of alternative wage garnishment processes.<sup>36</sup> The sources of lost value in property execution, on the other hand, seem inherent in the forcible transfer of ownership of property from the debtor to a new owner. They cannot be avoided by mere procedural manipulation. It is this contrast that encourages me to conclude that the unavoidable social costs of property execution are higher than the costs of income execution need be.

Before finally arriving at that conclusion, however, it is necessary to consider the relation between wage garnishment and dismissal of the debtor-employee. Because employers have sometimes dismissed garnished employees, wage garnishment has long been a much-feared remedy among low-income consumers. Commentators have, from time to time, called for its abolition.<sup>37</sup> The legislative response has been to regulate employer conduct by prohibiting dismissal due to garnishment in most circumstances.<sup>38</sup> These statutory prohibitions turn on the employer's motive. Thus, it is not illegal to dismiss an employee who has been garnished, provided that garnishment is not the motive for the dismissal.

Motive, however, is difficult to determine. Moreover, the statutes do not purport to prohibit an employer from punishing a garnished employee by taking action other than dismissal, such as withholding promotions. There is an absence of empirical evidence as

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<sup>35</sup> At common law, garnishment was conceptualized as an *in rem* proceeding, the thing seized being the debt owed by the garnishee to the principal debtor. In wage garnishment, this meant not only that each order reached only a single paycheck, but that only that portion of the wages due and owing at the time garnishment process was served was properly attached. Hence, there was the incentive to wait until late in a pay period to initiate garnishment. Today, many jurisdictions especially provide that the garnishment process reaches all nonexempt wages due and owing in a particular pay period. E.g., Wis. Stat. Ann. § 812.18(1)(b) (West 1977). See Whitford, *supra* note 11, at 1132 n.325.

<sup>36</sup> See *infra* notes 41-48 and accompanying text.

<sup>37</sup> E.g., Kerr, Wage Garnishment Should Be Prohibited, 2 *Prospectus* 371 (1969); Note, Wage Garnishment as a Collection Device, 1967 *Wis. L. Rev.* 759.

<sup>38</sup> The principal restriction, contained in federal legislation, prohibits dismissal for garnishment in connection with a single indebtedness. Consumer Credit Protection Act, 15 U.S.C. § 1674(a) (1982). States sometimes enact more pervasive restrictions. E.g., N.Y. Civ. Prac. Law § 5252 (McKinney 1978 & Supp. 1986) (dismissed employee can recover up to six weeks of lost wages, and may be reinstated).

to the impact of the statutory prohibition of job dismissal due to garnishment, but in these circumstances one must assume that wage garnishment still affects some debtor's employment.

That wage garnishment can impact on a debtor's job is a matter of serious concern. In our culture, it is likely that debtors will have at least as special a relationship to their jobs as to their possessions, since one's job defines social status. Extensive unemployment can have devastating effects on the debtor's self-esteem. If one employee loses a job because of wage garnishment, then another person, perhaps a previously unemployed one, will get that job. It is possible, however, that there is still a social cost to dismissal, perhaps because the loss of esteem to the newly dismissed employee exceeds the gain in esteem to the newly employed.<sup>39</sup>

There is no consensus about why employers sometimes dismiss employees whose wages are garnished. It is likely that the substantial financial burden that wage garnishment imposes on employers is an important part of the reason. These costs give employers a great incentive to persuade their employees to deal with their creditors so as to avoid a garnishment action. Credible threats of job dismissal for garnishment, therefore, may be the most effective tool employers have to persuade employees of the need for such behavior. In order to maintain their credibility, these threats must sometimes be backed up with action. If this supposition is correct, then amendment of garnishment procedures to reduce the financial burden on employers<sup>40</sup> should substantially reduce whatever adverse effects garnishment now has on a debtor's job.

The balance of this article rests on the proposition that the total social cost of property execution commonly exceeds the necessary social costs of income execution. While I have advanced substantial support for that proposition, I also acknowledge that the validity of the proposition ultimately rests upon the currently unknown relationship between wage garnishment and the debtor's employment status. I will assume that a combination of existing legislative regulation and my recommended reforms of garnishment procedure will reduce to acceptable levels the effects of garnishment on a debtor's job.

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<sup>39</sup> It can be safely assumed that there will be little lost value because of the loss of a productive employee to the employer. If there would be substantial transaction costs to the employer from a change in employees, or if there would be productivity loss because the old employee had special skills difficult to replace, it is not likely the employer would choose dismissal as a sanction for wage garnishment.

<sup>40</sup> See *infra* text following note 44.

## II. ENCOURAGING INCOME EXECUTION

Section I argued that consumer credit has tended to take the secured form partly because the costs of property execution are so much less to creditors than the equivalent costs of income execution. Yet, the total social cost of property execution exceeds the necessary total social cost of income execution. The immediate implication is that there is a need for legal reform to bring private incentives in line with the social good. I will first discuss ways to accomplish this goal by reducing the private costs of income execution and increasing the private costs of property execution. I will then consider a variety of objections that have been made to any reform of the current collection system.

### A. *Reducing the Costs of Income Execution*

The preceding part described the many unnecessary transaction costs of wage garnishment as practiced in most jurisdictions. The most promising way to limit these costs would be implementation of a procedure that permits one garnishment order to authorize deductions from several of the employee's paychecks. A minority of jurisdictions has already adopted this system,<sup>41</sup> which I call continuous garnishment. This system would reduce the percentage of garnished funds absorbed by filing fees and other court costs. More money would be available for debt retirement, thereby making garnishment a more attractive remedy to creditors.<sup>42</sup>

While continuous garnishment is an obvious way to reduce the unnecessary costs of income execution, two concerns militate against reduction of execution costs to the absolute minimum. The first concern relates to the historical fear that wage attachment can adversely affect a debtor's job status.<sup>43</sup> My argument for encouraging income execution rests on the assumption that these effects can be severely limited. I suggested that the financial cost of wage garnishment to the employer—a cost for which there is rarely adequate recompense

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<sup>41</sup> See S. Riesenfeld, *Creditors' Remedies and Debtors' Protections* 237 (3d ed. 1979). New York is one such jurisdiction. See Note, *supra* note 29, at 320. Wisconsin authorizes garnishment of this nature only if the debtor is a public employee. Wis. Stat. Ann. § 812.23(1)(a) (West 1977).

<sup>42</sup> There is presently a conflict between the courts of appeals as to whether bankruptcy renders payments made within 90 days preceding a bankruptcy filing pursuant to a continuous garnishment order voidable as preferential payments. Note, *supra* note 29, at 309. If such payments are voidable preferences, continuous garnishment would become somewhat less attractive to creditors, as compared to property execution. Of course, the filing of a bankruptcy proceeding always terminates the future effectiveness of a continuous garnishment order, because of bankruptcy's fresh start policy. *Id.*

<sup>43</sup> See *supra* text accompanying notes 37-39.

under today's statutory schemes<sup>44</sup>—is largely responsible for whatever effect garnishment has on job status. There are ways to reduce the employer's costs. The employer should receive adequate notice so that amounts need not be withheld from an employee's paycheck on short notice. Exemption laws should be simplified to ease the employer's burden in calculating the amount to be withheld. However, notwithstanding these cost reduction measures, if wage garnishment is to prove inexpensive to an employer—an essentially innocent party in a dispute between creditor and debtor—it will probably be necessary to increase the fee paid to an employer for wage garnishment. Unless the state further subsidizes garnishment, these payments will have to be added to the other court costs of a wage garnishment proceeding. These costs are borne initially by the creditor but they may ultimately be collectible from the debtor. This increase in transaction costs seems inconsistent with the overall objective of encouraging income execution. Nonetheless, the social desirability of income execution as a substitute for property execution may depend on limiting the impact of garnishment on debtors' jobs. It is best, therefore, to err in favor of proposals tending to reduce this impact, even if transaction costs of income execution are increased as a consequence.

The second concern militating against maximum reduction of the costs of wage garnishment relates to the interrelationship between the cost and availability of formal execution remedies and the informal settlement of collection disputes. Informal workouts between a creditor and debtor which provide for payment of a delinquent account from future income commonly represent the lowest social cost solution to a delinquency problem. Workouts require none of the transaction costs associated with the need for a court order. Since payment comes from income, none of the lost value associated with property execution is incurred. Because the employer is not directly involved, there is little risk that the debtor's job will be threatened. Finally, since the debtor must agree to the terms of payment, the timing and size of agreed payments may be more convenient than the mandatory payroll deductions associated with garnishment.<sup>45</sup>

A continuous garnishment scheme runs the risk of reducing a creditor's incentive to participate in informal workouts. It takes a creditor and debtor some time and effort to reach agreement on an

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<sup>44</sup> In Wisconsin, for example, the employer is allowed \$3 for its trouble. Wis. Stat. Ann. § 812.06 (West 1977).

<sup>45</sup> For example, the payment schedule might take into account weeks in which a mortgage or child support payment must be made.

acceptable workout. Under continuous garnishment, one court order will insure the creditor payment of the nonexempt portion of the debtor's paycheck without the necessity of obtaining the debtor's voluntary cooperation. The disincentives to concluding workout agreements will be especially strong if priority rules<sup>46</sup> provide the creditor obtaining the first garnishment order with the exclusive right to the nonexempt portion of the debtor's wages until paid in full. In such a case, a creditor must fear that if it relies on a voluntary workout as a method of collection, another of the debtor's creditors will initiate garnishment, seizing, for an extended period of time, the very income from which the debtor had intended to make the voluntary payments. In sum, the interaction of continuous garnishment and the priority rules could accentuate the "race to the courthouse" between creditors, and minimize the likelihood of satisfactory workout agreements in the process.

The interaction of the priority rules with continuous garnishment has another undesirable effect. If one creditor acquires exclusive rights to the nonexempt portion of a debtor's wages for an extensive period of time simply by being the first to initiate a garnishment action, other creditors to whom the debtor is in default will of necessity look to seizure of property as a means of collection. Yet an unsecured creditor often has difficulty executing on tangible property, partly because exemption laws, with respect to personalty, often favor debtors. Consequently, creditors who anticipate this problem would have an even greater incentive to condition the extension of credit on the granting of a security interest in personalty.<sup>47</sup> If the overall objective is to encourage creditors in general to rely more on income execution than property execution, these effects seem counterproductive.

Both of these potential effects of continuous garnishment would be limited if a garnishment order was effective only for a limited number of pay periods—for example, four to six. A single garnishment order would then suffice to collect only smaller debts, thus leav-

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<sup>46</sup> Priority rules determine which of several creditors shall be entitled to collect from a particular asset (e.g., unpaid wages) when the debtor does not have sufficient assets to pay all creditors. In general, the common-law rule is that, as between unsecured creditors, the first in time to obtain some kind of court order granting rights in a nonexempt asset has exclusive rights to collect from that asset until its debt is paid in full. When a debtor appears unable to satisfy all creditors, this creates what is known colloquially as a "race to the courthouse doors" between unsecured creditors. See, e.g., Cal. Civ. Proc. Code § 706.023 (West Supp. 1986).

<sup>47</sup> Exemption laws do not impair a secured creditor's right to foreclose on collateral. Moreover, under general priority rules, a secured creditor, whose interest is perfected, has the right to collect from the encumbered asset before any unsecured creditor, regardless of who is the first to initiate legal process. U.C.C. § 9-301. Taking a security interest is, therefore, a way to avoid the "race to the courthouse doors."

ing many creditors with an incentive to arrange informal workouts. Moreover, a mandatory waiting period should be imposed before a creditor could obtain a second garnishment order. During this waiting period, other creditors would have an opportunity to execute on the debtor's wages, thereby reducing their incentive to obtain a security interest or otherwise resort to property execution.<sup>48</sup> Limiting continuous garnishment in this way would reduce the cost savings achieved by reforming the procedures for income execution, but is desirable nonetheless.

An additional way to reduce the transaction costs of income execution would be to encourage wage assignments by legalizing them in the many jurisdictions in which they are now prohibited.<sup>49</sup> A creditor can collect money under a wage assignment simply by notifying the employer that it is exercising rights under an assignment of wages contained in a credit agreement.<sup>50</sup> Wage assignments, therefore, can provide creditors a portion of the debtor's paycheck without the necessity of any court process at all.

One problem with wage assignments is the difficulty a debtor has in asserting defenses to the underlying obligation where the creditor holds a wage assignment. The FTC's recent Credit Practices Rule addresses this problem by requiring that all wage assignments be revocable at will.<sup>51</sup> Once an assignment is revoked, the creditor must turn to garnishment in order to attach wages. Because garnishment procedures require an opportunity for a hearing before an order can be entered, the debtor can raise defenses at that hearing.<sup>52</sup>

Another problem with wage assignments is that they enable the creditor, at no cost to itself, to inconvenience the debtor's employer.

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<sup>48</sup> I first discussed these ideas for modifying a continuous garnishment scheme in Whitford, *supra* note 11, at 1132-33.

<sup>49</sup> The Uniform Consumer Credit Code § 3.305 (1974), prohibits wage assignments in many consumer transactions. This statute has been enacted in about ten states. Other states prohibit or severely limit the availability of wage assignments by special statutes. For a more detailed discussion of existing state law respecting wage assignments, see FTC, Credit Practices Rule: Statement of Basis and Purpose, and Regulatory Analysis, 49 Fed. Reg. 7740, 7755 (1984) (to be codified at 16 C.F.R. pt. 444) (proposed February 17, 1984) [hereinafter cited as Statement of Purpose].

<sup>50</sup> The general provision providing for notification as the method of executing an assignment of contract rights is U.C.C. § 9-318(3). Unless there is a special statute governing wage assignments, this provision controls.

<sup>51</sup> 16 C.F.R. § 444.2(a)(3) (1986). Excepted from the revocability requirement are assignments of earnings already due at the time of assignment and authorizations for payment by payroll deduction, providing the deductions commence at the time of the transaction.

<sup>52</sup> Though preserving debtor defenses always seems like a noble goal, I have earlier expressed my doubt that reforms such as the FTC's revocability requirement for wage assignments will have much effect. Most debtors will not raise defenses at a hearing on a garnishment order, even if they believe they can. See Whitford, *supra* note 11, at 1086-96.



Such action may adversely affect the debtor's job. Traditionally, no payment to the employer has been required as a condition for execution of a wage assignment. It may be desirable to require such a payment, in part to give creditors an incentive to negotiate a satisfactory workout. The FTC's solution—making assignments revocable at will—at least permits the debtor to require the creditor to resort to garnishment whenever the debtor has reason to fear employer reaction to execution of a wage assignment. The costs of garnishment, in turn, give the creditor an incentive to seek a negotiated solution.

### B. *Disincentives to Property Execution*

The proposals advanced above, particularly the proposal for continuous garnishment, should make wage garnishment a more practical remedy. However, the costs of execution on wages will continue to exceed the current costs of property execution so long as wage assignments are restricted. Present constitutional law requires prior notice and an opportunity to be heard before wages can be seized by court process.<sup>53</sup> In contrast, tangible personalty can often be repossessed by self-help or by an expedited replevin procedure, neither of which provides for preseizure opportunity to be heard.<sup>54</sup> As a result, obtaining a wage garnishment order almost always takes longer than repossessing personalty. Usually, it requires more trips to the courthouse by the creditor or its lawyer. These disincentives to wage execution can be expected to continue even after adoption of the garnishment reforms I have recommended above.

This imbalance between the costs of income and property execution must be corrected if consumer credit collection is to be channeled towards wage execution. The imbalance could be redressed either by decreasing the costs of wage execution further than do my recommended reforms, or by increasing the costs of property execution. The former is not likely, as altering the procedural prerequisites to a wage garnishment order would require the Supreme Court to alter existing precedent.<sup>55</sup> Legislative or administrative repeal of any restrictions on the executions of wage assignments might be constitu-

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<sup>53</sup> See supra note 7 and accompanying text.

<sup>54</sup> See supra notes 5-6 and accompanying text.

<sup>55</sup> Perhaps the Court would be willing to reconsider *Sniadach*, given the anomaly of stricter procedural protections for the debtor in wage garnishment than in property execution. See supra note 30. Before the Court could do so, however, some state would need to alter its garnishment procedures to provide for ex parte seizure of wages (presumably with an opportunity for an immediate postseizure hearing), and then a debtor would need to bring a test case.

tionally permissible, but it seems unlikely to happen.<sup>56</sup> It may also be undesirable, due to concerns about burdening the employer and about providing incentives to negotiate voluntary agreements.<sup>57</sup>

However, there are several feasible ways to increase the costs of property execution so that it is no more advantageous to the creditor than wage garnishment. The most important reform would prohibit the cheapest form of coercive execution available: self-help repossession of collateral. This reform was adopted in Wisconsin thirteen years ago,<sup>58</sup> but to date has not been adopted elsewhere, perhaps because of fear that such a dramatic change would have substantial effects on the availability of credit.<sup>59</sup> Further correction of the imbalance in costs between income and property execution would occur if *ex parte* replevin procedures were eliminated. This has also occurred in Wisconsin.<sup>60</sup>

The Bankruptcy Code permits a consumer-debtor to redeem certain collateral from a security interest by paying the creditor the fair market value of the collateral, when that figure is less than the outstanding debt, as it usually is.<sup>61</sup> To my knowledge no suggestion has ever been made to extend a similar right to debtors outside bankruptcy, but it could prove an effective way to discourage property execution in situations in which the potential lost value is high. If the collateral's market or resale value is far less than its value to the debtor—in which case the potential lost value is high—a well-informed debtor would be expected to redeem the collateral by paying the resale value. The creditor would have a claim for the deficiency under this suggested reform, but it would be an unsecured claim. Un-

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<sup>56</sup> On the contrary, the FTC has just acted to further restrict wage assignments. See *supra* note 51 and accompanying text.

<sup>57</sup> See *supra* notes 44-47 and accompanying text.

<sup>58</sup> Wis. Stat. Ann. § 425.206 (West 1977 & Supp. 1985). The prohibition permits self-help repossession only after "judgment for the creditor has been entered in a proceeding for recovery of collateral." *Id.* The provision applies only to "consumer credit transactions," which are defined basically as credit transactions entered into for consumer purposes in which there is a finance charge. *Id.* § 421.301(10) (West 1977).

<sup>59</sup> This and other objections to these reforms are discussed *infra* notes 63-85 and accompanying text. The actual effects of the Wisconsin statute are discussed in Grau & Whitford, *supra* note 2, at 988-94. I there concluded that elimination of self-help repossession was effective in reducing the incidence of motor vehicle repossession, while having only modest effects on credit availability.

<sup>60</sup> In consumer credit transactions, Wisconsin requires a judgment on the merits before goods may be seized under a security interest. Wis. Stat. Ann. § 425.206 (West 1977 & Supp. 1985). California also requires a preseizure opportunity for a hearing in most instances in which self-help repossession is unavailable to the creditor. Cal. Civ. Proc. Code § 512.020 (West 1979).

<sup>61</sup> 11 U.S.C. § 722 (1982). See S. Rep. No. 989, 95th Cong., 2d Sess. 95, reprinted in 1978 U.S. Code Cong. & Ad. News 5787, 5881.

secured creditors have no particular incentive to pursue property execution; given exemption laws and the awkwardness of sheriff sales, such creditors typically prefer wage garnishment as a means of coercive execution. Consequently, execution under this reform would take the form of a voluntary redemption payment plus possible wage garnishment of a deficiency claim.

One difficulty in extending the redemption idea to consumer debt is to devise a practical system of administration to inform debtors of this right, and to adjudicate disagreements about the collateral's resale value (i.e., the redemption price). Creditors will have an incentive to hold out for a high value because, until a redemption payment is made, they retain the right to repossess. Because repossession will cause the debtor to suffer the lost value, the debtor is in a weak bargaining position, yet may be unwilling or unable to meet the creditor's price.<sup>62</sup>

If a creditor were required to get the court's permission before repossessing, a practical means to administer a redemption right suggests itself. The creditor would be required to estimate its net proceeds from repossession and resale. To insure the creditor's good faith in making this estimate, the size of the creditor's deficiency judgment would be measured by this estimate, unless the creditor was able to obtain an even higher amount upon resale. The court would then take the initiative to inform the debtor of the redemption right and the amount that must be paid to exercise the right, presumably the creditor's estimate unless the debtor can show that a lower amount is more reasonable. The effective date of any replevin writ would be delayed a few days to enable consumers to assemble the funds required to redeem. Whether this scheme would be sufficient to make a redemption right practical for consumers is unclear. Among primary concerns would be whether debtors would appreciate the significance of the right, and whether most consumers would find it impractical or impossible to make the substantial cash payment needed to redeem goods from security status.

### C. *Objections to Reform*

The reforms suggested above are designed to shift the relative incidence of income and property execution. They will also almost surely increase the cost of collecting consumer credit. The costs of wage garnishment may be reduced somewhat, but probably not to the

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<sup>62</sup> If bargaining about the redemption price leads to an impasse, the creditor may feel compelled to repossess in order to establish the credibility of its threats to do so, and then the threatened lost value will actually occur. See *supra* note 20 and accompanying text.

point where garnishment becomes as inexpensive as is repossession presently. It follows that the proposed increases in the cost of repossession will increase the overall costs of collecting consumer debt. Though it is impossible to predict with certainty, it is likely that these increased collection costs will be reflected in higher costs of credit and/or decreased credit availability, particularly to consumers considered by creditors to present the greatest risk of delinquency.<sup>63</sup>

That the proposed reforms will tend to increase the cost and decrease the supply of consumer credit certainly should be viewed as a social cost, to be weighed against the benefits of my proposal.<sup>64</sup> It cannot plausibly be argued from the mere existence of these costs, however, that my proposal would render the consumer credit market less efficient in the resource allocation sense. The market already deviates so substantially from the perfect market that the effects of the proposed reforms may be to move the supply and price of consumer credit closer towards that which would exist in a perfect market. The state already heavily subsidizes the court system that provides the means of most coercive execution. Income tax laws permit consumers

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<sup>63</sup> In earlier articles, I have detailed the argument that increased collection costs will probably drive up the price of credit and/or decrease credit availability. Whitford, *supra* note 11, at 1077-79; Whitford & Laufer, *supra* note 2, at 625-26. It is always possible, of course, that in the short run, market conditions will make it impossible for creditors to pass on these costs and will instead be forced to accept reduced profit margins. If such market conditions persist, however, the likely ultimate result would be reduced investment in consumer credit markets and thus reduced credit availability.

<sup>64</sup> If there is a less costly way to accomplish the objectives sought, these reforms should not be adopted. The goals sought here—greater reliance on income execution and less on property execution—could be achieved if delinquent debtors would always invoke chapter 13 of the Bankruptcy Code before coercive execution. Chapter 13 wage-earner plans provide for payment from future income, avoiding in the meantime, repossession of collateral due to the Bankruptcy Code's automatic stay provision. 11 U.S.C. § 1322 (1982 & Supp. II 1984). Moreover, a chapter 13 plan can be confirmed without first obtaining the creditor's consent, so long as it provides that the creditor will receive the amount of his claim, or that all of the debtor's future income will be applied to payments under the plan. *Id.* § 1325(b). It is now widely believed that debtors using chapter 13 avoid much of the social stigma formerly associated with bankruptcy. Perhaps the only reform needed is publicizing the availability of chapter 13 proceedings.

There are, however, substantial financial barriers to filing a chapter 13 proceeding that render it inadequate as an exclusive form of relief for debtors faced with the prospect of repossession and its corresponding lost value. It is difficult for a debtor to file a chapter 13 plan without first retaining an attorney, whose fee usually runs quite high. Furthermore, it is likely that the trustee will charge a fee of between five and ten percent of all debts paid pursuant to the chapter 13 plan. *Foster v. Heitkamp (In re Foster)*, 670 F.2d 478, 491-92 (5th Cir. 1982) (trustee's fee computed using payments made under and outside the plan). See generally 11 U.S.C. § 1320 (1982 & Supp. II 1984) (discussing duties and compensation of court-appointed trustee).

Publicizing the availability of chapter 13 plans should certainly be encouraged, but a practical program to discourage socially undesirable property execution will also require the reform of state laws governing coercive execution.

to deduct interest charges even for personal purchases.<sup>65</sup> The welfare system cushions debtors from the worst possible consequences of credit extension, such as unemployment or loss of all household possessions. These features of our system decrease the cost of credit to creditors and debtors, presumably tending to increase the demand and supply of credit. The reforms I suggest should somewhat counteract these market distortions by reducing the supply of credit. I do not claim that the resulting equilibrium will necessarily make the supply and price of credit closer to that which would exist in a perfect world. I can and do claim, however, that it is impossible to make a case against my suggested reforms as inefficient in the usual resource allocation sense. The case for or against the reforms must be made on other grounds.

The most substantial argument against the proposed reforms rests on an analysis of their distributional effects. Since the costs and benefits of my reforms will not be visited on the same people, the reforms can be said to create winners and losers. Applicants who would have received credit but for the reforms will be worse off, if they could have repaid the credit without difficulty. Credit applicants who receive credit, but at higher prices, will also be worse off.<sup>66</sup> Winners will include, most importantly, debtors who default after the reforms, since they will more often avoid the lost value associated with property execution.

It is impossible, particularly a priori, to determine whether the gains to the winners from this regulation outweigh the losses to the losers.<sup>67</sup> If the regulation's major gainers and losers are participants in the regulated transaction, it is appropriate to ask why we should not just accept the contract terms those parties accept. Consumers could, after all, insist on credit contracts which provide no security interest in tangible collateral. Alternatively, contracts could provide procedural prerequisites to repossession that make it at least as expensive as wage garnishment. For example, self-help repossession could be contractually prohibited. In the absence of any compelling economic or philosophical grounds for considering the winners more deserving than the losers, what case can be made for ignoring

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<sup>65</sup> While this article was in press, Congress amended the tax laws, disallowing interest deductions for personal purchases in most instances. See Joint Comm. on Tax'n, Summary on Conf. Agreement on H.R. 3838 (Tax Reform Act of 1986) (JCS-16-86), Aug. 29, 1986.

<sup>66</sup> Some of this group will feel less stress and anxiety, knowing that the consequences of default, should it occur, will be less severe. This point illustrates the difficulty of identifying the winners and losers, though they will exist.

<sup>67</sup> This just restates, of course, my earlier conclusion that efficiency analysis is indeterminate. See *supra* text following note 64.

consumers' apparent preferences, as manifested in their contractual behavior, for the status quo?

### III. CONSUMER CONSENT TO CREDIT PRACTICES

#### A. *Does Consent Validate Present Practices?*

The typical response to the question posed in the previous section is that consumers lack sufficient information and/or sophistication to make intelligent marketplace choices. In effect, the argument is that consumers have not really consented to the present system. Professor Alan Schwartz has recently argued, however, that if some consumers have both accurate information about credit terms, and the inclination to shop for favorable terms before making marketplace choices, it is reasonable to suppose that sellers will respond to those consumers' preferences in setting contract terms.<sup>68</sup> If we further assume that credit terms are standardized, and that the consumers' preferences are similar whether or not they shop, it is possible to conclude, according to Schwartz, that the balance drawn between the cost and availability of credit and the provisions respecting collateral reflect consumer preferences. Professor Schwartz' argument is elaborate and sophisticated, and persuasive if his many clearly identified assumptions are accurate.<sup>69</sup>

One assumption Schwartz makes is that, in terms of their risks of default, there is no difference between consumers who shop and those who do not. I disagree with this assumption.<sup>70</sup> It seems likely that shopping consumers—the ones who in Schwartz' scheme act essentially as bargaining agents for consumers generally—are less likely to default than consumers generally. Certainly Schwartz offers no evidence to the contrary, and my assumption is consistent with what I

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<sup>68</sup> Imperfect Information, *supra* note 4, at 1422-23 ("[I]f enough comparison shopping occurs, the only single price equilibrium is at the competitive price without security."). Schwartz and Wilde argue that any monopoly power held by creditors because of debtors' lack of information will be exploited through pricing, and not more restrictive contract terms than would occur under competitive conditions. *Id.* at 1452-53.

<sup>69</sup> At one point, Schwartz concedes the possibility that consumers, even those who shop, systematically underestimate the risk that default will occur. He argues, however, that this is insufficient to justify regulation, because the burden of proof lies with those who would regulate. *Id.* at 1444-46.

<sup>70</sup> Schwartz argues that the creditors' incentives not to lend to debtors who present an unreasonable risk of default will tend to correct any debtor tendency to underestimate the likelihood of default. Excessively optimistic debtors will be unable to get credit despite their misinformed desires. *Id.* at 1434-35. Perhaps this analysis contributes to Schwartz' assumption of homogeneity in consumers' risk of default.

While creditor behavior will limit the range of default risk, it will not eliminate all risks. It will just remove from the debtor population those who present the greatest risk of default.

believe are the ordinary presumptions that shopping consumers are likely to be better educated and thus better able to make decisions as to whether they can afford the credit required. Yet on this assumption, shopping consumers should be less likely to resist harsh default terms, preferring instead lower interest rates or some other benefit. These preferences are contrary to the interests of their nonshopping counterparts. Therefore, even if fully informed,<sup>71</sup> shopping consumers would not be appropriate "bargaining agents" for their nonshopping counterparts.

Another of Schwartz' assumptions which I question is that creditors do not differentiate between debtors with respect to credit terms.<sup>72</sup> Many creditors, such as banks, offer both secured and unsecured credit, with somewhat discretionary standards for determining who gets which.<sup>73</sup> Perhaps debtors who shop with respect to credit terms—the ones whose preferences Schwartz argues will dictate contract content—are more likely than other debtors to obtain unsecured credit. Moreover, though some creditors (for example, sales finance companies) offer only secured credit, there is enough competition among creditors to permit many debtors to shop and choose to borrow elsewhere. However, not all consumers shop. Even if a reasonable percentage of consumers shop with respect to credit terms, as Schwartz assumes, it is entirely plausible to assume that the customers of particular creditors—for example, the personal finance companies, who commonly take the most extensive security interests in the industry—contain few shoppers. For the customers of these firms, the contract terms would not be validated by the consent of shopping consumers.

I have just advanced reasons, Schwartz' contentions notwithstanding, to doubt that existing patterns of contractual content reflect general consumer preference for the present system of coercive execu-

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<sup>71</sup> In assessing the desirability of agreeing to a secured loan, a consumer needs to understand the difference in the consequences of creditors being secured or unsecured. My assumption is that while debtors will often understand that a secured creditor may repossess collateral, they will less frequently appreciate the loss in value that is likely to result. This latter knowledge is likely to escape even shopping consumers, unless they happen previously to have been victims of repossession.

<sup>72</sup> Schwartz makes this assumption explicit. *Imperfect Information*, supra note 4, at 1421 ("A firm can lend with or without a security interest, but cannot do both.").

<sup>73</sup> For a description of typical systems for granting consumer credit, see Taylor, *Meeting the Equal Credit Opportunity Act's Specificity Requirement: Judgmental and Statistical Scoring Systems*, 29 *Buffalo L. Rev.* 73 (1980). Briefly, a "judgmental scoring" system uses a subjective process to evaluate the applicant's ability to pay by considering character, financial capacity, and availability of collateral. *Id.* at 86-87. A "statistical scoring" system involves the use of empirical techniques to predict statistically the probability that an applicant will repay. *Id.* at 88. Both are subject to various antidiscrimination requirements. *Id.* at 86-87.

tion. Further, I presume that it would make little difference to levels of consumer awareness if we mandated prominent disclosure, in standard form contracts, of information about the effects of security agreements. Available evidence indicates that disclosure regulation generally has little effect on consumer learning or behavior.<sup>74</sup> On the other hand, I cannot prove that informed consumers would in general reject existing patterns of contractual content and coercive execution, given the costs and benefits of change.

In such circumstances, we must either defend the status quo, for lack of any good reason to change, or rely on the judgments of well-informed observers who lack a material stake in the outcome.<sup>75</sup> Those judgments should both reflect what is in the best interests of consumers generally, and assess the distributional consequences in an effort to avoid burdening the least fortunate with the inevitable costs of reform.

In my judgment, the benefits to the winners of the collection law reforms I advocate are likely to outweigh the possible costs to the losers. In the first place, although it cannot be proven, it is likely that the reforms will reduce the overall cost of credit collection. Though the costs to creditors will increase, debtors will be spared lost value. Further, from a distributional perspective, the benefits will go to people likely to be in need—those who have defaulted on a debt. If the costs of reform take the form of higher interest rates, the impact will be dispersed widely. Therefore, for each individual affected, the impact will be quite modest. Some of the costs will take the form of denial of credit, which can have severe consequences for the person affected. However, frequently the credit denial resulting from the proposed reforms will not be absolute; rather, the credit applicant will only be required to make a larger downpayment as a precondition to the loan.<sup>76</sup>

From a distributional perspective, the greatest concern exists when the denial of credit resulting from the reforms is absolute. This will usually occur when the applicant presents substantial risk of default, making the reforms' extra collection costs an especially important factor in the creditor's decision. Low income groups, generally

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<sup>74</sup> Whitford, *The Functions of Disclosure Regulation in Consumer Transactions*, 1973 *Wis. L. Rev.* 400, 403-05.

<sup>75</sup> For an elaborate defense of the latter approach, which I adopt, see Kennedy, *Distributive and Paternalist Motives in Contract and Tort Law, With Special Reference to Compulsory Terms and Unequal Bargaining Power*, 41 *Md. L. Rev.* 563 (1982). Remember that I am rejecting the possibility of improving consumers' understanding of consent through disclosure regulation. See *supra* note 73 and accompanying text.

<sup>76</sup> See Whitford & Laufer, *supra* note 2, at 625, 635-36.



assumed to be represented in the population of high risk debtors far in excess of their presence in the general population, will thus receive less credit.<sup>77</sup>

My distributional concerns are ameliorated by my judgment that many low income credit applicants will be better off without credit, their personal preferences for it notwithstanding. Over the years, I have interviewed many who are familiar with the situations of low income consumers, and who believe that this group is encouraged to borrow, usually on disadvantageous terms, far more than is in their best interests. Collection law reform can be seen as a modest corrective for some of the marketing excesses of finance companies which lend primarily to a low income clientele. Or, it can be seen as one more case in which the law steps in paternalistically to counteract a natural human tendency to favor immediate gratification—in this instance, more credit at lower prices—at the expense of protection from long-term risk (here, default, the occurrence of which is not entirely in a debtor's control). In the past, I have often advanced this justification for consumer protection regulation.<sup>78</sup>

#### B. *Would Consent Alone Be Sufficient Validation of Present Practices?*

Suppose Schwartz is correct in his assumption that the present pattern of execution remedies in consumer credit transactions accurately reflects the choices well-informed consumers would make in competitive markets. It still does not follow that my reform proposals should be rejected. The attractiveness of relying on informed consumer choice to determine contract content rests on the necessary presence of value judgments in the consumer's decision to grant a security interest. A consumer cannot know in advance whether default will occur. Therefore, the decision necessitates a classic confrontation between short-term benefit (most likely, more credit available at lower cost) and avoidance of the risk of a long-term loss (most importantly, lost value from property execution in the event of breach). While actuaries devise purportedly objective methods for discounting the risk of future gains or losses to their present value, so that they can be compared with other gains and losses,<sup>79</sup> none of these methods can

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<sup>77</sup> See White, *The Abolition of Self-Help Repossession: The Poor Pay Even More*, 1973 *Wis. L. Rev.* 503, 522-24.

<sup>78</sup> Whitford, *supra* note 11, at 1074-75 nn.94-95. Default is often beyond the debtor's control because it frequently results from unanticipated unemployment or sudden illness.

<sup>79</sup> In this context, an actuary might group a number of consumers together using demographic data and then estimate the probability of default followed by repossession, based on historical data about the delinquency and repossession experience of a similarly situated group

accurately reflect the decision a particular consumer must make. This is so because the objectivized formulas cannot take into account the various subjective differences between consumers. For example, people differ in their willingness to delay immediate gratification (to "invest"), and these differences will bear on the cost of foregoing credit now in order to avoid the risk of a later default. Attitudes about risk aversion also bear on a consumer's judgment about the benefits to be derived from avoidance of a risk of long-term loss.

In our secular democracy, it is considered inappropriate to substitute a social judgment for that of the individual on matters so obviously resting on personal taste as aversion to risk or the costs of delaying gratification. Reliance on manifested consumer preferences to devise a system of collection remedies is the best way to avoid making these inherently value-laden judgments. A second reason to rely on manifested consumer preferences is that collective decisionmaking about contract content—what we call "regulation"—necessarily benefits some consumers while harming others.<sup>80</sup> There is no method to evaluate whether the winners gain more than the losers lose that does not involve an interpersonal comparison of utilities, and this also cannot be done in an objective, value-free way. As a society, we have labeled such questions "distributional." Academics have cast these questions outside the parameters of "scientific" debate, and have a tendency to prefer market decisions on such questions in order to avoid difficult subjective judgments.

The arguments for relying on manifested consumer preferences as a method of determining contract content rest on a key assumption—that consumers are rationally maximizing their true preferences. If so, by avoiding difficult social judgments, we can be assured we are not severely prejudicing the interests of individual consumers. However, this rational maximization hypothesis, which underlies almost all policy analysis passing under the banner of law and economics, is increasingly being drawn into question. Even well-informed consumers can make "mistakes"—analytic errors about which marketplace choice will provide the most enjoyment or best serve other

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of consumers. A similar approach could be used to determine the average "lost value" suffered by a consumer in this group when a repossession does occur. The actuary would be able to say there was  $X\%$  probability that a consumer granting a security interest will suffer lost value of  $\$Y$ . The resulting product would then be discounted to its present value, probably using market interest rates to determine an appropriate discount rate. This figure could then be compared with the benefits of granting a security interest. Those benefits are sometimes measurable by a difference in interest rates for secured and unsecured credit, but if credit can be obtained only by granting a security interest, an objective measure of those benefits is likely to be complicated.

<sup>80</sup> See *supra* note 66 and accompanying text.

personal values. And consumer preferences change over time; a consumer may make a marketplace choice now that she will later come to regret because of changed preferences.<sup>81</sup>

People seek a bundle of preferences that sometimes conflict. In mediating conflicts, they do not always come to consistent conclusions, as they oscillate between inconsistent preferences. Psychologists are now developing hypotheses about factors that tilt consumers toward one preference or another.<sup>82</sup> Schwartz, for example, discusses the effects on marketplace choices of the "availability heuristic"—the thesis that marketplace choices are influenced by recent dramatic events that call attention to the advantages or disadvantages of particular marketplace choices.<sup>83</sup> I have long believed that much modern advertising—that which might be described as noninformational—seeks to encourage consumers to act on one of several inconsistent preferences that influence market choices.<sup>84</sup> If choices between inconsistent preferences can be so easily influenced, any assumption that consumers reflect an internal prioritizing of conflicting goals in their marketplace behavior is undercut.

Questioning the rational maximization hypothesis does not enhance the case for relying on manifested consumer preferences as a way of validating a system of collection remedies. Nor does it provide any help in devising another method for determining what collection system is most appropriate. Allocative efficiency analysis, as I argued above,<sup>85</sup> is as inconclusive a guide as consumer choice. If consumer

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<sup>81</sup> Mark Kelman should get major credit for introducing these concerns to the legal literature. E.g., Kelman, *Choice and Utility*, 1979 *Wis. L. Rev.* 769; Kelman, *Consumption Theory, Production Theory, and Ideology in the Coase Theorem*, 52 *S. Cal. L. Rev.* 669 (1979).

<sup>82</sup> See, e.g., *Judgment Under Uncertainty: Heuristics and Biases* (D. Kahneman, P. Slovic & A. Tversky eds. 1982) (discussions on the variance between institution-based predictions and statistical theory-based predictions). See also R. Nisbett & L. Ross, *Human Inference: Strategies and Shortcomings Of Social Judgment* (1980) (discussing principles of individual decision-making); *Symposium: Legal Implications of Human Error*, 59 *S. Cal. L. Rev.* 225 (1986) (articles on choicemaking in the marketplace).

<sup>83</sup> *Imperfect Information*, *supra* note 4, at 1436-42. Schwartz implies that this decisional bias tends to make consumers risk averse because dramatically unfortunate consequences from product use or property execution are likely to be newsworthy and capture the public's attention.

Schwartz discusses what he calls the "fundamental attribution error" with respect to security interests. The suggestion is that consumers are likely to underestimate the risk of their own default because they have an exaggerated opinion of their own ability to repay. Though Schwartz concedes this possibility, he believes there is insufficient evidence of this phenomenon to justify regulation. *Id.* at 1442-46; see *supra* note 68.

<sup>84</sup> Much modern advertising encourages consumers to favor urges for immediate gratification, to throw caution to the wind and to put aside feelings that it is often wiser to save to protect oneself against unfortunate future events.

<sup>85</sup> See *supra* text following note 64.

choice is to be rejected as a basis for decision, the social choice again becomes preservation of the status quo for its own sake, or paternalistic intervention to reform the credit collection system. For the reasons previously given, I favor the latter option.<sup>86</sup>

### C. Summary

At this point, it is appropriate that I recapitulate my argument. In the previous part, I developed the argument that while the necessary social costs of property execution exceed those of income execution, property execution has become the norm where the creditor is secured. I developed proposals that would facilitate wage garnishment while making repossession of collateral more expensive and less common. These proposals would probably make consumer credit somewhat more expensive and less available than it would be if the regulation were not adopted. However, these proposals would bring about the benefit of presumably less repossession of collateral, and consequently, less of the loss in the use value of the repossessed property that such collection behavior entails. Given the other already existing distortions in the consumer credit market, no plausible argument can be made that such regulation either increases or decreases resource allocation efficiency.

Schwartz has argued, however, that marketplace behavior indicates that there is reason to believe consumers as a class would rather not make the tradeoff I would force upon them. In rebuttal, I have argued that consumers may not be fully informed before manifesting the preferences they have apparently expressed in market choices. Even if this is not the case, however, I maintain that consumer preferences, as revealed through market choices, are not a good measure of the self-interest of consumers as a class. I argue for the proposed regulation on essentially paternalistic grounds—what will best serve both debtors' and the public's long-term interests.

## IV. PROHIBITING SECURITY INTERESTS

This part will discuss proposals to prohibit security interests in certain types of collateral—most particularly the FTC's recently adopted Credit Practices Rule which prohibits the taking of nonpossessionary, nonpurchase money security interests in specified household goods (hereinafter sometimes called "blanket security agreements").<sup>87</sup>

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<sup>86</sup> See *supra* notes 74-77 and accompanying text.

<sup>87</sup> 16 C.F.R. § 444.2(a)(4) (1986). The household goods covered by the rule include, *inter alia*, the "[c]lothing, furniture, appliances, one radio and one television, linens, china, crockery, kitchenware, and personal effects . . . of the consumer and his or her dependents." *Id.*

This regulation is more severe than that advocated in the preceding section, since it effectively prohibits repossession even in situations in which wage garnishment is not an available remedy.

The FTC offered two separate rationales for this part of its Credit Practices Rule.<sup>88</sup> One rationale reflects a judgment that there would likely be a very large loss in use value accompanying repossession of the prohibited collateral. Prohibition avoids that loss. In the case of household goods, the principal category of prohibited collateral, the judgment that repossession will yield sizable lost value seems quite reasonable.<sup>89</sup> However, this rationale ignores the true benefit to the creditor of blanket security interests in household goods. These security devices provide the creditor with considerable informal bargaining leverage. Though the creditor's gain from repossession may be small, the loss to the debtor is much larger. Consequently, the threat of repossession, if credible, can influence the debtor to favor the creditor at the expense of other obligations, or to borrow money from a friend or relative to pay off the creditor. If creditors cannot find a close substitute for this bargaining leverage, the FTC rule can have a substantial impact on a particular creditor's overall collection costs, if not on his costs in particular cases.

The second rationale offered by the FTC for its rule acknowledges the use of blanket security interests as informal bargaining leverage. However, it objects to creditors having this kind of leverage, which it characterizes as "psychological."<sup>90</sup> It is unclear exactly what the Commission finds objectionable in the use of psychological leverage. The Commission's major concern seems to be the psychic costs experienced by debtors threatened with repossession of household

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§ 444.1(i). The prohibition of blanket security interests in household goods is the most important provision of the rule, but it also prohibits cognovit notes, waivers of exemptions, and severely limits wage assignments.

<sup>88</sup> These rationales are offered in the Commission's "Statement of Basis and Purpose," required for all newly adopted rules. Statement of Purpose, *supra* note 49, at 7763.

<sup>89</sup> *Id.* In a famous unconscionability case, *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445 (D.C. Cir. 1965), the creditor retained a blanket interest and sought to repossess the following items:

1 wallet, 2 pairs of draperies, 1 apron set, 1 pot holder set, 1 set of rugs, 2 pairs of curtains, 4 sheets, 1 portable [fan], 1 portable typewriter, 2 gun and holster sets (presumably toys), 1 metal bed, 1 inner spring mattress, 4 chrome kitchen chairs, 1 bath mat set, shower curtains, [a washing machine, and a stereo].

Dostert, Appellate Restatement of Unconscionability: Civil Legal Aid at Work, 54 A.B.A. J. 1183, 1183 n.1 (1968). Most of these items have very little resale value, and some probably could not be resold at all (e.g., the shower curtains). Their value to the owner must have exceeded the proceeds of resale had the creditor been permitted to repossess (to apply the symbols used earlier in the article,  $V_2 > V_1$ ).

<sup>90</sup> Statement of Purpose, *supra* note 49, at 7765-66.

goods. The Commission characterized the impact of threatened repossession as "psychologically debilitating and disruptive."<sup>91</sup> Concern was also expressed that the action debtors take to stave off the threatened repossession may be in their short-term interest—because it avoids the repossession—but harmful in the long term. For example, debtors may agree to a refinancing on disadvantageous terms, or divert funds needed for payment of rent to pay the creditor holding the security interest in household goods, thereby risking eviction.<sup>92</sup>

There has been much discussion and litigation concerning the authority of the FTC to promulgate its Credit Practices Rule.<sup>93</sup> The Commission explicitly relied on its authority to regulate "unfair," as opposed to "deceptive," trade practices, and the scope of the unfairness concept is still largely undefined. Rather than discuss the extent of the FTC's authority, I choose to concentrate on whether prohibition of blanket security agreements in household goods is wise from a legislative or policy perspective.

The Commission's first rationale emphasizes the lost value resulting from repossession under a blanket security agreement. I relied on the existence of lost value in arguing for the collection law reforms proposed earlier in this article, which I believe would channel collection away from property execution and towards income execution. The case for the FTC's prohibition of blanket security agreements is more difficult to make, however, because the costs of regulation are likely to be extensive and borne by relatively few consumers. The major effect of the reforms advocated earlier should be the channeling of coercive execution to a slightly more costly form of collection—wage garnishment. I have argued that the extra costs are most likely to be reflected in higher finance charges and higher required downpayments, and that only a few prospective debtors will be denied credit altogether.<sup>94</sup> Blanket security agreements, on the other hand, are most likely to appear in the credit contracts of the poor, in part

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<sup>91</sup> *Id.* at 7764.

<sup>92</sup> *Id.* at 7764-65. Professor Schwartz asserts that some people object to in *terrorem* repossessions on the ground that when they do occur, one debtor is suffering in order to provide an example to others of what could happen if they do not respond appropriately to the creditor's threats. Schwartz then proceeds to criticize the validity of this objection. *Security Interests*, *supra* note 4, at 151-52. The FTC does not put forth the objection identified by Schwartz; nor to my knowledge has anyone else.

<sup>93</sup> The courts recently upheld the FTC's power to promulgate the rule. *American Fin. Servs. v. FTC*, 767 F.2d 957 (D.C. Cir. 1985), cert. denied, 106 S. Ct. 1185 (1986). See generally Rice, *Toward a Theory and Legal Standard of Consumer Unfairness*, 5 *J.L. & Com.* 111 (1985) (articulation of theory concerning process of developing concepts of unfair acts or practices).

<sup>94</sup> See *supra* text accompanying notes 75-76.

because their income is at or below the exempted amount and consequently wage garnishment is not an available remedy. Unless the creditor is able to obtain a security interest in other collateral, therefore, the outright denial of credit to a person who otherwise would have received credit seems a more likely response to the FTC rule than to the reforms proposed in the preceding section.<sup>95</sup>

The effect of the preceding analysis is to render less viable a social insurance justification for the FTC rule. Debtors who avoid the lost value associated with repossession under a blanket security agreement will benefit from the rule, but the costs—primarily in the form of unavailability of credit—are not likely to be widespread. Nevertheless, one could still argue, as did the Commission,<sup>96</sup> that the benefits of reform exceed its costs. It is even possible that the debtors denied credit because of the FTC rule will be better off for their lack of credit. Perhaps we should intervene to save them from the folly of favoring the immediate gratification of more credit at the cost of bearing the long-term risk of living under the cloud of a blanket security agreement.<sup>97</sup>

Because the consequences of regulation are likely to include a considerable restriction of credit availability, I am reluctant to justify the prohibition of blanket security agreements solely on the basis of the lost value that undoubtedly accompanies repossession under such instruments. However, there are alternative justifications for the rule that are persuasive. The most evident justification is one not mentioned by the FTC—coordination of collection remedies with bankruptcy. Since the massive revision of the Bankruptcy Code in 1978, nonpurchase money security interests in household goods usually have been unenforceable in bankruptcy.<sup>98</sup> It is perverse to have a system that offers a debtor protection from a blanket security interest only by a declaration of bankruptcy. Unsavvy debtors, and those having moral scruples against bankruptcy, remain unprotected. More-

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<sup>95</sup> See White, *supra* note 77, at 511.

<sup>96</sup> Statement of Purpose, *supra* note 49, at 7765-66. The Commission cited evidence that prohibition of blanket security agreements would have no effect on credit availability. *Id.* The evidence was not strong, however, and the Commission offered few analytic reasons why that should be the case. If the rule increases creditor costs, either the creditor's dividends or retained earnings must be reduced, or the costs must be passed on to consumers in the form of higher finance charges or restricted credit availability.

<sup>97</sup> See *supra* text accompanying note 78. An alternative argument, not resting on a paternalistic assessment of another's best interest, would emphasize the need to limit welfare enrollments. After repossession under a blanket security interest in household goods, a debtor must frequently seek welfare.

<sup>98</sup> 11 U.S.C. § 522(f)(2)(A) (1982). In bankruptcy, the security interest is invalid only to the extent that it applies to goods that are exempt from execution by an unsecured creditor.

over, the incidence of bankruptcy is likely to increase, harming persons other than the debtor and the creditor holding the security interest (that is, other creditors) who are hurt by a bankruptcy that would not have occurred but for the household goods' security agreement. Although some might argue that the Bankruptcy Code provision is unwise, Congress recently reviewed and revised the consumer bankruptcy provisions,<sup>99</sup> and the rule invalidating nonpossessory security interests in household goods escaped unscathed. Since further Congressional revision of the Bankruptcy Code is unlikely for some time, federal action—here, through the FTC rule—to force state collection remedies to mirror the bankruptcy rule seems both wise and justified.

Another possible justification for the FTC rule derives from the Commission's position that repossession rarely occurs under blanket security agreements.<sup>100</sup> Assuming this observation is correct,<sup>101</sup> the question arises as to why the agreements are so rarely enforced. One possible explanation is that the threat to repossess, given the lost value that would result to the debtor, is sufficient to produce whatever payment is possible for the debtor. Where payment is not possible, repossession makes little sense, since the collateral will yield little, if anything, for the creditor upon sale. An alternative explanation, however, is that creditors are generally bluffing when they threaten to repossess under a blanket security interest. Even if a debtor is able to but refuses to pay, a creditor may back off from his threat to repossess because he is fearful of bad publicity or of driving the debtor into bankruptcy, rendering unreachable the assets with which the debt might be repaid.<sup>102</sup> In this circumstance, a creditor's threat to repossess can be deceptive. Consumers who alter their behavior in the face of threats to repossess are misled by a fraudulent representation by

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<sup>99</sup> Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333 (codified as amended in scattered sections of 11 U.S.C. (Supp. II 1984)).

<sup>100</sup> Statement of Purpose, *supra* note 49, at 7763.

<sup>101</sup> There is a conflict in the rulemaking record with respect to how frequently creditors actually repossess household goods under a blanket security interest. The presiding officer who conducted hearings of the FTC's Trade Practice Rule concluded that repossession was rare. *Id.* A National Consumer Law Center survey, however, found that repossession occurred in 20% of the cases in which there was a default of a debt covered by a nonpurchase-money security interest in household goods. See FTC Bureau of Consumer Protection, Staff Report & Recommendation on Proposed Trade Regulation Rule, 16 C.F.R. § 444, at 214-15 (1980).

<sup>102</sup> At first glance, it would seem that a reasonable incidence of repossession would be necessary to maintain the credibility of the threat to repossess pursuant to a blanket security interest in household goods. If few repossessions occur, as the Commission found, and if the threats continue to influence debtors nonetheless, it must mean that many debtors never become aware of creditors' actual practices.



the creditor—to wit, that he intends to repossess if the debtor does not pay. The representation is fraudulent because the creditor knew the threat was empty at the time it was made.<sup>103</sup>

The justification for the FTC rule that is most persuasive to me rests on a moral judgment regarding the propriety of any person having psychological leverage over the debtor. That leverage arises because the creditor has the capacity to take action of little direct benefit to itself but of great harm to the debtor.<sup>104</sup>

Our culture objects to gaining bargaining power solely by threatening to hurt another. Agreements reached that way are invalid under the law of duress.<sup>105</sup> Analogously, the use of discovery for the sole purpose of harassment undoubtedly strengthens the bargaining position of the party initiating discovery, but it is considered unethical nonetheless.<sup>106</sup> Federal law prohibits the making of frequent telephone calls for the purpose of harassing the debtor, although such action would frequently increase collection rates.<sup>107</sup> The prohibition of blanket security agreements in household goods can be seen as an extension of this principle, if it is assumed that creditors would rarely benefit directly from repossession and resale under such agreements.<sup>108</sup>

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<sup>103</sup> It seems likely that, even though repossessions are generally rare, some creditors actually carry out their threats to repossess. If so, it may be inappropriate to enact a rule that prohibits even those creditors who have not been deceptive from taking and enforcing a security interest.

<sup>104</sup> There is, of course, considerable controversy about whether it is appropriate for the FTC to adopt a rule based on its moral preferences, as opposed to an analysis showing a market failure that the rule is designed to redress. See Rice, *supra* note 93.

<sup>105</sup> According to the Restatement (Second) of Contracts § 175(1) (1979), a contract is voidable for duress if "a party's manifestation of assent is induced by an improper threat by the other party that leaves the victim no reasonable alternative." A threat is improper if "the resulting exchange is not on fair terms," and if "the threatened act would harm the recipient and would not significantly benefit the party making the threat." *Id.* § 176(2).

<sup>106</sup> Model Code of Professional Responsibility, DR 7-102(A)(1) (1980):

In his representation of a client, a lawyer shall not:

- (1) File a suit, assert a position, conduct a defense, delay a trial, or take other action on behalf of his client when he knows or when it is obvious that such action would serve merely to harass or maliciously injure another.

See also Committee on Prof. Ethics & Conduct v. Michelson, 345 N.W.2d 112, 117 (Iowa 1984) (attorney reprimanded for violating ethics rule by threatening criminal prosecution if debt not paid).

<sup>107</sup> Fair Debt Collection Practices Act, 15 U.S.C. § 1692d(5) (1982 & Supp. II 1984).

<sup>108</sup> I first advanced this argument for prohibiting blanket security agreements in an earlier article. Whitford, *supra* note 11, at 1112-14. The FTC rule is drafted to fit the implications of this argument. Works of art, most electronic entertainment equipment, antiques, and most jewelry are excluded from the definition of household goods. 16 C.F.R. § 444.1(i) (1986). Since these items usually have some resale value, repossession of them is of direct value to the creditor.

Similarly, another moral argument can be made by emphasizing the debtor's interests that the FTC rule protects, rather than the creditor's wrongful behavior. It is generally recognized that there are certain interests that a debtor simply cannot contract away—interests in personal integrity.<sup>109</sup> The prohibition of self-enslavement falls in this category, and many would include the prohibition of any waiver of a right to a bankruptcy discharge. Losing one's household possessions can be quite an affront to personal dignity. Perhaps society should prevent debtors from risking such a situation, no matter how clearly and intelligently a debtor perceives a blanket security agreement to be in his self-interest.<sup>110</sup>

It is important to distinguish the above moral arguments from the FTC's approach. The Commission placed great emphasis on the "psychological" leverage gained from threatening repossession under a blanket security interest on household goods. However, avoidance of the fear and anxiety produced by a threat to repossess was just another benefit of reform. When netting the benefits against the costs of reform, this fear avoidance was added to the benefit of avoiding the lost value resulting from repossession.<sup>111</sup> This approach cannot obviate the problem that there is no objective method to weigh the benefits

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<sup>109</sup> Kronman, *Paternalism and the Law of Contracts*, 92 *Yale L.J.* 763, 783-84 (1983).

<sup>110</sup> An analogy I frequently use to illustrate this perspective is the famous pound of flesh bargain in Shakespeare's *The Merchant of Venice*, Act I, Scene iii, lines 140-45:

If you repay me not on such a day,  
In such a place, such sum or sums as are  
Expressed in the condition, let the forfeit  
Be nominated for an equal pound  
Of your fair flesh, to be cut off and taken  
In what part of your body pleaseth me.

That contract was knowingly entered into, quite arguably in the self-interest of Antonio. But is there a court today that would permit foreclosure of a security interest in a pound of flesh?

<sup>111</sup> A weakness in the FTC's cost-benefit analysis is that it did not consider whether creditors will find some other way to exert psychological leverage now that nonpurchase money security interests in household goods are effectively banned. Creditors can exert leverage by threatening to inform neighbors or relatives of the alleged indebtedness, by taking a second mortgage in a home and threatening its repossession, and so forth. Before the FTC rule, some creditors apparently preferred the psychological leverage provided by a blanket security interest in household goods. This suggests that those creditors found such a security interest cheaper, more effective, or both, as compared to the substitutes I suggest. But I suspect the substitutes will be nearly as effective or cheap.

In any event, ways might be devised for protecting the debtor from these substitute threats as well. However, even before the FTC rule, the debtor could usually avoid a nonpurchase money security interest in household goods by filing for bankruptcy. See *supra* notes 97-99 and accompanying text. That there was a perceived need for further regulation implies that not all debtors availed themselves of this avenue of relief. This in turn suggests that many debtors will remain subject to other forms of psychological leverage, despite regulatory schemes limiting them, because those schemes will almost surely require debtors to take some initiative to protect themselves.

and costs of prohibiting blanket security interests, nor the objection that the FTC rule's costs are likely to be borne by a few people rather than spread widely in the tradition of social insurance. A justification of the rule on moral principles also does not avoid the unfortunate distribution of the costs of reform. It acknowledges that permitting blanket security interests in household goods may be in the debtors' collective self-interest, justifying prohibition instead on society's interest in the community's moral tone.<sup>112</sup>

## V. DEFICIENCY JUDGMENTS

When first proposed, the Credit Practices Rule included a provision that would have required a repossessing creditor to subtract the full retail value of the goods seized in calculating the outstanding debt.<sup>113</sup> The Commission did not adopt this provision.

At first glance, it might appear that the Commission's provision would have been an effective way to combat the lost value that occurs in repossession. Since creditors, when calculating the size of a deficiency, generally credit a debtor for an amount less than the wholesale value of the seized goods,<sup>114</sup> the proposed rule would have resulted in a debtor receiving a larger debt reduction as a result of repossession. However, if after adoption of the proposed rule, creditors could not have netted more from repossession and resale than they do now, the proposed rule would not have reduced the lost value associated with

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<sup>112</sup> Indeed, a case could be made for public subsidies to debtors denied credit because of an inability to grant a blanket security interest. They have, in effect, been taxed for the sake of the general moral culture of the community.

Any rationale for the prohibition of blanket security agreements must justify limitation of the prohibition to nonpurchase money security interests in household goods. Purchase money interests are not covered by the Bankruptcy Code provision invalidating security interests, so there is no need to prohibit them in order to coordinate state collection remedies and bankruptcy. Furthermore, it is generally assumed that purchase money secured creditors do actually repossess with some frequency. It cannot be said, therefore, that their threats to repossess are essentially fraudulent. It is also possible that purchase money secured creditors are better able to recoup some of the loan by disposing of repossessed collateral, since they are in the business of selling items of that kind. Hence, in threatening repossession, purchase money secured creditors are less likely to be threatening an act which will not benefit them directly, even as it harms another.

A similar analysis justifies limiting the FTC rule to household goods of little value. Creditors look to repossession of items with market value—particularly motor vehicles—as a direct way of collecting part of the debt. Threats to repossess under such security interests therefore raise fewer moral questions. Prohibition of such security interests would have a greater impact on the cost of collection, and consequently, a greater impact on the cost and availability of credit. Finally, except in rare circumstances, nonpurchase money security interests in motor vehicles remain valid in bankruptcy.

<sup>113</sup> 40 Fed. Reg. 16,347 (1975) (codified at 16 C.F.R. pt. 444) (proposed April 11, 1975).

<sup>114</sup> See White, *supra* note 14, at 403.

repossession. Goods would still have passed from a higher to a lower use, at considerable expense. But instead of the debtor absorbing all of this loss, the creditor would have been required to absorb a portion of the loss, as a consequence of being forced to credit the debtor with more than the creditor could net from repossession.<sup>115</sup>

This analysis suggests that underlying the proposal was a belief that repossessing creditors could commonly net more upon resale, yet have failed to do so, precisely because the availability of deficiency judgments removed any incentive to do so. A similar belief underlies the often-made proposal that secured creditors be forced to elect remedies.<sup>116</sup> Under this proposal, a repossessing creditor would not be entitled to any deficiency from the debtor, regardless of the amount realized from resale of the goods. Rather, the creditor could elect to waive any claim of repossession and seek to collect the entire amount due as an unsecured creditor.<sup>117</sup> The rationale usually given for such an approach is that creditors routinely sell repossessed collateral at irresponsibly low prices, as compared to prevailing wholesale market prices. This is so because effective policing of resale prices on a case-by-case basis, usually as a part of a proceeding to collect the claimed deficiency, is impractical.<sup>118</sup>

The Commission disagreed with the assumption that creditors

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<sup>115</sup> It is sometimes argued that if the repossessing creditor resells at retail, it is appropriate that the debtor receive credit for the retail price. The FTC once successfully took the position that such was required by the Federal Trade Commission Act. *Ford Motor Co. v. FTC*, 94 F.T.C. 564 (1979), vacated sub. nom., *FTC v. Francis Ford, Inc.*, 673 F.2d 1008 (9th Cir. 1982), cert. denied, 459 U.S. 999 (1983). If the creditor, not in the business of selling the collateral at retail, nonetheless makes an isolated sale of a repossessed item at or near prevailing retail prices, there is a sound argument for crediting the debtor with the price received, less the costs of resale. However, most such creditors will choose to dispose of the collateral at wholesale prices. See *Security Interests*, supra note 4, at 130-132. If the creditor is in the business of selling the collateral at retail, repossessed items will normally be resold at a retail price. Typically, however, the creditor should be required to credit the debtor only with the reasonable wholesale price of the repossessed item. This allows the creditor a reasonable profit on resale, on the theory that the creditor would have made the extra sale whether or not there had been a repossession. Either the ultimate purchaser would have purchased a different item from the creditor if no repossession had occurred, or the creditor would have stocked a different item which would have been sold to a new customer. In short, the creditor's position is analogous to the lost volume seller of sales law. See *Neri v. Retail Marine Corp.*, 30 N.Y.2d 393, 398-400, 285 N.E.2d 311, 313-15, 334 N.Y.S.2d 165, 169-70 (1972).

<sup>116</sup> E.g., Shuchman, *Profit on Default: An Archival Study of Automobile Repossession and Resale*, 22 *Stan. L. Rev.* 20, 54-56 (1969); Note, *I Can Get It For You Wholesale: The Lingering Problems of Automobile Deficiency Judgments*, 27 *Stan. L. Rev.* 1081, 1098-1103 (1975).

<sup>117</sup> Under most such proposals, it is presumed that even though the creditor chooses not to repossess in order to preserve its entitlement to the entire claim, the debtor would have the right voluntarily to surrender the collateral and receive credit for its resale value. In such circumstances, however, the creditor's right to a deficiency should be preserved. Otherwise, the creditor is not provided a true election of remedies.

<sup>118</sup> See Note, supra note 116, at 1098 n.71.

routinely sell collateral at irresponsibly low prices.<sup>119</sup> Professor Alan Schwartz has offered an extensive analysis of why the Commission's position is correct.<sup>120</sup> His basic argument is that, because only a proportion of deficiencies are ever collected, creditors have an incentive to maximize their proceeds upon resale of repossessed collateral. Schwartz interprets the data on the prices obtained at resale as basically consistent with his presumption that creditors maximize the proceeds of resale.<sup>121</sup> The data tends to show that, when repossessed cars are sold, creditors typically receive eighty percent of the wholesale value as published in trade guides.<sup>122</sup>

I agree with Schwartz that in certain circumstances the creditor has every incentive to maximize the proceeds of resale. Schwartz' analysis is deficient, however, in its failure to consider situations in which the repossessing creditor sells the collateral to a party with whom it is affiliated by common ownership or with whom it has a continuing business relationship. In such circumstances it is in the repossessing creditor's interest to sell collateral at less than the market price. For example, suppose the buyer is affiliated with the creditor by common ownership. The buyer directly benefits from prices that are below the prevailing price for goods of that kind. The seller will also be able to recoup part or all of the difference between the fair and actual prices if the deficiency proves partly or fully collectible.<sup>123</sup>

The analysis is similar if the creditor has an ongoing business relationship with the buyer of the seized goods. A low price for a repossessed good can be a substitute for a reduction in the creditor's price for other services provided the buyer. The bank will not have to absorb the full cost of this reduction, however, if it collects some or all of the deficiency claim. In effect, the debtor subsidizes some of the creditor's price reduction to favored customers. And the creditor is effectively able to reduce the price of services to a favored customer without offering the same reduction to other customers—price discrimination without its appearance.

The same data to which Schwartz refers lends credence to the hypothesis that creditors sometimes sell at very low prices for the rea-

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<sup>119</sup> Statement of Purpose, *supra* note 49, at 7783-84.

<sup>120</sup> Security Interests, *supra* note 4, at 125-39.

<sup>121</sup> *Id.* at 136-37.

<sup>122</sup> See White, *supra* note 14, at 408.

<sup>123</sup> In an interview with Jim Lattuner, Deputy Director, Legal Assistance Foundation of Chicago, I was told of a case his agency brought against a finance company that owned three separate subsidiaries whose sole business was reselling repossessed cars purchased at very advantageous prices from the parent finance company. Obviously, the subsidiaries directly benefitted from the below-market prices at which they obtained their cars for resale. The parent covered some of its losses through collectible deficiency claims.

sons indicated. It shows that, on average, the prices received by creditors for repossessed vehicles approximate eighty percent of published wholesale values, but it also reveals many sales at prices extensively below prevailing market prices.<sup>124</sup> Many of these below-market sales may reflect sales to favored buyers.

The question then becomes whether the possibility of a repossessed good being sold at a below-market price is sufficiently great to support either a complete ban on deficiency judgments or a requirement that the debtor be credited with the retail value of the collateral. Most resales of repossessed collateral are made at prices reflecting a good-faith creditor effort to maximize the proceeds of resale. Because creditors cannot sell at higher prices, they cannot compensate for losses which result from a restriction on deficiency judgments. These creditors will therefore experience an increase in collection costs, and, for reasons previously given, this increase may be reflected in higher credit costs or restricted credit availability. One likely creditor response is to increase required downpayment levels and to shorten maturities, so that the value of collateral upon repossession is likely to equal or exceed the amount of the outstanding debt, thereby eliminating the deficiency. If this occurs, it will amount to a substantial restriction in credit availability, since many consumers will not be able to afford either the increased downpayments or the higher monthly payments. Without clear evidence of resale abuse in a majority of repossessions, I am hesitant to conclude that the benefits of restricting deficiency judgments are sufficient to justify the resulting limitations on credit availability.<sup>125</sup>

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<sup>124</sup> See White, *supra* note 14, at 399-401.

<sup>125</sup> This is essentially the rationale given by the Commission for rejecting the proposed rule. Statement of Purpose, *supra* note 49, at 7744, 7784. The Commission noted that the proposed rule would establish a perverse incentive, because debtors would realize more on the collateral through repossession than in any other way.

If deficiency judgments are to continue to be available, as the FTC rule in effect provides, there remains the problem of providing a remedy for resale at unreasonably low prices. Presently, a debtor victimized by a resale at an unreasonably low price can sue the creditor for a penalty either in the amount of the finance charge plus ten percent of the principal or for actual damages. U.C.C. § 9-507(1). It is widely assumed that this private remedy is inadequate to protect against unreasonable resales. Debtors, typically ignorant of their legal rights, must somehow take the initiative to assert those rights. Proving that resale was at an unreasonably low price will often necessitate the services of an attorney, whose fees are not recoverable by the debtor under the UCC.

The deterrent effect of this private remedy could be strengthened if debtors were permitted to recover attorneys' fees together with the current penalty. Specific authorization and facilitation of class actions directed at a creditor who is systematically reselling repossessed goods at unreasonably low prices would also strengthen the effects of private remedies. In general, however, I doubt that private remedies will ever be sufficient protection for such a victimized debtor. Private remedies, except for class actions, put the burden on debtors to

Although it may be difficult to justify either a requirement that the debtor receive credit for the retail value of the collateral or a total ban on deficiency judgments, there is another argument that could justify a partial ban on deficiencies. A number of states have prohibited deficiency judgments when the amount either of the original loan or the amount due at default is below a stipulated amount, usually between one and two thousand dollars.<sup>126</sup> The typical effect is to prohibit deficiencies with respect to household goods while allowing them for most motor vehicles. The usual assumption is that household goods have little resale value. If so, a ban on deficiencies should strongly discourage repossession, as creditors instead elect to waive their rights under the security agreement and sue on the debt, essentially as unsecured creditors. Yet, it is precisely where collateral has little resale value that repossession is likely to produce the greatest lost value.<sup>127</sup> Prohibiting deficiencies for smaller loans thus creates an incentive for creditors to avoid repossession in precisely the situations in which we would most like to discourage it. At the same time, it preserves the right to repossess in those situations—bankruptcy—in which it is the only possible means of collection. Collection costs will no doubt increase nonetheless, with possible consequent effects on credit availability. But in the cost-benefit balancing that must be undertaken in shaping regulation, added to the benefit side of the equation is the avoidance of many repossessions that would cause lost value in considerable amounts. I argued earlier that this benefit is sufficient to justify regulation, even if it requires that we ignore, for

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initiate some kind of activity seeking redress, and debtors on the whole remain too ignorant of their rights and unassertive in their pursuit of them to permit private remedies to function as an effective deterrent. See Whitford, *Structuring Consumer Protection Legislation to Maximize Effectiveness*, 1981 *Wis. L. Rev.* 1018, 1026-27. Class actions, while occasionally quite effective with respect to the practices of particular creditors, are expensive, difficult-to-manage endeavors. As a result, I doubt that there will be sufficient litigation of this type to effectively deter intentional creditor malfeasance.

If private remedies are an inadequate solution to the problem of unreasonably low resales of seized collateral, the remaining alternative is more public agency policing of creditor practices. In many states, lenders of various types must be licensed, with licensees having their operations occasionally subject to examination for financial solidity. If the political will were present, it would be quite feasible for these examiners to check on lender practices in disposing of repossessed collateral as well. Systematic practices of selling at unreasonably low prices might be effectively curtailed in this way. It is unlikely, however, that these examiners could detect an occasional unreasonable sale—a sale perhaps to a friend of the creditor in a situation where it is thought highly likely that a deficiency can be collected. In these circumstances, there would seem to be no substitute for reliance on private remedies, as inadequate as they may be.

<sup>126</sup> E.g., *Ind. Code Ann.* § 24-4.5-5-103 (Burns 1982); *Mass. Gen. Laws Ann.* ch. 255B, § 20B (West Supp. 1986); *Wis. Stat. Ann.* § 425.209 (West 1977).

<sup>127</sup> This assumes there is a loose correlation, at best, between the resale value of the goods and the value to the debtor. See *supra* note 89.

paternalistic reasons, well-informed consumers' preferences for greater credit availability.<sup>128</sup>

A partial ban on deficiencies preserves this right for most motor vehicle transactions. Since cars have a ready resale value, even if deficiencies were totally banned, creditors would be unlikely to waive repossession rights in return for unsecured creditors' remedies. A total ban on deficiencies in those circumstances, therefore, would be unlikely to have a substantial effect on repossession rates, yet it would likely have a pronounced effect on the size of downpayments and the length of contracts, as creditors will strive to ensure that repossession proceeds cover the amount of outstanding debt upon default. Since, for many Americans, cars have become the only way to get to work, cars are a greater necessity than most household furniture. Consequently, a severe restriction in credit availability can be seen as especially undesirable.<sup>129</sup> The partial ban on deficiencies avoids this consequence.

### CONCLUSION

Consumer credit law has provided incentives for creditors to resort to repossession of collateral rather than wage garnishment and other forms of income execution when they seek to coercively collect a delinquent obligation. These incentives result largely from the lower cost of repossession, given the greater availability of *ex parte* and even self-help remedies. The major theme of this article has been that this incentive structure is misguided. Execution on property will result in a reduction in the use value of the goods (what I have called lost value) in a manner not necessarily associated with income execution. The indicated remedy is to reverse the incentives facing creditors, by reducing the costs of income execution and increasing the costs of repossession. In particular, I recommend abolition of *ex parte* repossession, just as *ex parte* wage garnishment was abolished fifteen years ago by the Supreme Court.<sup>130</sup> An option to redeem collateral from a security interest outside of bankruptcy should also be considered. I also recommend a partial ban on deficiency judgments,

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<sup>128</sup> See *supra* text accompanying notes 80-86.

<sup>129</sup> A perhaps unfortunate feature of the partial ban on deficiency judgments is that it uses a surrogate (the amount of the loan, etc.) in an attempt to exclude cars from the deficiency ban. The result is to ban deficiencies for only some cars, particularly low value used cars. These cars are purchased disproportionately by the poor and the predictable effect is to increase the downpayment levels the poor must pay. Whitford & Laufer, *supra* note 2, at 636-37. It might be better simply to state that deficiencies are allowed for motor vehicle credit, or at least purchase money motor vehicle credit.

<sup>130</sup> *Sniadach v. Family Fin. Corp.*, 395 U.S. 337 (1969).



in an effort to discourage repossession of objects particularly subject to lost value upon repossession.

In advancing these positions, I acknowledge, as others have argued,<sup>131</sup> that consumers could exert market power to obtain such reforms as a matter of contractual right. Their failure to do so no doubt partly reflects the lack of information that is so endemic to consumer transactions. I do not rest my arguments solely on this point, however. The restrictions on creditor remedies that I advocate could result in an increase in the cost of credit or a restriction in its availability. I would not be surprised if even well-informed consumers expressed a preference for more and cheaper credit, at the cost of greater creditor power upon default.

Even if consumers would express such a preference, it does not follow that the regulation I suggest will render the consumer credit market less efficient in the resource allocation sense. That market is already heavily distorted by legal phenomena that tend to alter the supply and demand of credit from what they would be in a perfect market. Perhaps the reforms I recommend would tend only to counteract an excessive demand for credit, stimulated by some other rule such as the availability of a discharge in bankruptcy.

The restrictions I recommend would tend to inhibit the freedom of choice of consumers, as they would, to some extent, foreclose the option of trading off protections upon default for more and cheaper credit. However, we often interfere with consumer liberty, on essentially paternalistic grounds, particularly when there is reason to believe consumers are trading long-term risk for short-term gain. For example, we do not countenance waivers of a right to petition for bankruptcy discharge. The regulations that I advocate will not offer consumers quite such extensive protection as bankruptcy, but neither are they likely to have as great an effect on the price and availability of credit as does this long-standing and accepted contractual incapacity.

In preparing this article, I have been struck by the circularity of consumer credit collection law reforms over the past four or five decades. The first reforms were directed at inhibiting income execution. Wage assignments, a popular collection device in the 1930's, were the first coercive execution mechanism to face severe regulation.<sup>132</sup> In the 1960's, wage garnishment was the object of considerable regulatory

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<sup>131</sup> See Imperfect Information, *supra* note 4, at 1415.

<sup>132</sup> See generally Fortas, Wage Assignments in Chicago—*State Street Furniture Co. v. Armour & Co.*, 42 Yale L.J. 526, 528-32 (1933) (examination of employee borrowing practices).

attention that called for its abolition.<sup>133</sup> Creditors responded to these initiatives, quite predictably in hindsight,<sup>134</sup> with greater reliance on remedies against tangible property, particularly remedies gained by making that property collateral for the loan. In this article, I am arguing, in essence, that this has been an unfortunate development, and that we should return to whence we began—coercive execution on income sources.<sup>135</sup>

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<sup>133</sup> The Consumer Credit Protection Act established federal minimum exemptions for wage garnishment and prohibited employers from dismissing an employee for garnishment with respect to any single indebtedness. Consumer Credit Protection Act, 15 U.S.C. §§ 1671-1677 (1982). Representative articles calling for abolition of wage garnishment in the 1960's are: Brunn, *Wage Garnishment in California: A Study and Recommendations*, 53 *Calif. L. Rev.* 1214 (1965); Kerr, *Wage Garnishment Should be Prohibited*, 2 *U. Mich. J.L. Ref.* 371 (1969).

<sup>134</sup> In Pennsylvania, where wage garnishment has long been abolished, creditors have relied on repossession of homes, on which liens have been obtained with the help of cognovit notes. See *Swarb v. Lennox*, 405 U.S. 191 (1972).

<sup>135</sup> One can argue that bankruptcy law's concern with facilitating chapter 13 wage-earner plans, certainly one of the primary developments in consumer bankruptcy law of the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549, (codified as amended at 11 U.S.C. §§ 101-151326 (1982 & Supp. III 1985)), is a step in this direction.

