A CRITIQUE OF THE CONSUMER CREDIT COLLECTION SYSTEM*

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TABLE OF CONTENTS

Page

I. DESCRIPTION OF THE PRESENT SYSTEM 1049
  A. *Methodology* 1049
  B. *Collection by Bargaining, Not by Execution* 1051
  C. *The Relevance of Formal Legal Remedies: Providing Creditors' Leverage* 1056
  D. *Debtors' Potential Leverages* 1060
  E. *Limitations on Debtors' Leverages* 1064
  F. *Competition Between Creditors* 1066
  G. *Summary* 1071
II. COMPREHENSIVE CRITIQUES: PROPOSED RADICAL SOLUTIONS 1072
  A. *The Free Market Solution* 1073
  B. *Abolishing Coercive Execution* 1081
III. PARTIAL CRITIQUES 1086
  A. *Failure to Preserve Defenses* 1086
  B. *Inefficiencies in Execution* 1096
    1. TECHNICAL COURT PROCEDURES 1096
    2. SECONDARY COSTS OF COERCIVE REMEDIES 1097
    3. INCENTIVES TO CHOOSE AN INEFFICIENT REMEDY . 1098
    4. BANKRUPTCY AND EXEMPTION STATUTES 1100
  C. *Too Little Bargaining: Too Much Execution* 1106
  D. *The Informal Processes* 1109
IV. REFORMING THE SYSTEM 1116
  A. *Encouraging More Informal Bargaining and Settlement* 1117
    1. MEDIATION 1118
    2. CHANGING THE PRIORITY RULES 1121
    3. CREATING COST BARRIERS TO EXECUTION 1123
    4. MAKING EXECUTION LESS EFFECTIVE 1126

* Financial support for this study was provided by the Institute for Research on Poverty, University of Wisconsin, from funds made available by the Department of Health, Education and Welfare. I received helpful comments on earlier drafts from Professor George Wallace of Rutgers-Camden Law School and Professor Stewart Macaulay and David Trubek of the University of Wisconsin Law School. I am grateful for research assistance in the preparation of this article from Mr. Charles Grau, J.D., University of Wisconsin, 1977.

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5. REGULATING INFORMAL SETTLEMENT 1127
6. SUMMARY 1128
B. *Reducing the Costs of Execution* 1128
1. THE UNEASY CASE FOR INCOME EXECUTION 1129
2. THE PROBLEM OF SECURITY INTERESTS 1135
3. WAGE ASSIGNMENTS 1138
4. BANKRUPTCY 1140
V. CONCLUDING REMARKS 1141

In this article I offer a critique of the consumer credit collection system—that is, of the laws and practices that constitute the relationship between a creditor and a consumer debtor once a missed payment occurs.[1] The fundamental descriptive thesis of this article is that most creditor collection of delinquent consumer debts results from "voluntary" debtor payments, commonly made after some bargaining between creditor and debtor.[2] Moreover, I contend that bargaining ought to continue to dominate our collection system. In the course of the article, I will develop recommendations that I believe will increase the role of bargaining, while also making both the processes of bargaining and bargaining outcomes more efficient and socially desirable. Though I see bargaining as central to the consumer credit collection system, nonetheless I believe that a creditor's legal remedies—ones that permit a forcible transfer of assets from debtor to creditor, henceforth called "coercive execution"[3]—play an important role in determining the volume and outcomes of bargaining. Consequently, a continuing emphasis in this article will be on the interrelationship between formal legal rules and court processes on the one hand and informal norms and bar-

1. Law and practices pertaining to the formation of credit relationships, such as truth-in-lending, are considered only to the extent they impact significantly on collection behavior.

2. I consider in this article only obligations that have become overdue or "delinquent." Only a relatively small percentage of total outstanding consumer obligations ever fall into this category, thereby presenting a "collection" problem. Though the existence of legal remedies for the unpaid creditor no doubt partly accounts for the general debtor practice of making timely payments, it is my belief that both debtors' moral feelings and debtors' desires to preserve credit ratings are mostly responsible. Thus, even if legal remedies for collection were totally abolished, the impact on delinquency rates would probably be modest. *See generally* text accompanying notes 118-39 *infra*. For this reason, this article mostly ignores the impact of the collection process on delinquency rates.

3. By "coercive execution," or just "execution," I mean legally valid transfers of value to the creditor that occur without the debtor's consent—for example, when the sheriff seizes the debtor's property pursuant to a writ of execution, when the debtor's employer pays a portion of wages owed the debtor to the creditor pursuant to a writ of garnishment, or when the creditor under a security interest forcibly but legally repossesses property of the debtor by self help. Payment of a court judgment, even in the face of a threat of wage garnishment, will be denominated "voluntary" or "consensual"—*i.e.*, the outcome of bargaining.

gaining processes on the other.

The first section of this article sets forth the principal legal rules and practices pertaining to the consumer credit collection system. In this first section I demonstrate why the debtor-creditor relationship can be described as part of a bargaining system. In the second section, I provide two critiques of the consumer credit collection system, both of which propose relatively radical restructuring of the present system. Though I conclude that on the basis of available data it is impossible to reject completely either proposed reform, as a matter of political reality it is unlikely either could be adopted. In the third section, I present a series of critiques that focus only on particular features of the system rather than on the system as a whole. These partial critiques are premised principally on what I regard as centrist values, ones firmly imbedded in the mainstream of American politics and legal thought. The concept of allocative efficiency plays an important, but not exclusive role in these partial critiques. Finally, in the fourth section I respond to the partial critiques by advocating those reforms I believe will best remedy the problems of the present consumer credit collection system.

I. Description of the Present System

A. *Methodology*

This description presumes that consumer credit problems can be usefully conceptualized as part of a single system.[4] The reasonableness of this presumption is neither intuitively obvious nor justifiable *a priori*. Both creditors and delinquent consumer debtors come in widely diverging types (*e.g.*, banks, finance companies, plumbers, nice people, nasty people, and so forth) and behave in widely varying ways. The law has nonetheless long assumed that it is func-

4. There is obviously insufficient data to verify all aspects of a comprehensive description of the consumer credit collection system. Where possible, I take account of available empirical information, and in one instance I conducted new empirical research in the preparation of this article. *See* note 10 *infra*. To a considerable extent, however, this description rests on my impressions and intuitions gained through numerous conversations with creditors, collection agents, debtors and attorneys participating in the system. These conversations frequently were undertaken in preparation for the many courses I have taught in this area and in researching for this and other articles. *See, e.g.*, Whitford, *The Functions of Disclosure Regulation in Consumer Transactions*, 1973 WIS. L. REV. 400 [hereinafter cited as Whitford, *Disclosure Regulation in Consumer Transactions*]; Whitford & Laufer, *The Impact of Denying Self-Help Repossession of Automobiles: A Case Study of the Wisconsin Consumer Act*, 1975 WIS. L. REV. 607 [hereinafter cited as Whitford & Laufer, *Wisconsin Consumer Act*].

It should be noted that my perceptions about the consumer credit collection system—particularly my emphasis on bargaining as the central phenomenon of the system—are shared by other authors. *See* Leff, *Injury, Ignorance and Spite—The Dynamics of Coercive Collection*, 80 YALE L.J. 1 (1970) [hereinafter cited as Leff, *Coercive Collection*].

tional to generalize across these differences, by providing a single set of rules to govern all collection problems. I continue the tradition basically because it permits me, in the final section of this article, to draw useful conclusions about collection law. The validity of the generalizing approach is also supported by the following two observations.

Collection agencies to a great extent equalize the collection tactics available to creditors of different types. Because of economies of scale, creditors who regularly attempt to collect a large volume of delinquent accounts can use collection techniques practically unavailable to creditors, acting on their own, who have few collection problems. Moreover, creditors who desire to do business in the future with their delinquent debtors or who are concerned with their own reputation in the community are obviously more inhibited in their collection behavior than other creditors. Collection agencies serve primarily those creditors whose size, or concern about reputation or future business dealings, prevent them from adopting the most efficient collection techniques.[5] Collection agencies both deal with delinquent debtors in very large volumes, and are relatively unconcerned with preserving the good will of debtors from whom they are trying to collect. Consequently, they can behave much like large creditors uninhibited in their collection behavior. This equalization of small and large creditor behavior via small creditor use of collection agencies lessens the strength of an objection to a general description of the collection system on the ground that creditors come in many different sizes with different market strategies.[6]

The second observation concerns the diversity of legal regulation of credit collection practices among the states. If one accepts my characterization of the consumer credit collection system as primarily a bargaining system, however, legal diversity is not a bar to general description or analysis. The predominant role of legal regulation in this bargaining system is to affect bargaining leverages, and therefore bargaining outcomes.[7] Legal regulation has not,

5. *See, e.g.*, E. BARNES, BARNES ON CREDIT AND COLLECTION 155-78 (1961). As an illustration of this point, it is well known tbat medical debts are among those most frequently referred to collection agencies, largely because doctors generally do not have the debt volume to permit efficient collection and also because they fear that tough collection practices will interfere with patient relationships. Medical accounts are also a highly desired form of collection agency business because these accounts are likely to be less "worked" before referral. As a consequence, the agency, which is paid on a contingency basis, can expect to collect on a relatively high percentage of medical referrals.

6. Throughout the article I will use the term creditor even though in many instances a collection agency will be acting on behalf of tbe creditor.

7. *See* text accompanying notes 33-50 *infra*.

and I suspect could not, change the fundamental character of the consumer credit collection system as a bargaining system.

B. Collection by Bargaining, Not by Execution

The single most important fact about the consumer credit collection system is that, of the delinquent debts that are ultimately paid, the vast majority are collected through "consensual" debtor payments made after some kind of bargaining between creditor and debtor, and on occasion between the debtor's various creditors as well. Only a small percentage of delinquent debts are ever paid as the direct result of coercive execution. One important reason for this is that the most common cause for delinquency (at least delinquency of more than a few days) is temporary interruption of disposable income, usually due to unemployment or unanticipated major expense, often medical.[8] Because many, perhaps most, delinquent debtors feel an ethical obligation to resume payments once available resources permit, when this interruption ceases, payments often resume even in the absence of any creditor action.

Even when creditors take affirmative collection action, consensual payments overwhelm the proceeds of coercive execution.[9] For example, over the years there have been studies of creditor use of wage garnishment, in most jurisdictions the most common form of execution initiated by creditors. These studies indicate that even in those cases in which the creditor actually initiated garnishment proceedings, the most common outcome was still a settlement involving a consensual debtor-creditor payment schedule. Often the settlement was not reached until after one or two paychecks had been garnished (that is, until after one or two coercive payments to the creditor), but it has always been rare for a sizeable delinquency to be collected in full through garnishment.[10]

8. D. CAPLOVITZ, CONSUMERS IN TROUBLE 57-70 (1974); V NATIONAL COMMISSION ON CONSUMER FINANCE, TECHNICAL STUDIES 6-9 (1973).

9. Caplovitz, for example, estimated that about two-thirds of his sample of delinquent debtors—against all of whom a judgment had been obtained—had made at least partial payments within 4 to 6 months of the judgment. Almost all of these payments were "consensual," rather than the results of coercive execution. CAPLOVITZ, *supra* note 8, at 246-47.

10. *See, e.g., id.* at 245-50; H. JACOB, DEBTORS IN COURT 100-01 (1969); RAPSON, THE DANE COUNTY SMALL CLAIMS COURT 28-29 (1960) (unpublished Ph.D. thesis in University of Wisconsin Library). Rapson concludes "garnishments are more a means of persuasion than an actual collection procedure." *Id.* at 29.

In the preparation of this article I tested whether Rapson's conclusions continued to apply in the Small Claims Court of Dane County, Wisconsin, where he conducted his study. Garnishment procedure has changed substantially since 1960. Most importantly, debtor exemptions in wage garnishment are much higher now, and pre-judgment garnishment has been abolished. I was particularly concerned whether the latter change, which has the effect of

making garnishment a more expensive form of execution, changed the uses made of garnishment procedure. With one substantial modification, however, my results verify the continued validity of Rapson's conclusions.

To conduct the test, initially I selected, by a reasonably random procedure, 100 garnishment cases initiated in 1975. Garnishment proceedings in which a bank or the state was the garnishee were excluded, the former on the ground that in all probability they were not wage garnishment proceedings, and the latter because Wisconsin has an unusual procedure for garnisheeing the wages of public employees. *See* WIS. STAT. § 812.23 (1977). After selecting the 100 cases, I then searched the files to determine whether other garnishment proceedings had been initiated with respect to the same judgment. I concluded that if only a single or very few garnishments were brought with respect to a judgment, it would be an indication that garnishment was being used principally as a means of persuasion, since it is virtually impossible to collect very much in a single garnishment. The results of this study were as follows:

No. of Garnishments per Judgment		No. of Cases
1		73
2-3		23
4 or more		4
	Total	100

Though the above table appears to support Rapson's conclusion, further study of the garnishment files forced one significant qualification. The files frequently indicated the amount collected by wage garnishment as well as the size of underlying judgment, permitting a determination of whether a judgment had been substantially collected through garnishment. When a judgment was not substantially collected by garnishment, the files sometimes contained notations such as "settled" or "judgment satisfied," suggesting that the parties had negotiated an accord and satisfaction. On the basis of the files that contained this information, I could classify 69 of the 100 sample cases as: (1) "settled," meaning that less than 25 percent of the outstanding judgment had been collected by garnishment and there was indication in the files that an accord and satisfaction had been negotiated (*e.g.*, the notation "judgment satisfied" appeared); (2) "partially settled," meaning that between 25 and 75 percent of the outstanding judgment had been collected by garnishment and the files indicated an accord and satisfaction had been reached; and (3) "collected," meaning that over 75 percent of the outstanding judgment had been collected by garnishment. After classifying the 69 cases in this manner, I further classified them according to whether the amount of the outstanding judgment exceeded $100. I did this because I suspected that collection by garnishment was more likely in situations where it was more feasible because the judgment was small. The results were as follows:

Amount of Judgment	Number	Settled	Partially settled	Collected
$100 or less	40	11	6	23
Over $100	29	16	8	5
Totals	69	27	14	28

From this table it appears that where judgments are small, garnishment is often used as a direct means of collection, no doubt because collection in this way is not difficult. Of the 23 cases in which a judgment of $100 or less was substantially collected, 18 were collected in a single garnishment. Though this conclusion represents a substantial modification of the Rapson conclusion, it does not fundamentally undercut the basic conclusion that garnishment is used primarily as a means of persuasion, at least with respect to more substantial debts. *See also* CAPLOVITZ, *supra* note 8, at 250. The principal exception in the Caplovitz study is New York, where continuous garnishment is available. *See* text accompanying notes 327-29 *infra*.

It should not be surprising that bargaining and consensual payments characterize the consumer credit collection system. As Professor Arthur Leff has convincingly demonstrated, if it is certain that a lack of consensual payment will be followed by a successful coercive execution, there is also a range of possible settlements, consisting of consensual debtor payments, that will simultaneously benefit the creditor more and hurt the debtor less than coercive execution.[11] This is true basically because coercive execution has many substantial costs that can be avoided by voluntary settlement. One of the most important and obvious of the avoidable costs of coercive execution is simply the necessity of using courts and sheriffs.[12]

If a debt is unsecured,[13] a creditor must often obtain a judgment before invoking coercive execution.[14] Although this is often not difficult, as most debtors will not contest liability,[15] it remains an expense. After judgment, before a sheriff can be expected to levy, a creditor must first locate some non-exempt, unencumbered property belonging to the debtor.[16] If such property is found in the debtor's possession, a writ of execution must be obtained by the creditor, the sheriff must be persuaded to levy on the property, and an execution sale must be arranged.

Execution sales typically must comply with detailed statutory procedures, and at least partly for this reason the prices obtained

11. Leff, *Coercive Collection*, *supra* note 4, at 5-18. As Leff also details, a principal exception to the proposition in the text occurs when one of the benefits desired by the creditor or debtor is "spite"—tbe satisfaction that sometimes comes from hurting another. Where spite is valued, a creditor (or debtor) might opt for coercive execution rather than voluntary payment precisely because such action will hurt the other party more, even while otherwise netting the opting party less. *Id.* at 18-19.

12. In using this example, I will describe costs that impact initially only on the creditor, although often some or all of these costs can be transferred to the debtor. *See* text accompanying notes 23-24 *infra.*

13. The following description of execution procedures may be too abbreviated for the uninitiated. For a general introduction to execution procedures, see D. EPSTEIN, DEBTOR-CREDITOR LAW IN A NUTSHELL (1973).

14. A numher of Supreme Court decisions in the past 10 years have curtailed the availability of pre-judgment creditor remedies. The more recent decisions, however, appear not to preclude pre-judgment remedies in most circumstances, providing those remedies satisfy some reasonably rigorous procedural guidelines. *See, e.g.*, North Georgia Finishing, Inc. v. Di-Chem., Inc., 419 U.S. 601 (1975).

15. *See generally* CAPLOVITZ, *supra* note 8.

16. Most state statutes suggest that once a writ is delivered to a sheriff, the latter will search for leviable property. However, it is well known that today it is the creditor who must find the property and lead the sheriff to it. *See, e.g.*, Distler & Schubin, *Enforcement Priorities and Liens: The New York Judgment Creditor's Rights in Personal Property*, 60 COLUM. L. REV. 458, 467 (1960). Various discovery procedures are available to aid the creditor in this research. The most freuqently used is the supplemental proceeding. *Id.*

at these sales are notoriously low.[17] Largely for this reason, creditors usually favor garnishment of money (typically wages) owed to a debtor by a third party.[18] Garnishment of a money debt does not require an execution sale; the money owed to the debtor will simply be paid to the creditor. As a consequence, garnishment of money debts has the important advantage of accruing to the benefit of the creditor most of the loss realized by the debtor.[19] In contrast, in property execution much of the loss to the debtor is dissipated in the low price obtained at the execution sale. Garnishment, however, requires the initiation of an additional legal action after judgment is obtained against the debtor, this one against the person owing money to the debtor. Moreover, if the money debt subject to garnishment is wages, as it usually is in jurisdictions that permit wage garnishment, a substantial part will be exempt, oftentimes requiring several garnishments to obtain full collection of a substantial debt.[20] In most jurisdictions each garnishment requires the initiation of a separate legal action.[21]

The monetary costs of the various coercive execution actions are typically not substantial in absolute terms, as frequently the debtor defaults.[22] But because the recovery per execution is often small, in a relative sense the costs can be significant. In earlier times creditors customarily included a term in the credit contract providing that the debtor was to compensate the creditor for collection costs, including attorney fees. The amount specified was often in an amount in excess of the creditor's actual costs. Such a contractual provision in no way lessened the incentive for settlement. It only meant that, for a debtor facing the certainty of coercive execution, a settlement at an amount in excess of the debt owed was in the

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17. *See* EPSTEIN, *supra* note 13, at 50-51.

18. Though garnishment is the usual procedure for seizing wages for payment of debt, in a few states another form of action (for example, trustee process) must be used to obtain a similar result. *See* S. RIESENFELD, CREDITORS' REMEDIES AND DEBTORS' PROTECTION 208-10 (1975). There are types of debts owed to the judgment debtor that cannot be reached by garnishment, with the law in this respect varying widely between jurisdictions. In most jurisdictions, for instance, unliquidated tort claims cannot be reached by garnishment. Only Pennsylvania and Texas preclude garnishment of wages entirely. *Id.* at 228-29.

19. Court costs, varying in amount according to jurisdiction, will be assessed against the debtor. As these increase, the statement in the text becomes less accurate, but it remains generally true that garnishment is more "efficient" than most property execution.

20. *See* note 10 *supra*.

21. A few jurisdictions permit what I call "continuous garnishment," whereby the debtor's employer is directed to deduct and pay to the creditor regular amounts each pay period until the debt is settled. *See* notes 327-29 *infra* and accompanying text.

22. It is also worth noting that states heavily subsidize the use of courts and sheriffs by not passing on to the parties through fees the full cost of providing those services. If states were to increase fees and reduce the extent of the subsidy, the incentives for voluntary settlement would be greater.

debtor's interest (and usually in the creditor's interest as well).[23] Now, however, an increasing number of states are prohibiting or limiting the transfer of collection costs to debtors.[24] As they do so, it tends to make a settlement at an amount somewhat less than the amount owed mutually attractive to both creditor and debtor.

There are reasons other than the avoidance of unnecessary costs for the dominance of bargaining and voluntary payment in the consumer credit collection system. A risk inherent in almost all litigation is that one party will net nothing by losing the case entirely. For the creditor in consumer credit collection, this risk takes the form either that the debtor will be judgment proof or that the creditor will be judged not to own a valid debt. The creditor can avoid the risk that the debt may be declared invalid by obtaining voluntary debtor payment. Moreover, when the debtor is judgment proof, it does not usually mean that he or she is assetless, but rather that available assets are exempt or encumbered. Nothing in the exemption laws, however, prevents the debtor from making a voluntary payment from otherwise exempt assets. Alternatively, a judgment proof debtor can attempt to borrow from a friend or relative, or to obtain a consolidation loan from a finance company, in order to settle a debt. These sources of payment cannot be reached directly by a creditor through coercive execution, of course, and hence create additional incentives to the creditor for voluntary settlement.[25]

The analysis so far has concerned the collection of unsecured debts. Because of the availability of repossession, coercive execution for a secured debt can involve fewer avoidable, and essentially wasted, costs. The inapplicability of exemption statutes to secured credit means the secured creditor bears little risk that there will be no property reachable coercively. Moreover, private sales of repossessed collateral are usually permitted,[26] whereas public auctions are the generally required form of execution sales. Although the private sale of secured collateral frequently nets less than market price,[27] the prices obtained are generally more adequate than those obtained at forced public auctions.[28] Nonetheless, where the collat-

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23. *See* Leff, *Coercive Collection, supra* note 4.

24. *See, e.g.*, UNIFORM CONSUMER CREDIT CODE § 2.413 (West 1968); WIS. STAT. § 422.411 (1977).

25. The availability of exempt and other assets only through voluntary settlement creates incentives for settlement even wbere a debtor is not judgment proof, since they may facilitate quicker payment than would be possible through coercive execution.

26. *See* UNIFORM COMMERCIAL CODE § 9-504 (1972 version) [hereinafter cited as U.C.C.].

27. *See* Shuchman, *Profit on Default: An Archival Study of Automobile Repossession and Resale*, 22 STAN. L. REV. 20 (1969).

28. *See* U.C.C. § 9-504, Comment 1 (1972 version). The text's general statement is

eral is a consumer good other than an automobile, repossession remains a highly inefficient collection device. The market price of most used consumer goods is quite low, generally considerably less than the amount outstanding at the time of the debtor's default. The balance (the deficiency) will be an unsecured debt, and the appropriate coercive collection techniques will be those already described.[29] Thus, the creditor will have gained relatively little by execution and yet will have sacrificed the ability to threaten repossession to collect the major portion of the debt. It is in this circumstance that a settlement agreement typically will produce an outcome more satisfactory to both debtor and creditor.

When collateral is a motor vehicle, the situation differs in two important respects. First, a well established market exists for used vehicles and the amounts obtained upon sale are often substantial.[30] Also, in most jurisdictions, repossession of motor vehicles can typically be accomplished by self help, without the necessity of using an attorney or incurring many other collection costs.[31] There are still costs of coercive execution, of course, and to avoid them bargaining and voluntary payment still predominate in the collection of automobile credit. But because these avoidable costs are less than in other areas of consumer credit collection, the repossession and sale of automobiles and other vehicles subject to a security interest is the most common form of collection by coercive execution.[32]

C. *The Relevance of Formal Legal Remedies: Providing Creditor's Leverage*

Given present ethical attitudes, many, perhaps most, delinquent debtors would resume payments even if there were no possibility of coercive execution and no creditor reaction to delinquency.[33] Few creditors are willing, however, to rely solely on debtors' ethical commitments to pay debts when able. At a minimum, creditors can reinforce debtors' moral sentiments by contacting

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particularly true with respect to the type of public auctions required by statutes governing execution sales.

29. *See* text accompanying notes 13-25 *supra.*

30. Even so, the amount recovered through repossession typically is less than the amount owing. *See* Johnson, *Denial of Self-Help Repossession: An Economic Analysis,* 47 S. CAL. L. REV. 82, 103 (1973).

31. U.C.C. § 9-503 (1972 version).

32. *See* CAPLOVITZ, *supra* note 8, at 183-85. This conclusion is also supported by the evidence that wage garnishment, in most jurisdictions the other common form of coercive execution, is used predominately as a means of persuasion rather than collection. *See* note 10 *supra.*

33. *See* text accompanying notes 8-9 *supra.*

them informally and reminding them of their obligation.[34] In a number of situations, however, moral sentiments fail to ensure payment. First, some debtors, a sizable number in the view of many creditors, lack a substantial moral commitment to pay, even though they could—the so-called "won't pays," or "deadbeats."[35] Second, a debtor in financial difficulty invariably has many demands on his or her scarce monetary resources. A creditor relying solely on a debtor's moral sentiments to stimulate payment may find the debt ranks low on the debtor's list of priorities. Finally, sometimes debtors fail to make payments because they believe the money is not truly owed—for example, because they believe the quality of the goods or services received was less than promised. In this case, it is obvious the creditor cannot rely solely on moral sentiments to induce payment.

There are ways to persuade reluctant debtors to make voluntary payments that do not depend on the availability of coercive execution. Probably the most frequently used method is the threat to damage the debtor's credit rating.[36] It is also well known that many creditors have developed "harrassment" into an effective collection tool—for example, threatening the embarrassment of contacting the debtor's neighbors, or the annoyance of frequent telephone calls at inconvenient hours. An objective of each activity, of course, is to convince the debtor that substantial costs will be avoided by "voluntary" payment of the debt. If convinced, the debtor can either advance the priority assigned to a particular debt or draw on previously untapped financial resources.[37]

Formal legal collection remedies provide creditors with other ways of persuading debtors that substantial harms can be avoided

34. Thus, the initial contact with a debtor will likely be phrased in very polite language, suggesting perhaps that the debtor may have forgotten to pay, as is commonly the case.

A common outcome of informal collection attempts is a refinancing agreement whereby the debtor is allowed to make payments, perhaps in smaller amounts, over a longer period of time. Although refinancing agreements can have many purposes, one purpose is to reinforce the debtor's moral sentiments. The debtor makes a new promise to pay, while also affirming that the new payment schedule is realistically within his or her means. Many consumers find it highly embarrassing not to make the payments stipulated in a refinancing agreement, especially in the first few weeks.

35. *See generally* Leff, *Coercive Collection, supra* note 4.

36. For this reason collection agencies have been in the forefront of those who have sought to persuade consumers to consider a credit rating as a valuable property right. Thus, a sampling of dunning notices will likely uncover such messages as: "Protect Your Credit Rating!" In opposing any strengthening of the Fair Credit Reporting Act, however, the credit industry has resisted the position that a consumer's credit rating is such an important property right that it is entitled to due process protection. *See* note 134 *infra*.

37. Some of these sources include borrowing from a close friend or relative, surrendering or borrowing on a life insurance policy, or arranging a consolidation loan.

by payment of the debt. If a debtor can be convinced that upon refusal to make voluntary payment the creditor will collect through coercive execution, for reasons already explained it should become clear to the debtor that it is in his or her best interest to make the voluntary payment. Where a debtor can foresee, however, that a coercive execution would yield, as is typically the case, a very low return, a creditor may have difficulty persuading the debtor of the inevitability of collection by execution. Perhaps for this reason, the primary or most important effect of collection remedies is slightly different; they enable the creditor credibly to convince the debtor that initiation of coercive execution will necessarily or very likely ensue upon lack of voluntary payment, and whether or not such execution would benefit the creditor directly, it would probably cause the debtor serious harm. For reasons to be explained, the creditor does not face substantial credibility problems in conveying this message, and if the debtor is convinced, some kind of settlement will appear attractive as a means of avoiding the harm.[38]

There are several ways in which initiation of coercive execution can cause the debtor substantial harm.[39] A debtor whose wages are garnished runs a substantial risk of dismissal by his or her employer. The risk exists largely because a debtor's employer is forced to bear much of the cost of garnishment. For little or no compensation[40] the employer must revise the payroll, frequently on very short notice, to provide for the deduction of the appropriate amount from the debtor's paycheck and for payment of it to the court. It has been estimated that this process can cost the typical employer $25 or more per garnishment.[41] Moreover, many employers apparently believe that debtors who are garnished are often less productive than other employees.[42] By dismissing a garnished employee, an em-

38. This point and the following paragraphs are explained and defended more fully in Leff, *Coercive Collection*, *supra* note 4.

39. I noted earlier that a creditor's court costs and attorney fees often can be transferred to the debtor. *See* text accompanying notes 22-24 *supra*. Even if the creditor is unable to collect anything by coercive execution, the transferred costs will increase the size of the debtor's future obligation.

40. The amount varies between jurisdictions. In Wisconsin it is 3 dollars. WIS. STAT. § 812.06 (1977).

41. *See* CAPLOVITZ, *supra* note 8, at 237 n.10; Kerr, *Wage Garnishment Should be Prohibited*, 2 PROSPECTUS 371, 381 (1969).

42. Apparently these beliefs are not always without basis. During the 1975 season Willie Davis stopped playing briefly for the St. Louis Cardinals baseball team because his former wife had garnisheed his salary in order to collect back alimony. Davis did not care to "work" if the benefits were to be reaped by his ex-wife. When the garnishment order was removed, Davis resumed play. *N.Y. Times*, Aug. 19, 1975, § 1, at 26, col. 7.

Another reason some employers react adversely to garnishment stems from a paternalistic acceptance of responsibility for the actions of their employees and a belief that non-

ployer can both avoid future garnishments of a debtor-employee known to be debt prone and perhaps deter other employees from incurring debt difficulties likely to lead to garnishment.[43]

It is now a violation of federal law for an employer to dismiss an employee for wage garnishment in connection with a single indebtedness.[44] In many jurisdictions the state-imposed restrictions on dismissal are stronger.[45] These laws prohibit dismissal where the employer's only motive for dismissal is garnishment, however; nothing prohibits an employer from dismissing a garnished employee for some other reason. Enforcement of such laws requires, therefore, a difficult factual inquiry into the employer's motive, and consequently there is considerable doubt about the extent of compliance.[46] Moreover, no legal obstacle exists to prevent an employer from taking other action adverse to the interests of a garnished employee—such as refusal to promote or to schedule overtime—for the stated purpose of discouraging the particular employee from behavior leading to further garnishments and of deterring like behavior by other employees. Whether or not employers are in fact dismissing or subjecting debtors to other adverse action for garnishment, it seems likely that many debtors fear that such results might occur as a result of garnishment. This fear alone makes the threat

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payment of debts is immoral. *See* Project, *Wage Garnishment in Washington—An Empirical Study*, 43 WASH. L. REV. 743, 756 n.78 (1968) [hereinafter cited as Project, *Wage Garnishment in Washington*].

43. One of the more pernicious aspects of wage garnishment is that it is the easily replaceable employee—typically a low income worker—who is most likely to be dismissed for garnishment. *See* Leff, *Coercive Collection, supra* note 4, at 16-17.

Even though dismissals due to wage garnishment clearly do occur, reliable estimates of their frequency are rare. Nineteen percent of the respondents to the Caplovitz survey who had wages garnished reported loss of job as a result. CAPLOVITZ, *supra* note 8, at 238-39. I suspect this estimate is high, with many respondents losing their jobs for other reasons while blaming it on garnishment. Another study reports only seven percent of the granished debtors surveyed reporting job loss as a consequence. JACOB, *supra* note 10, at 104. Both surveys were taken before the effective date of the Consumer Credit Protection Act. *See* text accompanying notes 44-47 *infra*. *See also* Brunn, *Wage Garnishment in California: A Study and Recommendations*, 53 CALIF. L. REV. 1214, 1229-1333 (1965); Project, *Wage Garnishment in Washington, supra* note 42, at 756-59.

44. Consumer Credit Protection Act, Title III, 15 U.S.C.A. § 1671-1677 (1974).

45. *See, e.g.*, N.Y. CIV. PRAC. LAW § 5252 (McKinney 1977); WIS. STAT. § 425.110 (1977). It has also been held that a policy of dismissal for garnishment violates Title VII of the Civil Rights Act, since such dismissals impact disproportionately on minorities. Employers typically cannot establish the requisite correlation between job performance and absence of garnishment. *See* Johnson v. Pike Corp. of Am., 332 F. Supp. 490 (C.D. Cal. 1971).

46. Another impediment to enforcement has been general uncertainty about the availability of private remedies, and particularly the remedy of reinstatement. *See* Comment, *Restrictions on Garnishment and Their Enforcement: Focus on Judicial Implication of a Private Remedy*, 23 KAN. L. REV. 729 (1975); Note, *The Implication of a Private Cause of Action Under Title III of the Consumer Credit Protection Act*, 47 S. CAL. L. REV. 383 (1974).

of garnishment a potent collection device.[47]

Property execution, the other principal form of coercive execution, not only deprives a debtor of the property seized, but the value of the lost property to him or her is nearly always far in excess of the amount of debt retired by the execution. This "lost value" phenomenon is a result both of the inadequate prices typically obtained at execution sales and of the undeveloped state of most used goods markets. Moreover, the value of a used good tends to be higher to a present owner than to a potential buyer because the owner is familiar with the good's peculiarities and can generally be more certain about its future performance.[48] Because a deficiency action remains available in most jurisdictions,[49] in both secured and unsecured transactions the debtor may bear the entire loss represented by the difference in the value of property to the debtor and the price realized upon sale. Consequently, a credible threat of property execution has tremendous potential to persuade debtors to make "consensual" payments in order to avoid more serious harm.[50]

D. *Debtors' Potential Leverages*

If debtors had no countervailing leverages, execution remedies would seemingly provide creditors sufficient leverage to persuade

47. Employee-debtor fear of garnishment underlies the historically popular collection tactic of informing a debtor's employer of the delinquency, or threatening to do so. There are now various federal and state restrictions on such contacts. *See, e.g.*, 15 U.S.C.A. § 1692C(b) (Supp. 1979). Such restrictions, however, are easily avoided. A common example is for an agent to telephone a debtor at work and to leave the name of a collection agency for a return call.

48. *See* Leff, *Coercive Collection*, *supra* note 4, at 12-14.

49. An action for a deficiency is a suit for the amount remaining unpaid after the net proceeds of property execution (including repossession) are applied to the original outstanding obligation. An obligation to pay a deficiency will invariably be an unsecured one, even if the original obligation was secured, inasmuch as the collateral will already have been repossessed.

A secured creditor's right to deficiency after repossession is now limited to special circumstances in many jurisdictions. *See, e.g.*, WIS. STAT. § 425.209 (1977). An unsecured creditor always has a right to a deficiency if property execution fails fully to satisfy the judgment, however.

50. The effectiveness of property execution is illustrated by the type of "add-on" clause involved in the famous case of William v. Walker-Thomas Furniture Co., 350 F.2d 445 (D.C. Cir. 1965). The creditor in that case retained a security interest in a wide variety of household goods, including such minor items as a used shower curtain. It seems clear that many of the items secured would have yielded little to the creditor upon execution, see note 209 *infra*, but the ability to threaten to deprive the debtor of them gave the creditor a very effective collection method. The replacement cost to the debtor would have been substantial, of course.

The Caplovitz survey also supports the conclusion that the availability of property execution at least partially induces consensual payments. Caplovitz found creditors were at least as successful in collecting in Pennsylvania, a state prohibiting wage garnishment, as in other jurisdictions. CAPLOVITZ, *supra* note 8, at 265-66.

almost any debtor able to make "voluntary" payments to do so — and on terms favorable to the creditor. The only debtors likely to avoid payment would be those who had no choice but to accept any harm inflicted by creditors because they simply, in the language of creditors, were "can't pays." Moreover, a creditor is unlikely to invest resources in collection if the creditor knows in advance that the debtor is a "can't pay."[51]

Debtors are not without their leverages, however. Perhaps most obviously, there are informal sanctions a debtor can impose on a creditor who insists too strenuously on payment. If the creditor desires the debtor's future patronage, the threat to deprive the creditor of such patronage is typically effective. However, few consumers with collection problems are fortunate enough to be so needed. Alternatively, a debtor can threaten to damage the creditor's reputation with other potential customers. Such threats, and even the possibility of such threats, are not without their effects on the collection process; in fact, they partly account for the presence of collection agencies.[52] But efficient means for a debtor to communicate broadly with a creditor's future customers do not usually exist.[53] Since creditors know this, a threat to ruin a creditor's reputation has only limited leverage value.

The debtor can also simply refuse to do anything, forcing the creditor to use formal methods of execution if it is to collect anything. If the creditor will actually initiate formal execution, this course is ordinarily fruitless for the debtor.[54] But in initiating formal execution the creditor risks that assets sufficient to cover its costs of execution cannot be reached. As a consequence, many creditors routinely do not extend the collection process as far as formal execu-

51. It is not costless to a creditor to determine whether a debtor is a "won't pay" or a "can't pay," and as a consequence creditors will sometimes fruitlessly harrass or sue a "can't pay" because it is cheaper than determining the debtor's true status. *See* Rock, *Observations on Debt Collection*, 19 BRIT. J. SOC. 176 (1968).

52. *See* text accompanying note 6 *supra*.

53. Whatever the intention of their creators, Better Business Bureaus and similar institutions do not perform as effectively for the consumer as credit reporting agencies do for the creditor. One possible reason is that Better Business Bureaus regularly screen complaints to ascertain their merit. Nonmeritorious complaints will either not be reported to persons seeking information about a creditor's business reputation or they will be reported as lacking merit. Credit reporting agencies, on the other hand, typically either do not screen reports about allegedly slow paying debtors, or screen them only if the affected debtors request an investigation of the report's accuracy.

It should be noted that various consumer action organizations have attempted to aid consumers by developing a means to communicate widely a creditor's poor business practices. Consumer picketing is a tactic commonly chosen. While such organizations have at times been effective, it is not a resource generally available to consumers.

54. *See* text accompanying notes 39-50 *supra*.

tion where the debt is small, *e.g.*, less than $100.[55] A debtor who can credibly threaten not to pay voluntarily, therefore, may escape payment altogether.

A debtor's ability to gain leverage by refusing to pay voluntarily has been enhanced in recent years as it has become increasingly necessary for a creditor to obtain a judgment on the debt before initiating coercive execution. Usually obtaining a judgment is not a problem for a creditor, as most debtors will default. If a debtor chooses to contest a debt, however, and does so successfully, not only are the creditor's litigation costs wasted, but the chances that the debtor will voluntarily pay the underlying debt are probably eliminated entirely.[56] Of greater concern to the creditor than the risk of losing a judgment, however, is the risk that a properly counseled debtor might extensively delay the proceedings on the merits. Delay can often have particularly pernicious effects on a creditor. Not only will the creditor commonly be unable to impose enough extra charges on the debtor to compensate for its opportunity costs and litigation expenses, but during the period of delay the debtor might skip, incur further financial setbacks, declare bankruptcy, or waste or transfer existing non-exempt assets. Because of all these risks, a debtor can obtain substantial bargaining leverage by credibly threatening to raise or actually raising a defense on the merits.[57]

The debtor's ability to exert leverage by threatening to force the creditor to coercive execution is further enhanced by state exemption statutes, which eliminate certain property and wages from a creditor's reach through coercive execution.[58] Exemption statutes provide leverage most importantly by providing a resource pool—a carrot as it were—from which to offer voluntary payments to the creditor in return for appropriate concessions, such as favorable refinancing terms or a reduction in the size of the debt.[59]

55. But recall that wage garnishment by a creditor can be a reasonably efficient means of direct collection of small amounts. *See* note 10 *supra*.

56. Consumer protection legislation enacted in recent years has substantially enhanced the potential for a debtor successfully to defend an action on a debt. There are presently so many technical laws, such as truth-in-lending, governing a consumer credit transaction that the incidence of technical violation of these regulations must be substantial. *See generally* Landers, *Some Reflections on Truth in Lending*, 1977 U. ILL. L. FORUM 669.

57. It has been reported that in England many creditors routinely discontinue collection proceedings for small amounts whenever a debtor enters a defense on the merits. CONSUMER CREDIT: REPORT OF THE COMMITTEE at 302-09 (1971) (Crowther Comm., C'mnd No. 4596).

58. In jurisdictions which provide for personal property exemptions by defining the types of exempt assets, a debtor can further enhance his or her leverage by ensuring that as many assets as possible are exempt. *See* note 217 *infra*. It is generally held that even after insolvency the sale of a non-exempt asset for a fair consideration to acquire an exempt asset is not a fraudulent conveyance. *See* RIESENFELD, *supra* note 18, at 378 n.3.

59. For this reason a common feature of a refinancing agreement is a grant to the

Potentially the most effective leverage for the debtor lies in the right to declare bankruptcy. For unsecured creditors bankruptcy is generally a most feared outcome of the collection process. The filing of a bankruptcy petition automatically stays all coercive execution, while also effectively preventing the unsecured creditor from collecting privately.[60] Moreover, the assets of a bankruptcy estate for the typical consumer debtor are likely to be absorbed completely by priority payments, such as the costs of administration; rarely is there money for the unsecured creditor.[61] The situation in bankruptcy for the secured creditor is somewhat better, since the secured creditor ordinarily retains rights in the collateral as against both the trustee in bankruptcy and the debtor. But any difference between the value of the collateral and the debt—the deficiency—is considered an unsecured debt dischargable in bankruptcy. Consequently, if the deficiency is great, even a secured creditor may fear bankruptcy.[62]

A consumer debtor usually has an absolute right to declare voluntary bankruptcy and to obtain a general discharge,[63] legally terminating liability for most unsecured debts existing at the time

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creditor of a security interest in exempt property, thereby enabling the creditor to reach exempt assets by coercive execution should the debtor later breach the refinancing agreement. Exemption statutes, of course, do not prevent foreclosure under a security agreement.

60. 11 U.S.C.A. § 362 (West Sp. Pamph. 1979). *See* Rules Bankr. Proc. Rule 13-401, 601. Private collection generally is foreclosed because upon the filing of the petition, the debtor's property becomes the property of the bankruptcy estate. 11 U.S.C.A. § 541 (West Sp. Pamph. 1979).

The prohibitions against coercive execution and private collection are generally observed in practice, in part because the debtor usually is represented by counsel at this stage. The new Bankruptcy Act became effective in most respects on October 1, 1979. Citations are to the new Act unless otherwise indicated.

61. D. STANLEY & M. GIRTH, BANKRUPTCY: PROBLEM, PROCESS, REFORM 87-88 (1971). The unsecured creditor will also be unable to attach future income, unless its claim fits under one of the exceptions to discharge established in 11 U.S.C.A. § 523 (1979). From a debtor's perspective, the exemption of future income from the claims of unsecured creditors is a principal benefit of bankruptcy.

62. A secured creditor may also fear bankruptcy because of the risk that a security interest will be deemed invalid in the bankruptcy proceeding, thereby rendering the creditor's claim unsecured.

63. Technically, there is a difference between the right to declare bankruptcy, which is virtually absolute for an individual—11 U.S.C.A. §§ 109, 301 (1979)—and the right to a general discharge, which is usually but need not be granted as part of a bankruptcy proceeding. The denial of a general discharge does not terminate a bankruptcy proceeding, which continues for the purpose of marshalling the debtor's assets and distributing them to creditors. Debts not paid as part of a bankruptcy distribution remain personal obligations of the debtor in the absence of a discharge. However, the only practically important reason a consumer debtor might be denied a general discharge in bankruptcy is that he or she has received another discharge in a bankruptcy proceeding commenced within six years of the filing of the petition. The other grounds for denial of a general discharge are typically applicable only to business debtors. 11 U.S.C.A. § 727(a) (1979).

of bankruptcy. This right lends credibility to a debtor's threat of bankruptcy. That credibility is further enhanced by the automatic stay of collection proceedings, which promises the debtor what is typically most wanted—immediate temporary relief from creditor harassment and the rigors of a threatened coercive execution.

The inherent credibility of a threat of bankruptcy, and its potential leverage effects, are undercut by several factors, however. First, bankruptcy can adversely affect a debtor's credit rating,[64] and much of the population still attaches considerable stigma to bankruptcy.[65] If a creditor believes a debtor is influenced by such considerations, a threat of bankruptcy may not be credible. Second, there are important limitations, known to many creditors, on the extent of relief many debtors can receive in bankruptcy. For example, many debts are not dischargeable in bankruptcy even though the debtor is entitled to a general discharge.[66] If a creditor knows or believes his debt will be unaffected by bankruptcy, he is not likely to adjust his bargaining position substantially in the face of a bankruptcy threat.[67]

E. *Limitations on Debtors' Leverages*

There are several important limitations on the ability of most debtors to maximize the potential of the leverages available to them when bargaining with creditors over debt collection. The most pervasive limitations are simply ignorance and inexperience. Many consumers are undoubtedly unaware of the sources of debtor leverage—for example, the difficulty of collecting directly through the execution process or the ability to manipulate the exemption statutes. Even those debtors who are aware of potential leverages, however, are often unskilled in bargaining and as a consequence incapable of making good use of the leverages.

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64. Though creditors will always try to persuade debtors that bankruptcy would harm their credit rating, in some circumstances bankruptcy can actually enhance a debtor's rating. The debtor will be barred from discharge in bankruptcy for six years, and there are creditors who believe that if they cannot collect within six years, they do not deserve to be in the business.

65. *See* JACOB, *supra* note 10, at 111-15; STANLEY & GIRTH, *supra* note 61, at 62-64, 230-32.

66. 11 U.S.C.A. § 523(a) (1979). Formerly, an important limitation on a debtor's relief in bankruptcy concerned the enforceability of reaffirmations of otherwise dischargeable debts. The new Bankruptcy Act makes important changes in this respect. *See* notes 210-11 *infra* and accompanying text.

67. Even if a debt is not discharged, bankruptcy remains an inconvenience to the creditor since coercive execution will be delayed at least until expiration of the automatic stay. Therefore, a threat of bankruptcy by the debtor can be a moderately effective leverage device.

Even knowledgeable debtors with experience and skill in bargaining face institutional impediments to maximizing their potential leverages. Most importantly, it is difficult to threaten various actions credibly without the assistance of an attorney. Relatively few debtors can or are willing to litigate to the utmost (*e.g.*, assert a complicated breach of warranty defense to an action on the debt), or to declare bankruptcy, *pro se*.

Although the cost of an attorney often can be transferred to the creditor if the debtor successfully litigates,[68] most debtors do not know this. Moreover, most debtors do not actually want to litigate or to declare bankruptcy, but rather just to threaten such action. The cost of attorney assistance in making such threats credible is rarely transferable to creditors. As a result, debtors are reluctant to contact an attorney for fear that their costs will exceed the amount in dispute. Creditors are aware of these considerations, of course, and consequently a debtor without an attorney often finds it impossible to threaten credibly any of the actions which can provide debtors bargaining leverage.[69] Most debtors play the collections game only sporadically which further limits the ability of a debtor to threaten action credibly. In contrast, for most creditors, collection is likely to be a continuous venture. As a result creditors are frequently more willing and able to sacrifice in one case for the sake of the long run. For example, a creditor, having threatened property execution without achieving the desired results, can reasonably decide to follow through with execution, even though the direct returns are low, because an important benefit lies in the enhanced credibility of similar future threats. Likewise, when faced with a debtor threat to litigate, a creditor can rationally decide to go to court, even if the resulting costs are high and the amount in dispute is small, in order better to dissuade a future debtor from carrying through on

68. *See, e.g.*, UNIFORM CONSUMER CREDIT CODE § 5.202(8) (West 1969). The failure of such provisions to stimulate more litigation is probably due not only to ignorance but also to a widespread belief, perhaps justified, that courts will not award attorneys' fees commensurate with the fees the attorney could earn elsewhere. *See* Macaulay, *Lawyers and Consumer Protection Laws: An Empirical Study*, 14 LAW & SOC'Y REV. ___ (1980) (forthcoming).

In bankruptcy, the debtor's allowable attorney fees are one of the earliest priorities in any distribution. 11 U.S.C.A. §§ 330, 503(b)(2), 507(a)(1) (1979). If an attorney is prepared to limit the fee to the amount receivable in this manner, a debtor can effectively transfer attorney fees for bankruptcy to creditors. In the past, however, attorneys commonly have demanded money in advance as a condition for taking a bankruptcy case. The new Bankruptcy Act contains a provision designed to prevent debtors' attorneys from obtaining excessive fees in this manner, but it is too early to determine whether the provisions will be effective. *See* 11 U.S.C.A. § 329 (1979).

69. A conversation with a legal services attorney, who will undoubtedly report a substantial shift in creditor attitude once a debtor is represented by an attorney, should help confirm the validity of this conclusion for the reader.

a similar threat.[70] On the other hand, only a debtor willing to expend unlimited resources for the sake of principle, or to hurt a particular creditor, can sensibly decide on a similar course of action, for the debtor will not be engaged in enough future collections to recoup his investment.[71]

Even assuming that a debtor might be represented by a competent attorney, capable of making credible threats, a debtor's bargaining position may still be compromised by the lack of any effective way to counteract a creditor's informal leverages. If a creditor chooses to harass a delinquent debtor with frequently telephone calls, or by contacting neighbors, the debtor may be forced to grin and bear it.[72] A well represented debtor may also be essentially defenseless if, during bargaining, a creditor chooses to damage the debtor's credit rating by reporting the delinquency to a credit reporting agency.[73]

F. *Competition Between Creditors*

Creditors are often in competition among themselves for the limited assets of an insolvent debtor; a debtor delinquent with respect to one debt is likely to be, or soon to become, delinquent with respect to others. There are numerous legal rules for determining in formal execution which creditors should have "priority" in the distribution of an insolvent debtor's limited assets. A properly secured creditor will ordinarily have prior rights to the extent of the collateral secured, even in bankruptcy. Any deficiency will be unsecured.

70. *See generally* Galanter, *Why the "Haves" Come Out Ahead: Speculations on the Limits of Legal Change*, 9 LAW & SOC'Y REV. 95 (1974); Leff, *Coercive Collection, supra* note 4, at 34-38.

71. Even creditors with a small debt volume can gain many of the advantages of being a continuous player by using a collection agency. This is one of the main reasons why such creditors should probably use collection agencies. *See* text accompanying notes 5-6 *supra*.

By and large counterpart institutions do not exist for debtors. The principal exception may be legal services agencies, which, because they do not bill their clients and because they regularly participate in the consumer credit collection process, can afford to, and I suspect do, act like continuous players. For example, it must often be in the interests of a legal services agency to litigate to the utmost when dealing with a creditor or collection agency with whom its clients frequently have collection problems, even if the amount of the contested debt is small. For this reason, in terms of bargaining leverage the clients of legal services agencies are undoubtedly better off than most other consumers subjected to creditor collection activities.

72. Although both federal and state legislation has been enacted in an attempt to limit this kind of creditor behavior, as will be discussed later in this article, there are difficulties both in defining the creditor behavior to be prohibited in sufficiently specific terms to be useful, and in devising sanctions that will induce compliance. *See* text accompanying notes 233-62 *infra*.

73. *See* notes 130-34 *infra* and accompanying text. There are stories of aggressive debtors who retaliate by harrassing a creditor in some manner, but collection agents commonly protect themselves from such activity by using pseudonyms in their contacts with debtors.

The general common-law rule, prevailing in all but a few jurisdictions, for determining priorities among unsecured creditors is that the first creditor to obtain a lien in an asset has prior rights *vis-à-vis* other unsecured creditors in that asset. The procedures for obtaining a lien in a debtor's assets vary substantially between jurisdictions, but usually the creditor who first initiates coercive execution will be the first to obtain a lien in available unencumbered, non-exempt assets.[74]

These priority rules encourage an unsecured creditor, faced with an insolvent or potentially insolvent debtor, to resort to coercive execution more quickly than would be necessary if the priority rules did not favor the "early bird." The partially secured creditor—and most secured creditors in the consumer area are only partially secured—would seem to face similar incentives. Such a creditor will want to repossess quickly in order to establish the amount of the deficiency and be in a position to enter the "race" with other unsecured creditors to obtain a priority interest in unencumbered, non-exempt assets.[75]

It is ironic that this aspect of the consumer credit collection system creates an incentive for quick resort to coercive processes. To creditors as a class, quick coercive execution is likely to be counterproductive. Wage garnishment may cause the debtor to lose his or her job, depriving the debtor of future income with which to satisfy the debt. Garnishment might also induce bankruptcy, perhaps to

74. In most jurisdictions a lien on real estate (called a judgment lien) is obtained by docketing a judgment in a county or other political subdivision in which the real estate is located. To obtain a lien on personal property (an execution lien), on the other hand, most states require that a judgment creditor obtain a writ of execution from a court clerk and arrange for the sheriff to "levy" on the personalty. Jurisdictions vary as to whether the priority of an execution lien dates from the time of delivery of the writ to the sheriff or from the date of levy under the writ. If garnishment is the desired form of execution, process other than a judgment is always required. Generally the first creditor to obtain a garnishment order or to have it served on the garnishee has prior rights in the amount subject to garnishment. *See generally* EPSTEIN, *supra* note 13; Distler & Schubin, *supra* note 16.

A few jurisdictions deviate from the general first-in-time, first-in-right rule for determining priorities and provide for pro-rata distribution to creditors in some circumstances. *See* note 286 *infra*. Pro-rata distribution is, of course, a basic principle in bankruptcy with respect to unsecured creditors.

75. As a general rule it is technically possible for a partially secured creditor to initiate coercive execution by seeking a judgment and then levying on the collateral, other unencumbered, non-exempt assets, or both. Absent special statutory restriction, the only impediment to levy on all nonexempt assets is common law liability for excessive or wrongful attachment. *See* RIESENFELD, *supra* note 18, at 349-52. A secured creditor will rarely proceed this way, however, for it requires foregoing the cost advantages of self-help repossession.

While I have no systematic empirical information that confirms my belief that the priority rules encourage quick coercive execution, my intuitions in this regard have been confirmed consistently in conversations I have had with collection agents and attorneys with collection practices.

forestall future, job-threatening garnishments.[76] Property execution, because of the lost value phenomenon, tends to lower the debtor's overall net worth, while depriving creditors of the potential of gaining bargaining leverage by threatening execution on that property. Yet a particular creditor who for any of these reasons delays coercive execution runs the risk that another creditor will initiate coercive execution, collect what money can be collected and leave the other creditors with a considerably diminished opportunity to collect anything.[77]

Competition between multiple creditors which leads to coercive execution is also not in the interests of a debtor, of course. Bankruptcy is one solution for such a debtor. If such extreme action is not attractive, there are several other possible ways for the debtor to dissuade or prevent creditors from coercive execution. So long as only one or a very few creditors seem likely to initiate coercive execution, a temporary solution is to grant a security interest in unencumbered (perhaps exempt) property or even future wages by means of a wage assignment. Any creditor acquiring such a security interest will usually be protected if other creditors later initiate coercive execution.[78] But often such action will only buy the debtor time. When other creditors later begin pressing, there may be no further assets available in which to grant a security interest.

76. It is well established that fear of garnishment is an important precipitating cause of bankruptcy. Thus, states with lower exemptions in garnishment tend to have higher rates of personal bankruptcy. STANLEY & GIRTH, *supra* note 61, at 28-32; Shuchman & Jantscher, *Effects of the Federal Minimum Exemption from Wage Garnishment on Nonbusiness Bankruptcy Rates*, 77 COMM. L.J. 360 (1972).

77. Jacob reports that debtors subjected to garnishment tend to pay garnisheeing creditors more quickly than other creditors, no doubt in hopes of forestalling still further garnishments. JACOB, *supra* note 10, at 101-02.

In theory, unsecured creditors losing the race to the courthouse for a coercive execution can protect themselves by forcing a debtor into involuntary bankruptcy, thereby gaining the advantage of the basic pro-rata distribution policy of bankruptcy. The preference provisions of the Bankruptcy Act can then be used to deprive the victor in the courthouse race of the fruits of that victory. 11 U.S.C.A. § 547 (1979). As a general rule, however, this is not a practical course of conduct, because the expectation of future income is commonly the debtor's most valuable asset and bankruptcy in effect renders this asset exempt.

78. There is considerable confusion as to how effectively a wage assignment will protect either the creditor-assignee or the debtor-assignor from future wage garnishments. *See* Sears, Roebuck & Co. v A.T. & G. Co., [1976] LAB. L. REP. (CCH) (78 Lab. Cas.) ¶ 33,352 (App., Jan. 6, 1976). Security interests in property, if properly perfected, will protect the creditor unless the granting of the security interest constitutes a fraudulent conveyance. In general, if the value of the collateral far exceeds the amount of debt secured, or if the favored creditor is a close friend or relative, there is a substantial risk the security interest will be set aside as a fraudulent conveyance. *See* EPSTEIN, *supra* note 13, at 103-05. In bankruptcy, security interests for antecedent debts are likely to be set aside as voidable preferences if entered into within three months of the filing of the petition, but it is unlikely that other creditors will petition for involuntary bankruptcy in order to take advantage of this provision. *See* note 77 *supra*.

A second possible course of action for a debtor is to arrange for a consolidation loan, usually from a finance company. In a consolidation loan, the lender agrees to satisfy all or most existing debts, leaving the debtor with one large debt but typically with payments spread over a longer time period than the pre-existing debts. Though a consolidation loan can avoid the special harms of coercive execution, among the disadvantages for the debtor is the high interest rate typically charged for such loans. Moreover, the debt load may be so extensive that no lender will accept the risk entailed.

Still a third solution is for the debtor to arrange a composition or extension plan by which all creditors agree to forego coercive execution in exchange for the debtor's commitment to devote a sizeable portion of future income and assets to paying off creditors over time. Largely because it avoids the special harms of coercive execution, creditors as a class are likely to collect more money under such a plan than if collection efforts evolved into a race to the courthouse.

Despite the attractiveness of composition and extension plans, several impediments to their successful implementation exist. If a plan is arranged privately, someone, usually a major creditor or the debtor, must devote a considerable effort to obtaining the consent of all or most creditors to forego execution, and perhaps to excuse some debt, in return for the debtor's agreement to apply some portion of income and perhaps other assets to debt retirement.[79] Moreover, while these negotiations are taking place, there is nothing to prevent some creditor from initiating execution.[80] For these reasons

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79. Such agreements are legally enforceable by all parties, the consideration received by each creditor being the agreement of other creditors to forego coercive execution. *See* EPSTEIN, *supra* note 13, at 124; A. CORBIN, CORBIN ON CONTRACTS 202 (one vol. ed. 1952). Hence one creditor can sue to prevent another creditor from initiating coercive execution or from accepting a payment from the debtor in excess of the agreed amount. If the agreement provides that creditors eventually will be paid all that they are owed, it is conventionally called an extension agreement. If creditors are to receive less than full payment, it is called a composition agreement.

A not uncommon problem encountered in arranging composition agreements is that larger creditors, invariably proponents of the scheme, have difficulty in convincing smaller creditors to consent. Smaller creditors have less at stake and may believe that they have a possible chance at collecting in full through coercive execution. *See* note 10 *supra*. As a result, privately arranged composition agreements sometimes provide that smaller creditors will be paid more quickly than larger creditors. Alternatively, larger creditors may agree to pay off smaller creditors, taking an assignment of their claims, in order to forestall a bankruptcy-triggering coercive execution and to obtain the requisite agreements to a composition.

80. A general assignment for the benefit of creditors is a statutory procedure, available in most states, that provides another non-bankruptcy alternative that can prevent coercive execution even without the consent of creditors. While technically it could be used to prevent an uncooperative creditor from initiating execution while negotiations are taking place between the debtor and his or her other creditors, as a practical matter such assignments are virtually never made in the consumer area.

it is often more practical for the debtor to work out a similar plan under the auspices of Chapter 13 of the Bankruptcy Act. Once the debtor files a Chapter 13 petition with the Bankruptcy Court, all unsecured creditors are automatically enjoined from initiating or continuing execution until the plan is completed or the proceedings dismissed.[81] Moreover, creditor consent is not a prerequiste to court approval of a plan. In the past, Chapter 13 plans have not been feasible in many situations for a variety of technical reasons.[82] The new Bankruptcy Act makes important changes in this respect, however, and as a result, composition and extension plans may become much more common.[83]

In sum, the rules governing priorities among competing creditors must induce quicker and more frequent coercive execution where there are many unsecured or partially secured creditors than would be the case if the priority rules did not extend an advantage to the creditor who first executes. Yet, as noted repeatedly above, coercive execution is not ordinarily in the interests of either creditors as a class or the debtor. A seemingly desirable solution to this

81. 11 U.S.C.A. § 362 (1979). *See* Rules Bankr. Proc. Rule 13-401. Secured creditors are also automatically enjoined from execution by the filing of a petition under Chapter 13, but where appropriate they can obtain relief from the stay before the plan is completed. *Id.*

82. For a general discussion of Chapter 13 plans under the old Bankrtupcy Act, see D. COWANS, BANKRUPTCY LAW AND PRACTICE 82-95 (1963). A variety of technical provisions rendered composition plans virtually always infeasible. Even extension plans often proved unworkable because of the provisions concerning secured creditors. Before the court could confirm a plan, all secured creditors "dealt with" had to approve the plan. Bankruptcy Act § 652, 11 U.S.C. § 1052 (1976) (repealed 1979). The majority rule provided that the secured creditor was "dealt with" unless the plan either provided for payment at the contract rate or permitted repossession. Cheetham v. Universal C.I.T. Credit Corp., 390 F.2d 234 (1st Cir. 1968). Even though it was possible and common to prefer secured to unsecured creditors in Chapter 13, it often was impossible to pay all secured creditors at the contract rate during the early months of a plan. As a result, in majority rule jurisdictions, unless the secured creditors consented to receiving less or the debtor was willing to give up the collateral, a viable Chapter 13 plan was impossible. For a different view of the meaning of "dealt with," that tended to make a Chapter 13 more feasible, see Thompson v. Ford Motor Credit Co., 475 F.2d 1217 (5th Cir. 1973).

83. Composition plans are generally much more feasible under the new Bankruptcy Act. There is no requirement that a majority of unsecured creditors consent to the plan, though the court must find that the plan is proposed in good faith, presumably meaning that the debtor has devoted all future income, not needed for basic living expenses, to the plan. 11 U.S.C.A. §§ 1322, 1325 (1979). A secured creditor's consent to a Chapter 13 plan is required only if repossession is enjoined and the present value of the amounts to be distributed to the secured creditor under the plan is less than the value of the collateral at the time the Chapter 13 proceeding is initiated (*i.e.*, less than the secured portion of the debt). 11 U.S.C.A. § 1325 (1979). Because the value of the collateral typically is far less than the debt, in most circumstances a debtor presumably can pay a secured creditor less than the contract rate and still have a plan confirmed without obtaining the secured creditor's consent. Indeed the present value concept suggests that monthly payments to secured creditors can be made quite low, providing they are extended for a sufficiently long period of time.

conundrum is an extension or a composition plan, either arranged privately or under the auspices of Chapter 13 of the Bankruptcy Act. For a number of reasons, however, perhaps the most important being the costs of arranging and implementing such plans, they are often impractical or at least untried.[84]

G. Summary

This description of consumer credit collection obviously has not mentioned all the factors that influence creditor and debtor behavior. Nonetheless, I believe I have described the most important aspects of the system. It is a system characterized by bargaining and "voluntary" payment of delinquencies rather than by collection through formal legal processes. The bargaining is importantly influenced by each party's ability to exert leverage—usually credible threats of action that will harm the other. The main relevance of legal rules governing formal execution is that they provide leverages to one or the other party to the bargaining.[85] Rarely is coercive execution an effective means of collecting debts.

A partial exception to these generalizations concerns motor vehicle finance. Self-help repossession of vehicles subject to a security interest is a relatively efficient collection method. Precisely because it is, a creditor threat to repossess is an inherently credible one, and hence a leverage technique regularly used by motor vehicle creditors to induce voluntary payments. It remains true that actual repossession, a form of coercive execution, is also an important means of collection, much more important than is execution with respect to almost all other forms of consumer credit.

Previous commentators on the various legal procedures for debt collection have often, and I believe wrongfully, presumed that the principal function of the procedure is to provide a means of collecting money. Throughout the succeeding sections of this article, in

84. There has been an extremely wide variance in the use of Chapter 13 proceedings between different bankruptcy jurisdictions. REPORT OF THE COMMISSION ON BANKRUPTCY LAWS OF THE UNITED STATES pt. 1, ch. 6 (1973) [hereinafter BANKRUPTCY COMM. REP.]. A principal cause of this variation apparently has been the differing attitudes toward Chapter 13 of bankruptcy judges in the different jurisdictions. Judges who have favored Chapter 13 proceedings have appointed standing Chapter 13 trustees and in other ways established the administrative machinery needed to facilitate a large number of Chapter 13 plans. In jurisdictions where such actions have not been taken, attorneys rarely file Chapter 13 petitions.

Because the new Bankruptcy Act makes Chapter 13 proceedings so much more attractive to debtors, see note 83 *supra*, it may be that many more jurisdictions will establish the administrative machinery needed to process Chapter 13 actions in large numbers.

85. *Cf.* Mnookin & Kornhauser, *Bargaining in the Shadow of the Law: The Case of Divorce*, 88 YALE L.J. 950 (1979) (legal rules govening divorce litigation important primarily for their effects on settlement negotiations).

which I criticize the consumer credit collection system and suggest reforms, I maintain the view that the principal function of any legal collection procedure is to provide bargaining leverages.

II. Comprehensive Critiques: Proposed Radical Solutions

In this section I discuss two comprehensive critiques of the consumer credit collection system. Each of these critiques evaluates virtually all aspects of the system and suggests a fundamental reform. In later sections I will discuss partial critiques that tend to focus on particular aspects of the system.

A critique of a legal rule or system generally presupposes some underlying value structure to use as a basis for evaluation. These days it is fashionable to base critiques on efficiency in the allocation of resources. Efficiency analysis requires, however, some definition of what objectives are sought to be accomplished by the efficient allocation of resources.[86] In general efficiency analysis, maximization of human satisfaction is assumed to be the ultimate objective. Although such an analysis is ultimately normative, maximization of human satisfactions is a norm that presumably is shared widely in this secular age. Unfortunately, there rarely are reliable empirical techniques to determine the range of human satisfactions at stake in evaluating legal rules. (For example, does our present system of court procedure satisfy the desire shared by many people for entertaining sport?)[87] Consequently, to be practical, an efficiency analysis must presume a limited number of potential human satisfactions to be served by the legal procedure under examination. Typically, the presumed satisfactions relate to material benefits to the parties and to society, which I will henceforth refer to as the wealth maximization objective.

Wealth maximization is also a widely shared objective, but most people would not approve of it as the sole objective for a body of legal rules. Many people would be more concerned about redistributing income, for example, while others might believe that it is important for the collection system to be perceived as fair by citizenry, so as to enhance the legitimacy of the legal and marketing system. Both of these goals are commonly excluded from wealth

86. *See* Leff, *Economic Analysis of Law: Some Realism About Nominalism*, 60 Va. L. Rev. 451 (1974).

87. This example is taken from Leff, *Law and*, 87 Yale L.J. 989 (1978). Efficiency analyses sometimes try to avoid this difficulty by showing that decisions are made in a perfectly operating market or its equivalent, since there are theoretical reasons for assuming decisions so made necessarily maximize human satisfaction. Decisions are rarely made in this context, however, particularly with respect to consumer credit collection.

maximization analyses.[88] Other problems in applying wealth maximization analysis stem from the difficulty of quantifying some costs and benefits. For example, almost everybody would consider anxiety and other types of psychic harm commonly suffered by debtors to be a cost of our present collection system. Because of the difficulty in expressing this cost in monetary terms, however, some wealth maximization analyses ignore it.[89]

In this article, I will presume a multiplicity of objectives, only one of which is wealth maximization. Moreover, only effects of a legal procedure easily expressed in monetary terms will be included in what are labeled wealth maximization analyses. Where it seems desirable to promote or discourage other effects, they will be attributed to objectives other than, and sometimes in conflict with, wealth maximization goals.

A. *The Free Market Solution*

Establishment of the rules governing the consumer credit collection system could be left basically to the free market rather than to protective legislation. Legislation would be needed to establish coercive execution procedures in the absence of an agreement, but the parties by contract could either preclude resort to some of the legislatively established remedies or add new ones. To a considerable extent, our system is already characterized by such contractual freedom. One function of a security agreement, for example, is to create new kinds of execution remedies (such as repossession). But important limitations on the ability of parties to create their own collection system by contract also exist. A debtor cannot by contract waive the right to go bankrupt, and almost all jurisdictions preclude resort to at least some execution remedies; Texas and Pennsylvania do not permit wage garnishment, for example.[90] Advo-

88. To be sure, making certain assumptions, these goals could be included in a wealth maximization analysis. An example of such an assumption would be the following: if there is a decline in the marginal utility of money, society is better off ("wealthier") if there is an equal distribution of income. Moreover, it is not hard to argue that society is materially better off because of general acceptance of its legal and marketing systems. Inclusion of all such objectives in a wealth maximization analysis, however, tends to blur the distinction between what I call a general efficiency analysis and a "wealth maximization" analysis. By a wealth maximization objective, I mean primarily maximization of tangible, material wealth—that is, maximization of the gross national product.

89. *See, e.g.*, Scott, *Constitutional Regulation of Provisional Creditor Remedies: The Cost of Procedural Due Process*, 61 VA. L. REV. 807 (1975).

90. TEX. REV. CIV. STAT. ANN. arts. 3836, 4099 (Vernon 1974); Integrity Trust Co. v. Taylor, 312 Pa. 3, 167 A. 363 (1933). Florida is often cited as a state that has abolished wage garnishment for heads of households, but such statements are misleading. The exemption from garnishment in Florida must be claimed and it frequently is not. *See* Note, *Florida Wage Garnishment: An Anachronistic Remedy*, 23 FLA. L. REV. 681 (1971).

cates of free market regulation of consumer credit presumably would support the repeal of all or most such restrictive legal rules.

Few commentators have argued that non-regulation of the consumer credit collection system would result in allocative efficiency,[91] and for good reason. If the market operates perfectly with no transaction costs, non-regulation is desirable by definition. There are transaction costs in the consumer credit collection system, however—for example, it is sometimes necessary for a creditor to sue a debtor—and the goal of minimizing these costs can sometimes justify regulation.[92] More importantly, other imperfections in the consumer credit market can justify extensive regulation on a variety of grounds, including wealth maximization.[93]

One source of imperfection in the consumer credit market is the imbalance of knowledge and experience between the creditor and the consumer. Because consumers only occasionally enter into credit contracts, and only a very few of those result in a delinquency, debtors are typically uninformed about the risks and harms associated with various types of coercive execution. Consequently, they cannot bargain knowledgeably about these matters, particularly at the time of contract formation. Moreover, given the relative infrequency of default, regulation of the collection system to achieve the system many or most customers would choose if well informed may be more practical or efficient than undertaking a consumer education program to inform all persons entering credit transactions of the harms associated with execution.

Even consumers well informed about the risks of default must make a judgment about what level of risk they are prepared to accept given the other costs and benefits of obtaining credit. Several commentators have argued generally that consumers have a propensity to underweigh long term risks, such as the risk of delinquency, when making credit or other decisions.[94] If so, regulation protective of delinquent debtors might be justified as being consistent with the true desires and interests of consumers.[95]

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91. *But see* P. McCRACKEN, J. MAO & C. FRICKE, CONSUMER INSTALLMENT CREDIT AND PUBLIC POLICY 97-114 (1965); Meckling, *Financial Markets Default and Bankruptcy: The Role of the State,* 41 LAW & CONTEMP. PROB. 13 (1977).

92. For example, parties probably should not be able to extend the return time on a writ of execution by contract because of the bureaucratic need of court systems for standardized procedures.

93. *See generally* Wallace, *The Uses of Usury: Low Rate Ceilings Examined,* 56 B.U.L. REV. 451 (1976) [hereinafter cited as Wallace, *The Uses of Usury*]; Wallace, *The Logic of Consumer Credit Reform,* 82 YALE L.J. 461 (1973).

94. *See* G. CALABRESI, THE COST OF ACCIDENTS 55-58 (1970); Whitford & Laufer, *Wisconsin Consumer Act, supra* note 4, at 652. *But see* Schwartz, *A Reexamination of Nonsubstantive Unconscionability,* 63 VA. L. REV. 1053, 1082 n.66 (1977).

95. A difficulty with this justification for regulation is that it presumes an ability to

Another way in which the consumer credit market operates imperfectly is that not all the costs of execution are always borne by creditors and debtors; there are externalities to the credit transaction. The costs of running the court system constitute perhaps the most obvious example of an externality, as the costs assessed to the parties are often insufficient to compensate for the court's or sheriff's expenses in performing the various procedural requirements of execution.[96] The collection process is also subsidized by social insurance (for example, the welfare system) against the most catastrophic consequences of execution, such as job dismissal. Employers bear much of the administrative costs of wage garnishment,[97] and even creditors other than the levying one often bear many of the costs of execution, since execution can make it less likely the other creditors will collect. Even well informed debtors cannot be expected to bargain for contract terms that minimize these costs. Consequently, some kind of regulation may be required either to internalize these costs (which is probably impractical) or to provide for a collection system approximating that to which parties would agree if these costs were internalized.

Another inherent drawback of the consumer credit market is that it is not fully competitive.[98] While various measures could be taken (and are advocated) to make the market more competitive,[99] at least in the absence of such measures it is possible that due to

determine the true interests or desires of consumers with regard to risk taking respecting default in some way other than by observing their actions in the marketplace. Simply by observing marketplace behavior, there is no way to distinguish between a propensity to underweigh risks and a preference for risk taking. Yet I believe, as do others, that there is substance, at least intuitively, to the idea that consumers often have a propensity to underweigh long term risks—that is, to discount long term risks more than their own value structure indicates they should. That seems often to be what people mean when they state that they should not have taken some risk, even though the risk did not eventuate. (Of course, sometimes they mean other things, such as that they would not have taken the risk if they had had more information). There is a relationship here to Professor Rawls' concept of the "original position." *See* J. RAWLS, A THEORY OF JUSTICE (1973). I am suggesting that consumers tend to discount long term risks more than they would advise if in the "original position." One possible source of this propensity is advertising. The extent to which non-informative advertising (such as a jingle) influences consumers is indeterminable. Nonetheless, in particular, many believe that such advertising encourages consumers, in the aggregate, to trade longer range security for immediate gratification. *See generally* A. LEFF, SWINDLING AND SELLING (1976). If so, and assuming it is not practical or desirable to regulate advertising to foreclose such effects, then regulation of the consumer credit system may be required to protect consumers from irresponsibly assuming long term risk.

96. *See* Brunn, *supra* note 43, at 1222 n.48.

97. *See* text accompanying note 41 *supra*.

98. THE NATIONAL COMMISSION ON CONSUMER FINANCE, CONSUMER CREDIT IN THE UNITED STATES 109-50 (1972) [hereinafter cited as NCCF REPORT]. *See* Warren, *Consumer Credit Law: Rates, Costs and Benefits*, 27 STAN. L. REV. 951 (1975).

99. NCCF REPORT, *supra* note 98, at 136-39.

conscious parallelism (if not covertly undertaken concerted activity) common in oligopoly situations, creditors would not offer credit contracts restricting various execution remedies even if a significant number of consumers were willing to pay an additional amount for them.[100] If that is in fact the case, regulation establishing restricted execution remedies may be the most efficient option available.

To summarize the argument just made, the consumer credit market does not operate perfectly, and it does not seem practical or possible to reform it so that it would.[101] Consequently, welfare economics does not justify a regime of non-regulation, whether the sole objective of our consumer credit collection system is maximization of human satisfaction, or even just wealth maximization. Rather, the teachings of welfare economics indicate that we must devise a "second best" solution—that is, a set of regulations that will permit the outcomes of the consumer credit collection system to resemble, as nearly as possible, the outcomes of an unregulated system existing in a perfectly operating market with no transaction costs.[102]

The better arguments for non-regulation (or, more realistically, for only minimal regulation) proceed on bases different than welfare economics. In my judgment, the best argument begins with the assumption that any analysis of the best "second best" solution, regardless of what objectives for the collection system are presumed, will be indeterminate, because the empirical evidence to ascertain the precise effects of different types of regulation will not be available. That being the case, it is at least possible that a non-regulation

100. Creditors, for example, might be uncertain as to what adjustments to make in the cost of credit in return for eliminating various creditor remedies. Rather than face this uncertainty, and the possibility of diminished profits if a wrong guess were made, creditors may prefer the security of the known, which, given the prevalence of conscious parallelism, they can enjoy without fear of adverse competition. For an argument that market structure probably does not influence the contract terms offered by creditors, see Schwartz, *supra* note 94, at 1071-76. In my judgment, Schwartz inadequately considered the desires of monopolists for stability and predictability in their affairs.

101. Although I have not fully justified this statement, I doubt many would seriously contest it. If consumers have a propensity to overdiscount long term risk, the statement is obviously true. And I have already implied that it is not practical fully to inform consumers of the risks of default prior to their entering into a credit transaction.

102. *See generally* Markovits, *A Basic Structure For Microeconomic Policy Analysis In Our Worse-Than-Second-Best World: A Proposal and Related Critique of the Chicago Approach to the Study of Law and Economics*, 1975 WIS. L. REV. 950; Lipsey & Lancaster, *The General Theory of Second Best*, 24 REV. ECON. STUD. 11 (1956). Stated generally, the theory of the second best, as applied to market economics, provides that when more than one of the conditions for a perfect market is lacking—a perfect market being by definition one yielding optimal resource allocation—it is not necessarily an improvement to correct less than all of the imperfections. The imperfections may tend to counterbalance each other, such that removal of some will produce even less optimal results. Unless it is possible to create a perfect market, the "second best" solution to a market failure may be deliberately to create further, counterbalancing imperfections.

approach will be the best "second best" solution—that is, as efficient in achieving almost any plausible objective as any alternative solution. Moreover, nonregulation, or little regulation, best serves the important value of liberty. While non-regulation might be seen as serving liberty values in several different ways, the most convincing argument concerns the likely effects of regulation of collection remedies on the cost and availability of credit.

The argument that restrictions on collection remedies will affect the cost of credit or credit availability begins with the assumption that creditors presently attempt to maximize monetary gains in their collection behavior—for example, given two equally efficient alternative collection strategies, creditors will always choose the cheaper, and when deciding whether to abandon collection of a debt, creditors consider only whether the cost of additional collection efforts exceeds the amount outstanding on the debt multiplied by the probability of collecting it.[103] From this assumption it follows that forcing a creditor to choose a collection strategy other than the one it would choose in an unregulated system must either increase the costs of collection, reduce the proceeds, or both. The resulting reduction in net proceeds, it is argued, will in some way be passed on to consumers, most likely either by increasing the cost of credit (interest rates) or by restricting credit availability.

In practice, however, creditors may not always attempt to maximize their monetary gains by their collection behavior. Therefore, regulation may sometimes induce creditors to adopt more efficient collection techniques without adversely affecting their net income.[104] Even where the maximization hypothesis applies, however, it is possible that restrictions on creditor remedies will not increase the collection costs of creditors as a class, as contrasted with the costs of a particular creditor who might have acted differently in the absence of the restrictions. As I detailed earlier, a maximizing creditor may sometimes act in a manner inconsistent with the creditor class interest—by inducing a job dismissal or bankruptcy through premature wage garnishment, for example.[105] Theoretically, these conflicts of interest between a single creditor and creditors as a class could be the subject of bargaining and agreement, and indeed they sometimes are.[106] Transaction costs frequently preclude such negotiation, however. Consequently some restriction of creditor remedies potentially can reduce collection costs of all creditors, presumably

103. *See* Johnson, *supra* note 30, at 90-93.

104. *See* Whitford & Laufer, *Wisconsin Consumer Act, supra* note 4, at 649-53.

105. *See* text accompanying notes 74-84 *supra.*

106. Composition agreements, for example, include an agreement between creditors respecting priorities.

with beneficial effects on interest rates or the availability of credit.

Remarkably, satisfactory empirical evidence does not yet exist to establish whether restriction of collection remedies commonly increases collection costs.[107] Assuming that many remedy restrictions would have such effects, it is virtually certain that at least part of the extra costs attributable to regulation will be passed on to consumers. Complete absorption by creditors of additional collection expenses or bad debts could be anticipated only if the credit industry were characterized by such high profits and elasticity of demand that creditors both could afford a lower return on investment without making other investment opportunities appear more attractive and would suffer a net loss due to lost customers by passing on any of the costs.[108] This is not, however, an accurate description of the credit industry.

The precise form in which the costs will be passed on will vary according to circumstances. An increase in interest rates is one possibility, although this route often will be precluded by legal interest rate limitations. Even in the absence of legal limitations, competitive considerations frequently will inhibit interest rate increases. Many creditors do not finely differentiate interest rates according to the risk presented but rather have one or at most a very few established rates. Consequently, a creditor raising interest rates risks losing its more desirable (i.e., lower risk) customers to another creditor who elects to respond to the increase in collection costs by offering credit only to low risk debtors rather than increasing inter-

107. *See* Shuchman, *Theory and Reality in Bankruptcy: The Spherical Chicken*, 41 LAW & CONTEMP. PROB. 66, 76-83 (1977). The principal effort by the National Commission on Consumer Finance to establish that collection remedy restrictions reduced credit availability is Greer, *Creditors' Remedies and Contract Provisions: An Economic and Legal Analysis of Consumer Credit Collection*, V NCCF, TECHNICAL STUDIES, 122-49 (1973) [hereinafter cited as Greer, *Creditors' Remedies*]. For reasons to be explained subsequently in the text, reduced credit availability is a good indication creditors are experiencing collection difficulties. *See* text accompanying notes 108-10 *infra*. The Greer study relied on a regression analysis to test which restrictions on creditors' remedies appeared to affect the supply of credit. The principal correlation found indicated that restrictions on wage assignments and garnishment affected the supply of low value, high interest, unsecured loans.

Like all regression analysis, the validity of Greer's results depends not only on the accuracy of data used but also on how well the regression equations anticipated all important determinants of credit supply. Greer's regression equations appear to use data on average family income and unemployment rates to measure the demand for credit (an obvious determinant of supply). While Greer's was certainly a reasonable approach, it is possible that for other reasons, perhaps cultural ones, demand for credit is less in some states.

The same NCCF study also reported the result of a survey of creditors asking which creditor remedies importantly affected their ability to collect. Not surprisingly, creditors placed nearly all remedies in that category. Greer, *Creditors' Remedies, supra*, at 27-122.

108. Though complete absorption of extra costs by creditors should rarely be expected, partial absorption is sometimes possible. *See* Whitford & Laufer, *Wisconsin Consumer Act*, *supra* note 4, at 624 n.77.

est rates. A second method, for creditors who are also sellers, to pass on costs is to increase the cash price of the goods or services sold. Often, however, competition for cash buyers will foreclose this approach.[109] A third possible reaction to increased costs, and the one commonly assumed to be the most prevalent, is largely to avoid them by restricting the credit available to the more substantial risks, a group that presumably disproportionately includes low income consumers. Finally, because downpayment level apparently is inversely correlated with delinquency, still another way creditors can respond to rising costs is to raise the level of required downpayments.[110] Since some consumers probably would find it most difficult to meet a higher down payment requirement, this last approach would most likely result in the restriction of the amount of credit available, again in a way that would disproportionately disadvantage low income consumers.

The suggested argument for non-regulation or minimal regulation, therefore, is that while restriction of creditor collection activities may save some debtors from hardship after delinquency, it will always impose costs—most likely restricted credit availability or high down payment requirements. Neither these costs nor the benefits of regulation will ever be precisely ascertainable. Thus, as suggested, it will always be possible that nonregulation, or minimal regulation, is the best "second best" solution for achieving regulatory objectives. The inevitability of costs associated with regulation means, however, that restriction of creditor collection activities necessarily involves some cost to the ideal of liberty. One practical way to determine whether consumers would prefer to bear the costs associated with harsh collection practices or the costs due to regulation thereof (such as restricted credit availability) is to provide them a choice. This is what a free market system with the possibility of precluding or expanding collection remedies by contract usually permits, at least if there is competition between creditors and consumers are generally informed. In any event, there is no escape from the point that making the choice between the two sets of costs by adopting legal regulation is to make choices for others.

If restriction of creditor collection activities were an efficacious

109. *See* note 147 *infra*, where in a related context I suggest there may be some such effect, largely to avoid legal limitations on interest rates. Increase in cash prices to recover increased collection costs can most often be expected by sellers with few cash sales, who are predominantly located in lower income neighborhoods. If a merchant sells almost exclusively on credit, it matters little whether the costs of credit or cash prices are increased, though the latter will sometimes avoid violation of usury statutes.

110. *See* Whitford & Laufer, *Wisconsin Consumer Act, supra* note 4, at 625, and authorities cited therein.

way to redistribute wealth to the benefit of the less well off, many would consider this benefit sufficiently worthy to justify some liberty restrictions. And in some respects, redistributive effects can be anticipated from regulation.[111] If a consequence of regulation is an increase in interest rates, borrowers who do not become delinquent, but who nonetheless must pay the higher interest rates, will in effect subsidize the extension of credit to borrowers who become delinquent. Moreover, if the consequence is an increase in the cash price, there may be some subsidization of credit buyers by cash buyers.[112] Such subsidies are redistributive, and they probably have a slight effect in benefiting the less well off at the expense of the somewhat better off, particularly since delinquency is so often caused by financial hardship. The credit market is largely organized along class lines, however; some creditors deal primarily with high or middle income borrowers while others serve primarily a lower income clientele.[113] Consequently, any wealth redistribution is likely to be from good to bad credit risks, or from cash to credit buyers, within the same general income class. If the creditor response to restrictions on collection activities is to restrict credit availability, as seems most likely, the distributional impact would probably be similar. It is possible that those who benefit from regulation are somewhat less well off than those who suffer,[114] but clearly those who suffer come disproportionately from lower income classes. Tbus, regulation is not significantly redistributive across class lines.[115]

This case for non-regulation is in some sense unassailable. Because the precise effects of restrictions of collection activities on interest rates and credit availability will never be perfectly ascertainable, it is always possible that regulation will be both inefficient, particularly in terms of the important wealth maximization objective, and impose liberty costs. Nonetheless, potential weaknesses in the argument exist. I earlier suggested that some well designed restrictions on creditor activities may have the predomi-

111. Only a limited distributional analysis is attempted here. For a fuller distributional analysis of the effects of a related type of regulation of the credit market, see Wallace, *The Uses of Usury*, *supra* note 93, at 457-70.

112. It has been argued that it is appropriate for cash buyers to bear some of the costs of credit. Merchants commonly are able to increase their overall sales volume by selling on credit, thereby achieving economies of scale that benefit cash buyers. *Id*.

113. *See* Project, *Resort to the Legal Process in Collecting Debts from High Risk Credit Buyers in Los Angeles—Alternative Methods for Allocating Present Costs*, 14 U.C.L.A. L. REV. 879 (1967).

114. *See* Wallace, *The Uses of Usury*, *supra* note 93, at 475-79.

115. Even if it is not significantly redistributive, regulation still tends to fulfill a loss spreading function. *See* note 122 *infra* and accompanying text. Some would regard this a sufficient benefit to outweigh liberty costs.

nate effect of inducing creditors to change their collection strategies in ways that have little effect on the profitability of collection, and thus do not affect either the cost or availability of credit, and yet offer substantial benefits to delinquent debtors.[116] Even where regulation has impact on the profitability of collection and therefore on interest rates or credit availability, there may be circumstances in which the benefits to delinquent debtors are so great that most persons would be reasonably confident that the regulation is efficient in the wealth maximization sense and worth the liberty costs. Even if regulation is not efficiently wealth maximizing, it might be seen as justifiable to fulfill other regulatory objectives, such as avoidance of mental anguish.[117] Perhaps the greatest weakness of the non-regulation critique as a serious proposal for reform, however, is its political unfeasibility. It is difficult to imagine many states repealing restrictions on execution remedies or informal collection practices that have been adopted as consumer protection measures; the trend in legislation seems quite the opposite. On the other hand, the non-regulation critique may provide a useful caveat against excessive regulation, a caveat to which I shall return later.

B. *Abolishing Coercive Execution*

Professor David Caplovitz suggested essentially that formal execution remedies for unsecured creditors be abolished.[118] The proposed Model Consumer Credit Act takes a similar approach with respect to unsecured creditors.[119] The Act would also prohibit a creditor from taking a security interest in most consumer goods other than motor vehicles,[120] while nonpurchase money security interests in real estate would be permitted only in limited circumstances.[121] Thus, the Act would also greatly inhibit the creation of execution remedies by contract.

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116. *See* text accompanying note 104 *supra.*

117. Professor George Wallace has made an elaborate argument favoring regulation for what he calls "non-utilitarian" reasons in his statement to the FTC in connection with the proposed Credit Practices Rule. *See also* text accompanying notes 122, 126 *infra.*

118. CAPLOVITZ, *supra* note 8, at 301-04.

119. The MODEL CONSUMER CREDIT ACT (1973) [hereinafter cited as M.C.C.A.] is in effect the successor to the NATIONAL CONSUMER ACT (First Final Draft, 1969). Both were drafted hy the National Consumer Law Center, an OEO Legal Services Program "back up" Center. Both are explicitly "pro-consumer" in their orientation and neither has been enacted in any state, though the National Consumer Act was the original basis for the Wisconsin Consumer Act. *See* Davis, *Legislative Restriction of Creditor Powers and Remedies: A Case Study of the Negotiation and Drafting of the Wisconsin Consumer Act,* 72 MICH. L. REV. 3 (1972). As an example of how the M.C.C.A. essentially eliminates coercive execution for unsecured creditors, see M.C.C.A. § 7.110 (establishing exemptions).

120. M.C.C.A. § 2.411(2)(b).

121. *Id.* § 2.411(2)(d).

The basic rationale for such proposals rests on the assumption that, because the vast majority of consumer debtors are morally and ethically committed to paying their just debts, delinquent consumer debtors will nearly always resume payments whenever it is feasible to do so. It follows that debtors who do not pay typically either cannot or could do so only by foregoing other needs deemed more urgent, such as providing family with clothing or medical assistance. Moreover, even if a few more debtors do not pay when coercive execution is abolished, these "costs" pale in significance when compared to the heavy costs often associated with formal execution, such as job loss or emotional strain leading to marital breakdown or ill health. Thus, abolition of coercive execution can be seen as consistent with wealth maximization objectives, as well as with an objective of saving debtors from physical and emotional harm. Finally, if abolishing coercive execution increases creditors' costs, resulting in an increase in interest rates, the distribution of these costs can be justified by loss spreading or insurance principles. Almost every debtor runs some risk of delinquency caused by unforeseen financial exigency or other circumstance, and paying slightly more interest can be seen as insurance against many of the harsh effects of coercive execution presently visited upon defaulting debtors.[122]

Related to the proposal to abolish coercive execution is Professor George Wallace's recent trial balloon of an "excusable default" defense in consumer credit transactions.[123] The idea, which is admittedly in rudimentary form, is to devise a system by which a delinquent debtor could not be subjected to coercive execution if the delinquency was due to an unforeseen circumstance such as financial hardship. The rationale for such a proposal presumably resembles that for proposals to abolish coercive execution. The Wallace proposal, however, would be more selective in deciding which debtors should benefit from abolition.

One predictable consequence resulting from the adoption of

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122. The spreading of the costs of default to all borrowers through regulation might be seen as less income redistributive than the combination of our present collection laws and welfare system. Welfare programs presently absorb some of the costs resulting from hardships visited on debtors by coercive execution. These programs are financed in part by progressive tax levies. I argued earlier in the text that distribution of regulatory costs is not likely to be progressive. The implication of this line of analysis is that creditors should be allowed a full range of execution remedies, with the welfare system protecting against the harsher consequences to debtors of execution. *See* Weistart, *The Costs of Bankruptcy*, 41 LAW & CONTEMP. PROB. 107 (1977). I will not discuss this radical approach in this article, though I do note that such reliance on the welfare system would amount in effect to subsidization of consumer credit and might lead to an economically inefficient over-extension of credit. Perhaps such effects could be countered in other ways.

123. *See* Wallace, *The Uses of Usury*, *supra* note 93, at 468-70.

either the Caplovitz or Wallace proposal would be greater creditor reliance on informal collection tactics, such as harrassment or threats to destroy or harm credit ratings. For example, in Texas, harrassment is reputedly quite common, perhaps because a combination of no wage garnishment and high property exemptions renders coercive execution frequently unavailable.[124] The threat to destroy credit ratings would become a more effective collection tool if creditors also placed greater reliance than they now do on credit ratings in deciding whether to extend credit. Partly for this reason, greater creditor reliance on credit ratings is a predictable consequence of the abolition of coercive execution.[125]

Either response to the abolition of execution remedies would increase the costs of regulating the collection process. All kinds of harm can result from excessive creditor harassment. Perhaps most importantly, such harassment can produce excessive anxiety in the debtor about what will happen next. It is well established that this psychic harm can have very concrete effects, most importantly in the form of health and marital problems.[126] Threats to destroy credit ratings can also be abused, particularly where used to persuade a debtor to pay a debt he honestly contests. Moreover, it is not clearly desirable that creditors place greater reliance on credit ratings when deciding whether to extend credit. Greater reliance on credit ratings may lead to demands, by creditors and consumers alike, that the procedures for formulating and distributing credit ratings be designed to ensure that decisions about who gets credit are made fairly, and regulation to bring about this result may prove unwieldly or costly.[127] Moreover, to make credit ratings better predictors about who will pay, credit reporting agencies will need to know a great deal about a debtor's past, lifestyle, and so forth. Many would regard the compilation of such detailed information in a single place as creating a high risk of excessive invasions of privacy and too high a cost to pay for solving the problems associated with coercive execution.[128]

124. *See* Anderson, *Coercive Collection and Exempt Property in Texas: A Debtor's Paradise or a Living Hell?*, 13 HOUS. L. REV. 84 (1975); Comment, *Consumer Credit Regulation in Texas—The Case for the Consumer*, 49 TEX. L. REV. 1011, 1054-55 (1971); *Consumer Credit Protection Act: Hearings on H.R. 11601 Before the Subcomm. on Consumer Affairs of the House Comm. on Banking and Currency*, 90th Cong., 1st Sess. pt. 2, at 1000-1221 (1967).

125. CAPLOVITZ, *supra* note 8, at 302-03.

126. *See id.* at 280-86; JACOB, *supra* note 10, at 105. For a more extensive discussion of the harms that can result from creditor harrassment, see text accompanying notes 233-38 *infra*.

127. The Equal Credit Opportunity Act, 15 U.S.C. § 1691 (1976), can be seen as a response to such demands.

128. *See* Miller, *Personal Privacy in the Computer Age: The Challenge of a New Technology in an Information-Oriented Society*, 67 MICH. L. REV. 1089, 1140-54 (1969). Perhaps consumers with one or two misdeeds in their past should not be hindered in their efforts to

Efforts can be and have been made to limit the use and the effects of these informal collection techniques. Full discussion of problems in regulating creditor harassment of debtors will be postponed until later in the article,[129] but it should come as no surprise that there are difficulties in devising effective regulation. There is also reason to doubt whether it is possible effectively to regulate ahusive behavior respecting credit ratings. The new federal Fair Debt Collection Practices Act prohibits a collection agency from reporting a disputed debt to a credit reporting agency without also reporting that it is disputed.[130] Regulation of this type could significantly protect debtors contesting the validity of alleged debts if it were extended to apply to creditors acting on their own behalf.[131] No regulation, including the Fair Credit Reporting Act,[132] has offered significant protections to a debtor's privacy[133] however, and it is doubtful whether any could be devised and enacted.[134]

While I would expect increased use by creditors of the informal leverages just discussed, I also expect the Caplovitz and Wallace proposals would adversely affect creditors' collection rates, resulting in the previously described impact on interest rates, cash prices, and credit availability.[135] I noted earlier the lack of conclusive empirical evidence that as a general proposition restriction of credit remedies increases collection costs.[136] Nonetheless, I have repeatedly argued that formal execution remedies are much more important to creditors for the threats they permit than for the direct collections

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improve their situation through the use of credit. To do so creates an inconsistency between promoting reliance on credit reports and the widely applauded "fresh start" principle of bankruptcy law.

129. *See* text accompanying notes 233-62 *infra*.

130. 15 U.S.C.A. § 1692e(8) (Supp. 1979).

131. In Wisconsin, state law effectively extends to all creditors the duty not to report a disputed debt unless they also report that the debt is disputed. WIS. STAT. § 427.104(f) (1977). For the contention that the Fair Debt Collection Practices Act will be ineffective because it inadequately sanctions non-compliance, see Note, *Private Enforcement Under the Fair Debt Collection Practices Act*, 28 CASE W. RES. L. REV. 710 (1978).

The Fair Credit Reporting Act, 15 U.S.C. § 1681 (1970), was intended to offer consumers protection from inaccurate information in credit files. It is now widely conceded, however, that the Act has been ineffective in this respect. *See* Feldman, *The Fair Credit Reporting Act—From the Regulators Vantage Point*, 14 SANTA CLARA LAW. 459 (1974). *See also* Note, 47 NOTRE DAME LAW. 1291 (1971).

132. 15 U.S.C. § 1681 (1970).

133. *See* Note, *Protecting Privacy in Credit Reporting*, 24 STAN. L. REV. 550 (1972).

134. Amendments regularly have been offered to strengthen the Fair Credit Reporting Act, but none have even approached enactment. *See, e.g.*, H.R. 3875, 95th Cong., 1st Sess. (1977). Even the amendments, however, have not offered a satisfactory solution to the basic dilemma that too much protection of privacy in credit reporting compromises the utility of credit reports as a measure of credit worthiness. *See* Feldman, *supra* note 131.

135. *See* text accompanying notes 103-10 *supra*.

136. *See* note 107 *supra* and accompanying text.

they make possible. I would expect, therefore, that voluntary payment rates would be significantly affected if creditors could not credibly threaten formal execution. For example, some debtors who presently pay "voluntarily" by foregoing other desires or needs, or by borrowing from a friend or relative, would probably regard themselves as "can't pays" in the absence of credible threats of coercive execution.[137] While tbis effect would be somewbat mitigated by the ability of creditors to substitute informal leverages, such as harassment, for threats of coercive execution, I would still expect a net adverse impact on collection rates.

In sum, like the case for non-regulation, tbe case for abolition of coercive execution, or alternatively for the establisbment of an excusable default defense, is an uncertain one. Both proposals rest in part on empirical questions about costs and benefits that cannot practically be resolved. Unlike non-regulation, abolition of coercive execution would certainly have benefits—it would eliminate the many harms coercive execution visits on debtors, for example—but costs of the reform include a likely increase in creditor harassment and a possibly undesirable restriction of credit availability.[138]

Given the uncertainty of the case for abolishing or severely limiting execution, a possible objection to these reforms is that the major objectives sought to be achieved can arguably be realized, at lesser cost, tbrougb amendment of tbe Bankruptcy Act. The objectives of the reformers to a great extent center on a desire to protect the financially pressed debtor, who today often either foregoes important needs in order to pay debts or suffers the ravages of coercive execution. Similar objectives are typically attributed to the Bankruptcy Act; indeed, a common precipitating cause of bankruptcy is a desire by the debtor for tbe benefits of tbe automatic stay of all coercive execution that is created by the filing of a bankruptcy petition.[139]

Finally, like tbe suggestion of non-regulation, the proposals to abolish coercive execution or to establish a concept of excusable default seem politically unfeasible. Reform of the consumer credit

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137. For a discussion of other circumstances in which the availability of coercive execution aids collection, see text accompanying notes 38-43 *supra.*

138. In this analysis, I have regarded restriction of credit availability as a cost of regulation. It is possible that the welfare of some consumers would be improved by an inability to obtain credit. These are consumers who have a propensity to underweigh long term risks when seeking credit. *See* text accompanying notes 94-95 *supra.*

139. To be sure, the relief offered the hard-pressed debtor in bankruptcy is often inadequate, but these difficulties might be solved simply by amending the Bankruptcy Act. For a discussion of some of the inadequacies of bankruptcy relief, see notes 207-12 *infra* and accompanying text.

collection system is likely to take a much more modest course.[140] An analysis of many of the possible directions modest reform could take will constitute the balance of this article.

III. PARTIAL CRITIQUES

Preparatory to developing more modest reform recommendations, in this section I will document the more important inadequacies of the present collection system. These critiques are "partial," in the sense that they focus on particular aspects of the system without fully considering the interrelationships of those aspects with other parts of the system. For example, while I criticize the inefficiencies of execution sale procedures, I do not consider in this section what effects eliminating those inefficiencies might have on creditor leverages and settlement rates. Whether the problems identified here can be solved without creating even greater problems in some other aspect of the system will be one subject of the following section.[141]

A. *Failure to Preserve Defenses*

Perhaps the most notorious weakness of the consumer credit collection systems is the difficulty it presents to the alleged delinquent debtor who wishes to contest his or her status as a debtor by raising defenses on the merits to the alleged debt.[142] Two classic illustrations of laws governing consumer credit that made it difficult for a debtor to raise defenses are the much maligned holder-in-due-

140. Perhaps the best support for this statement lies in the political explanation for tbe enactment of the Wisconsin Consumer Act. *See generally* Davis, *supra* note 119. As Davis' article indicates, the political circumstances in Wisconsin were about as favorable to enactment of pro-consumer legislation as they are ever likely to be anywhere. Yet, those representing consumer groups in the lobbying for the legislation found it necessary to accept many compromises from their preferred positions.

141. As I stated earlier, the critiques offered in this section will be based on values that I believe are widely accepted. I will, of course, identify those values as I proceed.

142. Potential debtor defenses can arise in several ways. Sometimes the defense will arise from the credit aspect of the creditor-debtor contract. Quite commonly today a debtor will have a partial defense or set-off arising from a technical violation of the Truth-in-Lending Act or other consumer protection statute. *See generally* Landers, *supra* note 56. Less commonly, the debtor may wish to allege fraud or unconscionability in the formation of the credit relationship, or a failure by the creditor to account for all the payments made by the debtor.

Where the credit contract is connected in some way with a sales transaction, the debtor may wish to assert a defense arising from the underlying sales transaction (for example, breach of warranty). It has sometimes been argued that debtors rarely are entitled legally to raise sales-related defenses in a collection action. Such arguments have been premised on the assumption that most creditors are holders in due course or can claim the benefits of a contractual waiver of defenses against assignees. *See, e.g.*, Scott, *supra* note 89, at 807, 837-39. As discussed in the following text, recent legal changes have deprived creditors of the benefits of those legal statutes.

course doctrine, and its functional equivalent, the contractual waiver of defenses against an assignee. These doctrines have now been rendered nugatory with respect to most consumer transactions by a Trade Regulation Rule issued by the Federal Trade Commission.[143] In their heyday the doctrines applied in the common situation where the original creditor (commonly also the seller of goods or services) assigned or "negotiated" the debt to a person or institution that was a stranger to the original creditor-debtor transaction. The usual effect of the doctrines was to prevent the debtor from asserting most defenses against the assignee or holder in due course.

The doctrines did not totally deprive the debtor of legal recourse for whatever acts gave rise to potential defenses. The debtor was required, however, to seek relief in a separate action against the original creditor, in which the debtor would be a plaintiff rather than a defendant. This switch often effectively deprived a debtor of legal redress. Sometimes it was difficult to obtain jurisdiction over the original creditor/seller; in any event the debtor was deprived of the many tactical advantages of being a defendant.[144]

Hindering debtors' ability to realize defenses in this way came to be recognized widely as inconsistent with a number of basic policy concerns. For example, a legal system which purports to provide valuable rights, but provides no practical way to realize them, loses legitimacy in the eyes of its constituents. Moreover, a debtor can feel terribly "put down" if forced to pay, or perhaps deprived of collateral, without being allowed even to demonstrate what is in his or her belief a bona fide defense. It is an affront to the western concept of individual dignity.[145] Another

143. FTC Trade Regulation Rule, Preservation of Consumers' Claim and Defenses, 16 C.F.R. § 433 (1979). For a discussion of some of the details of this rule, see Note, *The FTC's Preservation of Consumers' Claims and Defenses: Consumer Security or Consumer Fraud?*, 11 VAL. U.L. REV. 263 (1977).

The holder-in-due-course doctrine is established in virtually all states by legislation adopting the relevant sections of the U.C.C. §§ 3-302, 3-305 (1972). Since the Federal Trade Commission has no authority to repeal state legislation, the Rule requires that any credit contract to which the Rule applies must include a bold typeface notice stating that any holder of the contract is subject to claims and defenses available against the seller of goods or services. This notice probably renders a contract containing it non-negotiable, U.C.C. § 3-105(2), but even if it does not, any holder, even a holder in due course, would be subject to defenses arising from the underlying sales transaction, U.C.C. § 3-119(1). If a contract omits the notice, it could be considered an illegal contract, thereby giving the debtor an illegality defense against any holder of the instrument. *See* U.C.C. § 3-305(2)(b).

144. Perhaps the most significant disadvantage for the consumer debtor, who rarely retains an attorney, is that it generally is easier to defend than to prosecute *pro se*. For example, there typically are fewer technical requirements of pleading and proof imposed by law on defendants. Moreover, as a defendant, a debtor usually receives official notices (*i.e.*, process) telling him or her where to go.

145. *See generally* Wallace, *The Logic of Consumer Credit Reform*, 82 YALE L. J. 461

objection to the holder-in-due-course doctrine stemmed from concern about frustration of the policy objectives sought to be achieved through the original provision of defenses. Many debtor defenses are based on contract doctrine such as breach of warranty, fraud or misrepresentation. Provision of these defenses can be justified as part of our regulation of the market to achieve allocative efficiency and maximization of wealth.[146] Breach of warranty defenses, for example, encourage sellers to deal only in goods of adequate quality, avoiding losses associated with use of inferior goods. To the extent debtors do not assert or are prevented from asserting such defenses, sellers do not receive the appropriate incentive. In sum, abolition of the holder-in-due-course doctrine was justified partly as a means of making markets operate more efficiently.[147]

(1973); Dauer & Gilhool, *The Economics of Constitutionalized Repossession: A Critique for Professor Johnson and a Partial Reply*, 47 S. CAL. L. REV. 116 (1973).

146. *See generally* R. POSNER, ECONOMIC ANALYSIS OF LAW, ch. 4 (2d ed. 1977).

147. *See* FTC's State of Basis and Purpose for its Trade Regulation Rule, 40 Fed. Reg. 53,506 (1975); Kripke, *Consumer Credit Regulation: A Creditor-Oriented Viewpoint*, 68 COLUM. L. REV. 445, 469-73 (1968); Schwartz, *Optimality and the Cutoff of Defenses Against Financers of Consumer Sales*, 15 B.C. IND. & COMM. L. REV. 499 (1974); Comment, *Consumer Protection—The Role of Cut-off Devices in Consumer Financing*, 1968 WIS. L. REV. 505. Most of the arguments not mentioned in the text for abolition of the holder-in-due-course doctrine are adequately discussed in this literature.

One possible effect stemming from abolition of the doctrine has never adequately been considered. Abolition, if it has any effect at all in making it easier for debtors to assert defenses, will increase the cost of extending credit, with the predictable effects on interest rates and credit availability. So long as these increased costs are borne exclusively by credit consumers, and particularly if they take the form of higher interest rates, there is nothing necessarily inappropriate about this burden. More so than probably any other single reform, all debtors can potentially benefit from the abolition of the holder-in-due-course doctrine.

Because of usury statutes, it is possible that some of the extra costs associated with abolition of the doctrine will be transferred to cash consumers by raising the price of goods rather than the cost of credit. Competition between sellers for the business of cash customers, where such competition exists, should limit the extent to which costs are transferred in this manner. To the extent the costs are so transferred, however, it forces consideration of tbe equity of forcing cash buyers to pay for a benefit extended exclusively to credit buyers. In seeking redress for breaches of warranty and the like, cash buyers remain in basically the same position as credit buyers were in before the FTC Rule—tbat is, they must initiate an action against the seller.

It recently has been argued that it is appropriate for cash buyers to bear some of the costs of extending credit, as credit permits a seller to increase total sales, yielding economies of scale that benefit cash and credit buyers alike. *See generally* Wallace, *The Uses of Usury*, *supra* note 93. The FTC Rule may also make it more difficult for merchants dealing in shoddy goods or services to continue in business, possibly benefiting both cash and credit buyers. While there is considerable merit to these arguments, they do not indicate how much of the costs of extending credit should be borne by cash customers. Abolition of the holder-in-due-course doctrine, as it interacts with usury statutes, may cause cash customers to bear more credit costs than they should.

There is another way in which cash buyers could suffer from abolition of the holder-in-due-course doctrine. If abolition enables many or most credit buyers to obtain effective redress for breaches of warranty, one result may be lessened political pressure to develop other

There has been increasing recognition over the past ten years that pre-judgment execution remedies—or provisional remedies as they are often called—also often make it difficult for consumer debtors to raise defenses in collection actions. Provisional remedies permit a creditor to execute coercively without first obtaining a judgment establishing the validity of the alleged debt.

The availability of pre-judgment remedies has always varied considerably between states and by type of credit. Until recent years every jurisdiction afforded a secured creditor a method of seizing collateral without first establishing judicially the validity of the debt and the existence of a default. Private repossession by the creditor typically was permitted when the nature and location of the goods made seizure possible without committing a breach of peace.[148] Where a breach of the peace was likely to occur, as is generally the case except for repossession of motor vehicles and a few other goods, a secured creditor needed to obtain an ex parte writ from a court clerk and to arrange for the sheriff to levy on the collateral under it, pursuant to a procedure known alternatively as claim and delivery or replevin and double bonding.[149]

Provisional remedies have not been so uniformly available to creditors without consensual security interests. In nearly all jurisdictions certain kinds of creditors are given special rights in special assets of the debtor. These statutory liens—for example, the landlord's distress for rent, or the repairmen's lien in the goods repaired[150]—uniformly have allowed the creditor to retain or obtain

effective means of redress, ones that would benefit cash buyers as well—for example, improved court procedures so that it is easier for a consumer to prosecute *pro se*, or greater emphasis on public agency regulation of sellers who constantly breach implied or express warranties. *See generally* M. EDELMAN, POLITICS AS SYMBOLIC ACTION (1971).

The points herein raised militate against abolition of the holder-in-due-course doctrine. They are not presented as a conclusive policy statement, as there are many other arguments favoring abolition. Nonetheless, so long as usury statutes continue to exist, they identify costs to be weighed against the benefits of preserving defenses to a creditor's collection action. They have relevance, therefore, to the subsequent discussion of preserving defenses by eliminating provisional remedies.

148. U.C.C. § 9-503. For a discussion of what constitutes a breach of peace in the repossession context, see White, *Representing the Low Income Consumer in Repossessions, Resales, and Deficiency Judgment Cases*, 64 NW. U.L. REV. 808 (1970).

149. Typical procedures, those of Florida and Pennsylvania, are discussed in Fuentes v. Shevin, 407 U.S. 67 (1972).

150. There is an amazing variety of such liens, varying considerably between jurisdictions. Some are common law in origin, but more often today they are statutory. The liens in effect give special collection rights to the creditors benefited. Sometimes these special rights can readily be justified in policy but often the liens are most easily explained as protection of special interests. For example, in Wisconsin "every owner of a stallion, jackass, or bull, or semen therefrom" used for breeding purposes has a statutory lien on "any dam served" for the price of the service. WIS. STAT. § 289.49 (1977).

possession of the debtor's property without first obtaining a court order. In many jurisdictions, private sale of the property without prior judicial authorization or suit on the alleged debt has also been permitted.[151] Unsecured creditors without the benefit of statutory liens previously were sometimes able to garnish wages or attach assets of the debtor by obtaining a routine, pre-judgment, ex parte writ from a court official, typically a clerk. In some jurisdictions such remedies were available in almost any circumstances. In other jurisdictions the availability of such remedies was limited, typically to situations in which the creditor alleged or showed by affidavit that a special need for them existed.[152]

As is well known, since the Supreme Court's 1969 decision in *Sniadach v. Family Finance Corp.*,[153] nearly all provisional remedy provisions have been subjected to constitutional attack. To evaluate those attacks, it is useful first to describe how provisional remedies formerly made it difficult for consumer debtors to raise defenses.

Although provisional remedy procedures typically permitted a creditor to execute coercively before the debtor even received official notice of the proceeding, debtors in theory were always provided with some opportunity subsequent to seizure of the asset to assert alleged defenses to the debt or to claim that under the particular circumstances the creditor was not entitled to a provisional remedy.[154] In practice, debtors rarely benefited from an opportunity for

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Another type of statutory lien not discussed in the text gives the creditor no special rights of possession to the debtor's property but does help establish the favored creditor's priority in the debtor's assets *vis-à-vis* other creditors. A subcontractor's or materialman's lien is a good example.

151. At common law, liens of this nature, which generally arise out of bailment transactions, only gave the creditor the right to retain possession of the goods against the debtor's wishes. Statutes, however, often authorize self-help sale of the goods retained. *See, e.g.*, WIS. STAT. § 289.48 (1977); U.C.C. § 7-210 (1972).

152. To obtain a provisional remedy, a creditor often was required by statute to establish a legitimate reason to believe the debtor would conceal assets. *See, e.g.*, WIS. STAT. § 811.03(1)(B) (1977).

For a general discussion of pre-judgment attachment and garnishment procedures and prerequisites, see RIESENFELD, *supra* note 18, at 244-53. Another device preventing debtors from raising defenses, formerly available in some jurisdictions, was the cognovit clause. *See* EPSTEIN, *supra* note 13, at 35-38. Use of the cognovit clauses has largely disappeared in consumer contracts, primarily because of a provision in the Truth-in-Lending Act that establishes a "cooling-off" period for all contracts containing a cognovit provision. *See* Note, *Consumer Protection—Truth in Lending and the Cognovit Judgment*, 1970 WIS. L. REV. 216. *See also* Swarb v. Lennox, 405 U.S. 191 (1972).

153. 395 U.S. 337 (1968).

154. If the creditor was required to initiate a legal proceeding to obtain court approval for a provisional remedy, as under a claim and delivery statute, typically the debtor could request a post-seizure hearing within the same legal action. Liens can often be foreclosed by self-help procedures, however, and in such circumstances a debtor needed to file a new lawsuit to challenge the validity of the debt or lien foreclosure. *See, e.g.*, WIS. STAT. § 289.48 (1977).

a post-seizure hearing. Either the debtor did not request a subsequent hearing, or, where the provisional remedy procedure required the creditor to initiate the action, the case was settled or the creditor obtained a default judgment. Simple ignorance of legal procedures accounted for much of this debtor behavior. The other reason for this behavior illustrates most clearly how provisional remedies could cut off debtor defenses. Where property had been seized, the debtor suffered the loss of use of the assets and often also faced the prospect of an execution sale, with its customary "lost value" characteristics.[155] Though there is little direct evidence in point, it is widely believed that in these circumstances debtors often quickly agreed to resume "voluntary" payments if the creditor returned the assets, even if the debtor believed a defense to the alleged debt existed.[156] Pre-judgment wage garnishment was likely even more effective in inducing debtor acquiesence, since garnishment, and the resulting implicit threat of further garnishment, threatened or was perceived to threaten the debtor's job security.

Doctrinally, the constitutional attacks on provisional remedies have rested on the proposition that it constitutes a taking of property without due process to deprive an alleged debtor of use of assets, no matter how temporarily, without an opportunity for a hearing before seizure.[157] Though there is undoubtedly still some room for argument,[158] in the past few years the United States Supreme Court appears to have adopted a clear position respecting these attacks. In *Flagg Bros. v. Brooks*[159] the Court held that private sale of goods held by a creditor under a warehouseman's lien, which sale was explicitly authorized by statute, did not involve state action, and hence that constitutional prescriptions did not apply. There is every reason to believe a similar conclusion should be reached respecting other self-help procedures, such as repossession of motor vehicles.[160]

155. In some jurisdictions an execution sale under a provisional writ could occur before the subsequent hearing on the validity of the creditor's underlying claim. In such circumstances, even if the debtor could establisb the wrongfulness of coercive execution, the debtor could not obtain return of the seized assets, and a money judgment for wrongful seizure was unlikely to equal the value of the assets to the debtor.

156. Of course, sometimes the mere threat to initiate a provisional remedy procedure was sufficient to persuade a debtor to abandon a defense and to resume voluntary payments, without the necessity of actual resort to provisional remedies.

157. Technically, the most that supporters of this proposition could have expected would have been a constitutional rule that creditors are not entitled to provisional remedies unless they can establish at a pre-seizure hearing the *probable* validity of tbeir claims. *See, e.g.*, Sniadach v. Family Fin. Corp., 395 U.S. 337, 342 (1969) (Harlan, J., concurring).

158. *See* Newton, *Fuentes "Repossessed" Reconsidered*, 28 BAYLOR L. REV. 497 (1976).

159. 436 U.S. 149 (1978).

160. *See* Adams v. Southern Cal. First Nat'l Bank, 492 F.2d 324 (9th Cir. 1973), *cert.*

Where state procedures require prior court issuance of a writ before pre-judgment execution, state action clearly is present. The Supreme Court has indicated that in these situations a pre-seizure hearing after notice to the debtor is usually not constitutionally required.[161] Rather, it appears normally to be sufficient if the application for an ex parte writ is supported by an affidavit alleging specific facts supporting the creditor's entitlement to the pre-judgment remedy, and if there is provision for a prompt hearing subsequent to execution of the writ at which the debtor can raise defenses. It is also possible, although not yet clear, that issuance of the ex parte writ by a judge rather than a court clerk will be constitutionally required.[162] Although it is not yet resolved, there may be some instances where these procedures will not suffice—most importantly with respect to wage garnishment, where notice and an opportunity for a hearing may be required before pre-judgment execution.[163]

The Supreme Court's response to the constitutional attack on provisional remedies has been less than many commentators and consumer advocates had hoped for.[164] To be sure, a debtor who believes a valid defense exists may now be less motivated than previously to settle the case and to resume voluntary payments immediately following ex parte execution, since the hearing at which the debtor's defenses can be heard generally will be available more quickly than previously.[165] This impact will almost certainly be

denied, 419 U.S. 106 (1974). *But see* Thompson, *Piercing the Veil of State Action: The Revisionist Theory and A Mythical Application to Self-Help Repossession*, 1977 WIS. L. REV. 1.

161. North Georgia Finishing Inc. v. Di-Chem, Inc., 419 U.S. 601 (1975); Mitchell v. W.T. Grant Co., 416 U.S. 600 (1974). *See also* Carey v. Sugar, 425 U.S. 73 (1976).

162. In his concurring opinions in both *Mitchell* and *Di-Chem*, Justice Powell argued that it was sufficient if a neutral official, such as a court clerk, determined the sufficiency of the affidavits and issued the writ. In his opinion for the Court in *Mitchell*, however, Justice White emphasized that under the challenged Louisiana procedure, only a judge could issue the writ. It was not necessary for the Court to address this question in *Di-Chem*.

163. Neither the *Mitchell* nor the *Di-Chem* decisions disapproved the holding in *Sniadach*, generally understood to have prohibited any pre-hearing garnishment of wages. If *Sniadach* is an exception to the usual application of due process principles to creditors' remedies, the basis for the exception remains unclear. Perhaps *Sniadach* is part of an emerging "brutal need" doctrine, requiring more due process than usual when the contemplated deprivation will cause great hardship. *See* Mathews v. Eldridge, 424 U.S. 319 (1976); Goldberg v. Kelly, 397 U.S. 274 (1970). Justice Powell's concurrence in *Mitchell* is suggestive of this view. *Mitchell*, 416 U.S. at 628 n.3.

164. Still, the Supreme Court's standards for situations involving state action will require revision of most state statutes establishing provisional remedies. Rarely do present state statutes provide for a prompt post-seizure hearing at which the debtor can raise defenses. *See, e.g.*, United States Gen., Inc. v. Arndt, 417 F. Supp. 1300 (E.D. Wis. 1976), wherein Wisconsin's attachment statute was declared unconstitutional.

165. Similarly, the availability of a quick hearing will sometimes limit the leverage

modest however, as available evidence indicates that few debtors will take advantage of the immediate post-seizure hearing, even if they believe a defense exists.[166]

Procedural oppression practiced by creditors and court systems on the unrepresented consumer debtor is a sufficient explanation for much of the failure of debtors to raise defenses. For example, to contest a creditor's claim successfully, it is often necessary to make several different court appearances, each in the daytime usually requiring that the debtor take time off work.[167] Even if these practices were corrected, however, because of timidity and general alienation from courts, among other reasons, relatively few debtors without an attorney would be likely to take advantage of an opportunity for a hearing. Evidence for this view comes from the apparent failure of small claims courts, which typically have somewhat simplified procedures, to induce a great number of consumer debtors to assert defenses.[168]

The conclusion that the Supreme Court's standards for provisional remedies will have only modest effects in preserving debtor defenses raises the question of what else might be done. One implication of the preceding analysis is that not even complete abolition of provisional remedies would be very effective in preserving consumer defenses. A creditor would need then only to obtain a judgment—typically by default—before resorting to execution remedies.[169] Such a system would undoubtedly increase the creditor's

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effects of a threat to use provisional remedies. *See* note 156 *supra.*

166. The best available evidence comes from Professor Caplovitz' famous study of consumer debtors. CAPLOVITZ, *supra* note 8. Caplovitz' debtors were not subjected to provisional remedies, but rather were sued for a judgment on the merits. Thus, each debtor had a clear opportunity to raise defenses before judgment or execution. Only about 20% of the Caplovitz sample filed an appearance, and only about 5% filed an answer. Yet, fully one third of the Caplovitz sample believed they had at least a partial defense to the debt. *Id.* at 37-46, 91-123, 215.

167. *Id.* at 191-224; Note, *The Persecution and Intimidation of the Low-Income Litigant As Performed by the Small Claims Court in California,* 21 STAN. L. REV. 1657 (1969).

168. *See* Yngvesson & Hennessey, *Small Claims, Complex Disputes: A Review of the Small Claims Literature,* 9 LAW & SOC'Y REV. 219 (1975). It may be easier to defend than to prosecute *pro se,* see note 144 *supra,* but apparently it is not easy enough.

It is worth noting in this context that the Supreme Court's constitutional standards for provisional remedies apparently permit a procedure by which there would be no post-seizure hearing even scheduled unless the debtor takes the initiative to request one. This procedure might require the consumer to do more to obtain a hearing than do many contemporary small claims court procedures.

169. In an earlier study I co-authored concerning the impact of Wisconsin statutory provisions which largely eliminated provisional remedies, we found that debtors rarely raised defenses, even when the creditor was seeking judicial permission to repossess an automobile. Whitford & Laufer, *Wisconsin Consumer Act, supra* note 4, at 652. It is possible, of course, that the prospect of a pre-seizure hearing deters creditors from resorting to coercive execution where debtors have a valid defense.

costs in resorting to execution, but the increase in the percentage of debtors asserting defenses once execution was initiated would probably be slight.

One method of preserving debtor defenses would be to provide all consumers with free or heavily subsidized legal services. The Supreme Court's standards for provisional remedies to permit a debtor to assert defenses at a post-seizure hearing after suffering only the usually minimal inconvenience of nonuse of the seized goods for a few days. The availability of free legal services may provide many consumers with the moral fortitude needed to take advantage of this right, at no financial cost to themselves.[170]

A program of providing free legal services to nearly all debtors would be so tremendously costly that it is worth inquiring whether the policy objectives underlying the goal of preserving debtor defenses might be achieved in some other, cheaper way.[171] Some of these objectives emphasize protection of the debtor's dignity, and of perceptions of the legal system's legitimacy, by giving debtors a chance to be heard on bona fide defenses before being deprived of wages or property.[172] These objectives would no doubt be best served by the provision of some procedure which would ensure that debtors had defenses heard before execution. A system such as the one recently mandated by the Supreme Court may fulfill dignity objectives better than most prior systems, however, since it guarantees at least an opportunity for a meaningful hearing on alleged defenses.

The other principal reason identified earlier for preserving defenses concerns the market efficiency aspirations that underlie provisions of the defenses in the first instance.[173] Yet, there are a number of techniques for fulfilling these objectives other than preservation of debtor defenses in a collection action. Through class actions and government initiated suits to require restitution to defrauded consumers,[174] it is possible to compensate both cash and credit con-

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170. For these reasons, I suspect that the Supreme Court's new standards for provisional remedies will be quite effective in preserving the defenses of debtors who patronize legal services agencies. This depends in part on the ability of debtors to withstand the threats of execution and other harrassment likely to precede the invocation of provisional remedies, but legal advice may help in this respect as well.

171. Another possible objection to such a proposal is that it may be in some sense too effective. I have heard many legal services lawyers allege that they can win nearly any consumer credit case, regardless of the merits, simply by initiating extensive discovery or by exploiting some other litigation device. *See, e.g.*, Landers, *supra* note 56. The key is that the debtor's litigation strategy is relatively unaffected by cost considerations whereas the creditor does not enjoy such luxury.

172. *See* text accompanying note 145 *supra*.

173. *See* text accompanying notes 146-47 *supra*.

174. Many states now permit state agencies to seek court orders requiring fraudulent businesses to compensate all victimized consumers. The Federal Trade Commission recently

sumers for losses suffered as a result of systematic fraud or warranty violations. There is also considerable effort these days to prevent defenses such as breach of warranty from arising in the first instance, through the work of such agencies as the Consumer Product Safety Commission and the consumer protection divisions of state Attorney General offices.[175] There is nothing inconsistent, of course, with serving the market regulation objectives in these manners and in addition by effectively preserving debtor defenses in collection actions.[176] If the latter can be effectively accomplished only by providing debtors free legal services, the high cost might be justified if the effect would be greater general deterrence of breaches of warranty or other seller malfeasances.[177] Given the availability of other approaches to achieving market efficiency aspirations,[178] however, there is considerable doubt whether enough would be gained from the effective preservations of defenses to justify the high cost of providing free legal services to all debtors.

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received similar statutory authority. 15 U.S.C. § 57b (1976). The Magnuson-Moss Warranty Act, 15 U.S.C. § 2301 (1976), provides further public remedies against breaches of warranty and the like.

175. For a description of the work of these offices, see P. SCHRAG, COUNSEL FOR THE DECEIVED (1972); Jeffries, *Protection for Consumers Against Unfair and Deceptive Business*, 57 MARQ. L. REV. 559 (1974).

176. *See* Rice, *Remedies, Enforcement Procedures and the Duality of Consumer Transactions Problems*, 48 B.U.L. REV. 559 (1968).

177. Moreover, distribution of the costs through the tax system could be justified, since the benefits—better quality goods, improved legitimacy for the legal system, etc.—are widely dispersed. Even distribution through a highly progressive tax system can be viewed as simply distributing the costs in proportion to benefits received.

178. It is not my position that the public remedies noted previously have heretofore sufficiently deterred breaches of warranty. Moreover, I am quite aware of the many difficulties in making public remedies more effective. But given the tremendous cost of providing free legal services to all consumer debtors, I am not presently convinced that by means of a less costly investment public remedies can never be made to work adequately.

There are still other approaches to remedying and deterring fraud and breaches of warranty, of course. One would be to guarantee substantial damages to consumers who successfully litigate, irrespective of proof of actual damage. Such an approach provides an incentive to consumer litigation. Because it standardizes damages, it also makes class actions more feasihle. A similar approach is generally credited with forcing substantial creditor compliance with the Truth-in-Lending Act. *See* Feldman, *supra* note 131, at 484-85; Whitford, *Disclosure Regulation in Consumer Transactions*, *supra* note 4, at 432-35. This approach runs the risk, however, of stimulating costly "strike" suits by consumers. *See generally* Landers, *supra* note 56.

My analysis is analogous to assessments of suggested reforms of other systems, such as the welfare system, by "judicialization"—that is, by providing individuals in the system with private rights that must be asserted in adjudicative proceedings. There too it has been argued that unless expensive assistance is provided, most individuals cannot assert those rights effectively, and thus administrative reform has been seen as a less costly way of accomplishing the same objectives. *See* J. HANDLER & E. HOLLINGSWORTH, THE "DESERVING POOR" (1971); Handler, *Controlling Official Behavior in Welfare Administration*, 54 CALIF. L. REV. 479 (1966).

In sum, it appears that the consumer credit collection system does a relatively poor job in preserving consumer defenses. Since the effective abolition of the holder-in-due-course doctrine by Federal Trade Commission rule, the principal manifestation of this failure is the continued availability of provisional remedies. It is likely, however, that debtors would rarely preserve or assert their defenses even if provisional remedies were abolished, unless free legal services were provided to all consumer debtors. It is not at all clear that the objectives to be achieved by preservation of defenses would justify expenditures of that magnitude.

B. *Inefficiencies in Execution*

In this section I will critique a variety of procedures of formal collection procedure on the basis of whether the procedure is wealth maximizing. These critiques, I reemphasize, are only partial: I do not consider all possible ramifications of a given procedure on the consumer credit collection system.

1. TECHNICAL COURT PROCEDURES

Execution, like other court procedures, has many costly technicalities. The costs are often incurred by the creditor but transferred to the debtor if the creditor is successful. Some costs, inadequately covered by court fees, are absorbed by the taxpayer.[179]

Court procedures are commonly justified on the ground that they reduce error in litigation outcomes.[180] Although at one time a possible justification for many of the costly technicalities of coercive execution, this rationale often falls far short of the mark today. For example, it is the requirement in many jurisdictions that the summons and other court process be served on the debtor by a sheriff or a process server. But today, service by mail has been established as equally or more reliable, far less costly, and probably less prone to the corruption often involved in services of process.[181]

Another example of an unnecessary costly technicality concerns the problems facing a creditor seeking to discover what leviable assets the debtor owns. Supplemental proceedings are the principal device for discovery. In many jurisdictions a supplemental proceeding cannot be started until a writ of execution has been returned

179. *See* Brunn, *supra* note 43, at 1222 n.48.

180. *See* Posner, *An Economic Approach to Legal Procedure and Judicial Administration*, 2 J. LEGAL STUD. 399 (1973).

181. California Law Revision Comm., *Recommendations Relating to Wage Garnishment and Related Matters* 112-13 (1972); Shuchman, *Travel Costs for Service of Civil Process*, 5 CONN. L. REV. 458 (1973).

nulla bona.[182] This requirement at one time may have forestalled unnecessary discovery proceedings. Today, however, the requirement is a purposeless technicality, since a sheriff will not levy under a writ unless the creditor directs him to property subject to execution.[183]

2. SECONDARY COSTS OF COERCIVE REMEDIES

A debtor is typically injured more by coercive execution than a creditor is benefited. Partly this benefit-cost disparity is due to litigation costs.[184] But the secondary costs of coercive execution are even more important. A debtor whose wages are garnished may face job dismissal or other adverse reaction by his employer.[185] In property execution, a substantial part of the value to the debtor of the property is likely to be lost.[186] These secondary costs fall immediately on the debtor, but their impact by no means stops there. For example, creditors other than the one initiating execution are likely to have difficulty collecting, since the debtor's assets and income have been reduced. Also, in some instances execution will induce a debtor to declare bankruptcy.[187]

Some secondary costs are an unavoidable appurtenance to execution procedures. Whenever secondary costs can be avoided or limited without seriously inhibiting creditors' ability to collect through execution, however, such avoidance seems at first glance clearly consistent with wealth maximization objectives. But even avoidable secondary costs of execution are extremely valuable to creditors as bargaining leverage. As a debtor perceives the costs of execution increasing because of secondary costs, the threat of execution be-

182. *See, e.g.*, WIS. STAT. § 816.03(1)(a) (1977). Supplemental proceedings are today commonly statutorily authorized. Nonetheless, they are basically similar to the traditional creditor's bill proceeding in equity. Doctrinally, therefore, the requirement that an execution writ be returned *nulla bona* reflects the general rule that equitable remedies are available only if legal remedies are inadequate.

183. *See generally* Distler & Schubin, *supra* note 16, for a good general discussion of the wide range of senseless technicalities in New York.

184. Typically these costs are borne partly by each party, thus simultaneously adding to the debtor's injury while detracting from the creditor's benefits. *See* text accompanying notes 12-24 *supra*.

185. *See* text accompanying notes 40-47 *supra*.

186. *See* notes 48-50 *supra* and accompanying text.

187. Of course, the impact will not stop with these other creditors. They will pass the costs on in the form of higher interest rates or reduced credit availability. Paradoxically, therefore, structuring execution remedies so that secondary costs are high may result in reduced credit availability for the marginally creditworthy. A creditor will realize that a single coercive execution—a significant possibility with respect to the marginally creditworthy—can induce bankruptcy and in that way largely destroy the debtor's ability to repay other creditors.

comes a more powerful leverage technique. Debtors might become willing to tap resources not reachable by execution, such as exempt property or loans from friends, in order to settle. Ironically, therefore, one effect of limiting the secondary costs of execution would probably be fewer settlements and more coercive execution.[188] The extent of this effect presumably would be moderated by the incentive creditors would have, given their reduced bargaining leverage, to offer debtors more favorable settlements. Some of these offers would be accepted, thereby avoiding execution.

At this point it would be possible to speculate almost endlessly about the possible advantages and disadvantages of limiting the secondary costs of execution.[189] It is impossible to determine *a priori* whether, from a wealth maximization perspective, it would be desirable to eliminate avoidable secondary costs of execution. The possible effects of such elimination are so complex that it probably would not be practical to obtain enough data from a jurisdiction that had so experimented to permit an adequate wealth maximization analysis. In any event, such data do not exist. Neither do redistributive objectives necessarily favor elimination of avoidable secondary costs. Delinquent debtors would no doubt be somewhat better off, but at some cost to nondelinquent borrowers. Although such a shift in resources may be desirable, redistribution is not likely to take place across class lines.[190] In sum, on the basis of traditional values it is impossible to know for certain whether minimization of the secondary costs of execution would be desirable.

3. INCENTIVES TO CHOOSE AN INEFFICIENT REMEDY

As a practical matter, the choice of which coercive execution remedy to invoke is the creditor's alone. Yet the incentives operating on a creditor often fail to provide a reason to choose that execution remedy with the least total lost because the creditor does not

188. Though such an effect seems logical, there is virtually no empirical data bearing on the point. Of course, to the extent debtors would be unaware that execution had become less costly to them, their settlement positions would be unaffected.

189. Assume, for example, that on the average settlements would be more favorable to debtors if secondary costs of execution were minimized. This development would be a gain for dehtors but a cost to the creditors obtaining settlements. Creditors other than those who are parties to the settlements might also be benefited, because debtors with lower payments will more often regain their economic health and pay off all creditors. The gains and costs to different creditors would probably be reflected in the cost and availability of credit, for reasons previously detailed. *See* text accompanying notes 107-10 *supra*. Even debtors who never became delinquent could be benefited or hurt (most likely hurt), therefore, by limiting the secondary costs of execution.

190. For a more complete distributional analysis in a related context, *see* text accompanying notes 111-15 *supra*.

bear all the costs of execution. Litigation costs are often either incurred initially by or transferable to the debtor. Also, the creditor does not bear the secondary costs of execution, sucb as job loss resulting from wage garnishment.

Debtors could take account of the potential harms of coercive execution and bargain for either contract provisions excluding certain execution remedies or appropriate concessions on other terms, such as price. But clearly few debtors consider, or are even aware of, such possibilities. It seems highly improbable, for example, that a creditor could gain competitive advantage over other creditors by offering contracts excluding the availability of the more severe execution remedies.[191] Moreover, because there are externalities of execution, such as welfare costs,[192] not all costs of execution will usually bear on a creditor's choice of execution remedy.

Not only do creditors lack adequate disincentives to avoid the more severe execution remedies, but, because execution is primarily a means of obtaining bargaining leverage, creditors frequently have a positive incentive to choose a remedy costly to the debtor. The ability to make credible threats of imposing substantial costs through coercive execution enhances a creditor's bargaining leverage. Occasionally a creditor may initiate execution and impose such costs in order to establish a reputation that will lend credibility to later threats. This course of action can be rational for a creditor even if it is likely to render uncollectible a particular debt—where, for example, a debtor loses his or her job after garnishment.[193]

The incentive for creditors to choose a costly execution remedy is potentially efficient in a wealth maximization sense. For, as creditors enhance their bargaining leverage, presumably settlements increase and executions decline, thereby reducing overall collection costs. But because debtors rarely consider execution remedies at the time of contract, it would be pure chance if creditors choose execution remedies that maximize wealth optimally. More likely, creditors too often choose execution remedies which impose heavy costs on debtors.

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191. On the other hand, a creditor's competitive position can be affected adversely by a reputation for actually using harsh collection tactics. *See* text accompanying notes 52-53 *supra*.

192. *See* text accompanying notes 96-97 *supra*.

193. The landmark case of Williams v. Walker-Thomas Furniture Co., 350 F.2d 445 (D.C. Cir. 1965), must have involved a situation of this nature. *See* note 50 *supra*. *See also* Leff, *Coercive Collection*, *supra* note 4, at 34-36. Leff suggests that another reason a creditor may act in this otherwise "irrational" manner is to gain spite. *Id.* at 18-19.

4. BANKRUPTCY AND EXEMPTION STATUTES

Although the Bankruptcy Act and the various exemption statutes do not provide execution remedies, they do affect the outcome of coercive execution. Exemption statutes set an upper limit on what can be collected in a wage garnishment or property execution proceeding intiated by an unsecured creditor; discharge in bankruptcy is usually a bar to coercive execution by unsecured creditors.[194]

One difficulty in evaluating the efficiency of the Bankruptcy Act and exemption statutes is that both have a mix of inconsistent objectives.[195] Both types of regulation reflect concerns of maximizing wealth. Many exemption statutes reflect the philosophy that the debtor should keep some minimum property so that after coercive execution his or her skills can better be used productively. Thus, exemption statutes commonly exempt items needed for basic sustenance (clothing, cooking utensils, etc.) and tools of trade.[196] The discharge provisions of the Bankruptcy Act can be rationalized on similar grounds. The traditional "fresh start" rationale for the discharge provisions of the Act suggests a view that a debtor can become so overburdened with debt, and can anticipate such a lengthy period of subsistence living while disposable earnings are used mostly for debt retirement, that he or she loses incentive to exploit personal skills productively.[197] Discharge of debt, like exemption statutes, therefore, promotes wealth maximization through realization of human skills.[198]

194. Traditionally, bankruptcy was almost exclusively a creditor's remedy, a way in which creditors could force liquidation of a debtor's "estate" and pro-rata distribution to creditors. In this sense, bankruptcy was an antidote for the injustice sometimes resulting from the first-in-time, first-in-right priority rules that cbaracterize other creditor's remedies. Today, however, with respect to the consumer, involuntary, creditor-initiated bankruptcy is almost unknown. Creditors so rarely receive substantial payments through bankruptcy that I can appropriately analyze bankruptcy as exclusively a debtor relief process.

195. *See* Shuchman, *An Attempt at a "Philosophy of Bankruptcy,"* 21 U.C.L.A. L. REV. 403 (1973), illustrating the complex mix of objectives underlying tbe Bankruptcy Act.

196. *See, e.g.*, WIS. STAT. § 815.18 (1977).

197. *See* Weistart, *The Costs of Bankruptcy*, 41 LAW & CONTEMP. PROBS. 107, 110-11 (1977); *see also* note 42 *supra*. For the argument that this rationale for bankruptcy discharge is not persuasive, see *Discussion*, 41 LAW & CONTEMP. PROBS. 123, 150-57 (1977).

198. Exemption and bankruptcy statutes may also serve wealtb maximization objectives by setting a floor on the riskiness of indebtedness and hence promoting borrowing. If prospective debtors as a whole are excessively risk adverse, promotion of borrowing will further society's overall economic interests. In many circumstances borrowing can enable a debtor to act in a more efficient manner than he or she could otherwise. For example, borrowing can enable a debtor to purchase a washing machine rather tban to patronize a laundromat, effecting an overall reduction in laundry costs. This rationale is analogous to a common justification for the growth of limited corporate liability in the 18th and 19th centuries. *See also id.*

Although the general principles of exemption statutes and bankruptcy can be justified on wealth maximization grounds, there are many provisions that are most easily justified in terms of other objectives. Many provisions in exemption statutes and much of bankruptcy law reflects basic humanistic relief-of-hardship concerns. Such concerns seem the most obvious reason for those exemption statutes designed to prevent a drastic decline in a debtor's standard of living, such as the federally imposed requirement that wage garnishment not exceed twenty-five percent of earned income.[199] Other provisions in exemption and bankruptcy laws can be explained as special interest legislation. In Wisconsin, for example, up to one thousand dollars deposited in a savings and loan association, though not the same amount deposited in a bank, can be exempt from execution. This provision is seemingly designed to promote deposits in savings and loan institutions.[200] Various aspects of exemption and bankruptcy law are also means of relieving debtors from anxiety and emotional distress associated with collection. Thus, goods of sentimental value are sometimes exempt from execution.[201] Also, the automatic stay of all coercive execution resulting from the filing of a bankruptcy petition brings welcome relief[202] to the debtor fearing, or reeling from, repeated executions.

Because of the multiplicity of purposes served by exemption and bankruptcy statutes,[203] it is almost impossible to assess the

199. 15 U.S.C. § 1673 (1976).

200. WIS. STAT. § 815.18(22) (1977). The exemption is not available if the debtor claims a homestead exemption. *Id.*

In labeling this provision a "special interest" one, I do not mean to exclude the existence of possible legitimate public purposes. For example, because savings and loan institutions are generally required to invest almost exclusively in real estate, their existence may make more money available for purchase of individual homes than there would be if banks were the primary depository of consumer savings. Thus, the exemption statute cited in the text can be seen as part of the state's overall policy to encourage individual home ownership.

Another example of special interest influence in exemption laws is the common exemption of assorted interests in life insurance policies. *See, e.g.*, WIS. STAT. § 815.18(19) (1977). The life insurance industry, of course, has consistently supported such exemptions.

In bankruptcy, most tax debts are non-dischargeable. *See, e.g.*, 11 U.S.C.A. § 523(a)(1) (1979). The consistent vigorous support for this policy by federal, state, and local tax collection agencies may indicate that the policy reflects their special interests.

201. *See, e.g.*, WIS. STAT. § 815.18(10) (1977) (exempting "keepsakes").

202. 11 U.S.C.A. § 362 (1979).

203. The complexity is further illustrated by the many "exemptions" from exemption statutes—that is, debts of particular types to which exemption laws do not apply. Commonly, for example, property obtained with the proceeds of a loan or other credit extension is subject to execution by that creditor, even though that property is otherwise exempt and the creditor is unsecured. *See* Vukowich, *Debtors' Exemption Rights*, 62 GEO. L.J. 779, 854-55 (1974). Such provisions reflect the law's historical favoritism of the purchase money creditor. Tort and tax creditors are also often excepted from exemption statutes. *Id.* at 857-86. The latter exceptions might be justified on the ground that these creditors are largely "involuntary"

extent to which they fulfill those purposes. Indeed, a common criticism is that exemption and bankruptcy statutes attempt to serve too many conflicting purposes, with the result that nothing is accomplished very well.[204] A further difficulty in critiquing the Bankruptcy Act is that an extensive revision of the Act has just come into force.[205] Faced with these difficulties, I will content myself with a few comments, mostly reflecting wealth maximization concerns, about major aspects of exemption and bankruptcy statutes.

The exemption statutes of many states provide such limited exemptions that they do not protect sufficient assets to permit a debtor to remain productive. They are, thus, probably inconsistent with wealth maximization objectives. They also clearly fail to fulfill any reasonable relief-of-hardship objective. Moreover, in many jurisdictions it is necessary for a debtor to claim exemptions by some official procedure, such as showing in court that the exemptions are "necessary" for subsistence. Perhaps because of ignorance, timidity, or for other reasons, debtors in these jurisdictions often fail to claim or establish their full exemptions, again with deleterious consequences to wealth maximization or relief-of-hardship objectives.[206] Bankruptcy laws can also fail to provide adequate relief to the heavily indebted, for example, where many debts are unaffected by discharge.[207]

Perhaps the most common reason exemption statutes and the Bankruptcy Act have provided inadequate relief is that neither has had much impact on the position of the secured creditor. Few states

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creditors. Contractual creditors, on the other hand, are generally in a position to inform themselves of the risks imposed on them by exemption statutes before they extend credit.

204. *See id.*; Karlen, *Exemptions from Execution*, 22 BUS. LAW. 1167 (1967). The Report of the National Commission on Bankruptcy Laws reflected a similar view in many of its recommendations. For example, the Commission recommended drastic changes in the present Bankruptcy Act's provisions respecting the extent to which tax creditors were favored in bankruptcy. The attitude of the Commission seemed to be that although protection of public treasuries may be a legitimate objective, it had been allowed to interfere unduly with other objectives more basic to bankruptcy, including the wealth maximization objective of providing the debtor with a fresh start. BANKRUPTCY COMM. REP., *supra* note 84, at 213-18. The Commission's recommendations in this respect were not adopted by the Congress.

205. The new Bankruptcy Act will alleviate some of the inadequacies of state exemptions. Traditionally, state exemptions have applied in bankruptcy. The new Act, however, establishes federal exemptions in bankruptcy, and now allows a debtor to cboose those exemptions or state exemptions. A state may, however, provide that its domicilaries may not elect federal exemptions in bankruptcy, 11 U.S.C.A. § 522 (1979). The new federal bankruptcy exemptions are more generous than those granted by many states. A particularly desirable federal exemption permits a debtor unable to qualify for a homestead exemption to instead exempt other property of equivalent value. 11 U.S.C.A. § 522(d)(5) (1979).

206. *See* Brunn, *supra* note 43, at 1217-20; Comment, *Wage Garnishment in Washington—An Empirical Study*, 43 WASH. L. REV. 743, 761-63 (1968).

207. 11 U.S.C.A. § 523 (1979).

limit the ability of a creditor to take a security interest in any property, exempt or non-exempt,[208] and exemption statutes do not affect repossession of secured collateral. As a consequence, as illustrated by the facts of the landmark unconscionability case, *Williams v. Walker-Thomas Furniture Co.*,[209] a secured creditor can sometimes "wipe out" a debtor by repossession. Unlike exemption statutes, the Bankruptcy Act does affect the legal position of the secured creditor. The secured creditor's debt is discharged, like other debts, but its "property" interest in the collateral remains intact, entitling the secured creditor to repossess despite bankruptcy. If the creditor actually repossesses, no action for a deficiency lies, as the debt has been "extinguished." In the past, secured creditors have often refrained from post-bankruptcy repossession, preferring instead to induce the bankrupt to reaffirm the entire debt in return for the creditor's promise not to repossess immediately. Such reaffirmations have heretofore been enforceable.[210] But now, the new Bankruptcy Act renders such reaffirmations usually unenforceable.[211] The new Act also permits a debtor to redeem collateral from a security interest by paying the creditor only the fair market value of the collateral.[212] The new Act thus significantly enhances the relief from security interests obtainable in bankruptcy.

Some exemption statutes have been criticized for providing debtors too much protection from coercive execution.[213] One diffi-

208. *But see* WIS. STAT. § 422.417 (1977). The new Bankruptcy Act voids nonpossessory, nonpurchase-money security interests in exempt property, but the provision can be invoked only in bankruptcy. 11 U.S.C.A. § 522 (1979).

209. 350 F.2d 445 (D.C. Cir. 1965). The writ of replevin against Mrs. Williams sought seizure of a wallet, 7 pairs of curtains, an apron set, a pot holder set, 2 beds, a mattress, a chest of drawers, a rug, 4 sheets, a portable fan, a portable typewriter, 2 toy gun and holster sets, 4 kitchen chairs, a bath mat set, shower curtains, a washing machine, and a stereo. Dostest, *Appellate Restatement of Unconscionability: Civil Legal Aid at Work,* 54 A.B.A.J. 1183 (1968).

210. The debtor had incentive to reaffirm the debt in the face of a repossession threat, since it was likely to cost more to replace the items than the amount of debt outstanding, and, in any event, the debtor would have difficulty, given the recent bankruptcy, obtaining credit to finance a replacement purchase. The secured creditor also had an incentive to accept the reaffirmation in lieu of repossesion, as it regained a right to the deficiency in this manner. The reaffirmations were enforceable under state law as post-bankruptcy obligations unaffected by the discharge. *See* A. Corbin, CORBIN ON CONTRACTS 314-16 (one vol. ed. 1952).

211. Reaffirmations must be approved by the Bankruptcy Court before they become enforceable. 11 U.S.C.A. § 524(c) (1979). Because of the redemption provisions, see text accompanying note 212 *infra,* I expect that only rarely will a Bankruptcy Court approve a reaffirmation of an entire debt where the purpose of reaffirmation is to prevent foreclosure on collateral.

212. 11 U.S.C.A. § 522 (1979).

213. *See* note 200 *supra* and authorities cited therein. Texas provides an example of excessive exemptions. Apparently the exemption statues there have rendered coercive execution virtually worthless as a collection device. *See generally* Anderson, *Coercive Collection*

culty with excessive exemptions, it is argued, is that they increase creditors' bad debts and therefore their cost of doing business, inevitably causing increased finance rates or restricted credit availability. Either result is inconsistent with wealth maximization objectives, assuming the present or an increased level of credit extention is or would be optimal.[214] Homestead exemptions in particular are often identified as excessive, at least as they apply to urban dwellers. There is nothing in the objective of protecting a debtor's productive capacity or of avoiding undue hardship, it is argued, that requires protection of a substantial equity in a debtor's home. Roughly half the population, after all, survives more or less adequately as tenants.[215] Such a critique implicitly rejects as illegitimate any effort to prevent too drastic a reduction in a debtor's standard of living.[216] Also, exemptions which tend to be available only to wealthier persons can be seen as improper class legislation.[217]

One aspect of bankruptcy law that has been criticized as excessively generous to debtors is a debtor's absolute right to declare bankruptcy and, in the usual situation, to obtain a discharge. A debtor need not show that discharge or other benefits of bankruptcy are necessary for an economically efficient realization of the debtor's skills or for relief of hardship. Various creditor groups have argued from time to time for the abrogation of the absolute right to go bankrupt. They have contended that before becoming eligible for a bankruptcy discharge, a debtor should be required to attempt a Chapter 13 wage earner plan whenever the debtor's anticipated income and debt level makes such a plan appear feasible.[218]

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and Exempt Property in Texas: A Debtor's Paradise or a Living Hell?, 13 HOUS. L. REV. 84 (1975).

214. This analysis assumes that an increase in finance rates will reduce the demand for credit. Generous exemptions, by reducing the risk in becoming indebted, could stimulate a counter-balancing increase in the demand for credit.

The assumption that a reduced level of credit extension is inconsistent with wealth maximization objectives is commonly made, though it cannot be demonstrated. *Compare* Johnson, *supra* note 30 *with* Wallace, *The Uses of Usury*, *supra* note 93.

215. *See* Vukowich, *supra* note 203, at 806-07.

216. *See* text accompanying note 199 *supra*.

217. A more generalized criticism of the generosity of exemption statutes is applicable only to those jurisdictions which provide exemptions for specified types of property (rather than permitting the debtor to select property as exempt up to a given value). Usually, in these jurisdictions, a transfer of non-exempt for exempt property is not considered a fraudulent conveyance, even if the transfer occurs in anticipation of coercive execution or bankruptcy. *See* RIESENFELD, *supra* note 18, at 378 n.3. Such manipulation often enables a debtor to exempt more assets than is arguably justifiable. Moreover, because it is only the savvy or legally represented debtor (*i.e.*, usually a wealthier debtor) who will engage in such conduct, the ability to manipulate exemptions establishes still another way in which exemption statutes tend to discriminate on an essentially class basis.

218. One survey classified 13 percent of bankrupts as capable of settling their debts

The National Commission on Bankruptcy Laws rejected abrogation of the right to discharge and no such limitations were included in the new Bankruptcy Act.[219] The Commission pointed out that today a debtor rarely successfully completes a Chapter 13 plan without a deep personal commitment to it. It assumed experience would be similar under a compulsory Chapter 13, and further that debtors able and willing to complete a Chapter 13 would voluntarily choose that route even in the absence of compulsion.[220] Experience under a completely voluntary Chapter 13 system, however, cannot be a certain predictor of the result if a good faith effort to complete a Chapter 13 plan were a prerequisite for discharge in bankruptcy. Although the evidence cited constituted inadequate proof, perhaps the Commission was nevertheless correct in concluding that the proposed scheme was administratively impractical. In my judgment, however, the rejection of the creditors' proposal reflects in part other unarticulated beliefs about bankruptcy. A qualified right to go bankrupt seems to be becoming a settled part of our jurisprudence, not to be abrogated except for well-substantiated reason.

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from anticipated future income. H. MATHEWS, CAUSES OF PERSONAL BANKRUPTCIES, 87-93 (1969). For other studies, see STANLEY & GIRTH, *supra* note 61, at 37-39, and authorities cited therein.

Although stories exist of debtors who declare bankruptcy simply to hurt a hated creditor, it is commonly believed that the informal costs of bankruptcy—such as stigma and diminished credit rating—are sufficient to deter most inappropriate bankruptcies. There is, however, little hard data to support this view. A Brookings Institution study of bankruptcy collected data which tended to show both that Americans still attach considerable stigma to bankruptcy, but that for many bankrupts there is little adverse impact on ability to get credit. STANLEY & GIRTH, *supra* note 61, at 230-32, 62-64. But Professor Jacob's nearly simultaneous empirical study in Wisconsin came to considerably different conclusions. JACOB, *supra* note 10, at 111-15.

219. 11 U.S.C.A. § 727 (1979).

220. BANKRUPTCY COMM. REP., *supra* note 84, at ch. 6. Although Chapter 13 plans are not compulsory, if compositions become readily available under the new Act, see note 88 *supra*, the incidence of Chapter 13 proceedings may increase dramatically. One of the advantages of using Chapter 13 under the new Act is that a debtor can obtain a discharge of otherwise non-dischargeable debts upon satisfactory completion of a composition plan. 11 U.S.C.A. § 1328(a) (1979).

221. This view is supported by the House Judiciary Committee Report on the new Bankruptcy Act. HOUSE JUD. COMM. REP. No. 95-595, 95th Cong., 1st Sess., 120-21 (1977). The proposal to condition straight bankruptcy on the infeasibility of Chapter 13 was rejected basically for the same reasons as advanced by the Bankruptcy Commission. The Report also suggests, however, that the proposal might violate the Thirteenth Amendment to the Constitution, which prohibits involuntary servitude, "by forcing an individual to work for creditors." *Id.* As a doctrinal proposition, this suggestion borders on the ludicrous. Nothing in the proposal to condition the right to go bankrupt would require a debtor to work. Involuntary servitude would be no more involved than it is when an individual ineligible for a discharge in bankruptcy is subjected to wage garnishment. The suggestion nonetheless implies that many people think of voluntary bankruptcy as a "right."

C. *Too Little Bargaining: Too Much Execution*

Wealth maximization objectives are usually best served by a bargained rather than a litigated solution to a creditor-debtor dispute because in that way many of the secondary costs of coercive execution are avoided. For example, if a refinancing agreement or a consolidation loan is arranged informally, the debtor pays out of future income but without the risk of job loss that commonly accompanies wage garnishment. If the creditor insists and the debtor agrees to make a lump sum payment, the debtor may raise the money through sale of property. But since the sale can be made privately, the price obtained is likely to be higher, and the "lost value" less, than if there had been property execution.[222]

Bargaining and voluntary payment clearly characterize much of consumer credit collection. Nevertheless, there is too little bargaining and informal settlement, and too much litigation and coercive execution. One cause of excessive execution, already discussed, involves the rules for determining priority among unsecured creditors in an insolvent debtor's limited assets. Unless a composition or extension plan can be arranged, a creditor often has an incentive to seek quick execution. But for the existence of other unsecured creditors, however, that creditor would be better off negotiating a refinancing agreement acceptable to the debtor.[223]

A second cause of excessive execution has been extensively described by Arthur Leff.[224] As previously explained, given but a single creditor and perfect information, a settlement should always be expected.[225] Perfect information never exists, however. Thus, it is never possible for a debtor to predict with certainty whether execution will follow failure to settle; often it is also difficult for the creditor to know if execution proceedings will yield leviable assets. Acquiring information about such matters as the creditor's usual collection practices, the facts underlying any potential defenses to the debt, and the debtor's assets does increase the accuracy of prediction about the outcome of an execution proceeding, but obtaining such information is hardly costless. Moreover, acquisition of reliable information is more difficult because both parties have reason to mislead each other. For example, in attempting to secure a debtor's consent to a refinancing agreement, a creditor can hardly afford to

222. Private sales typically bring larger returns than the public auctions required by most statutory execution procedures. *See* U.C.C. § 9-504, Comment 1 (1972 version); EPSTEIN, *supra* note 13, at 49-51.

223. *See* note 75 *supra* and accompanying text.

224. Leff, *Coercive Collection*, *supra* note 4, at 38-46.

225. *See* text accompanying note 11 *supra*.

let the debtor know that coercive execution is an unlikely recourse if the debtor refuses to agree, even if that is in fact the case.

At some point, it becomes efficient for the parties to forego further investigation and to make rough guesses about the probabilities of execution outcomes. Inaccurate guesses increase the frequency of execution in several ways. Creditors may initiate execution proceedings in the belief that a single execution will persuade the debtor to somehow collect sufficient resources to resume voluntary payments so as to avoid future executions. A given debtor, however, may truly be a "can't pay." In that event the creditor will receive nothing directly in return for its investment in execution.[226] An even more important cause of unnecessary execution is failure of a debtor who can pay to believe a creditor's execution threat, or failure to appreciate the serious consequences of execution.[227] The result may be a partial execution by the creditor—for example, garnishment of a single paycheck—in order to establish both the credibility of the execution threat and the seriousness of the consequences. A debtor will often agree shortly thereafter to resume voluntary payments.

A third cause of excessive execution is that some of the costs of execution are borne by parties external to the transaction, while the rest of the costs are mostly borne by the debtor. I have previously suggested that this distribution sometimes induces a creditor to choose an execution remedy having the highest total cost.[228] For similar reasons, a creditor may sometimes choose execution even though a debtor is able and willing to resume voluntary payments. For example, a creditor may regard the payments as too small in amount, or the risk of further default too substantial, given the substantial lump sum recoverable immediately by foreclosure on

226. Though a creditor may gain some enhanced credibility for future execution threats, a creditor would normally prefer to invest in credibility only when a debtor is a "won't pay." Moreover, a creditor may suffer in the long run if it acquires a reputation for initiating execution against debtors who "can't pay." Few credit customers may choose to do business with such a creditor, for example. For a general description of the processes by which creditors attempt to distinguish "can't pays" from "won't pays," see Rock, *Observations on Debt Collection*, 19 BRIT. J. SOC. 178, 188-89 (1968).

227. A debtor's inaccurate assessment of the consequences of refusing settlement is a more common cause of unnecessary execution than is a creditor's misestimate of the costs of eschewing settlement and initiating execution. Creditors can generally acquire information needed to assess the desirability of settlement more cheaply than debtors. Credit reporting agencies, for example, can provide information useful in estimating the benefits of execution, such as whether there are other judgments outstanding against the debtor. There are few counterpart institutions providing information to debtors. Besides, creditors are typically more experienced in consumer credit collection and know better what information to look for and where to find it. *See generally* Leff, *Coercive Collection, supra* note 4, at 38-46.

228. *See* text accompanying notes 191-93 *supra*.

collateral or the certainty of some payment through wage garnishment. Yet the marginal gains to the creditor from execution, as compared to a settlement involving future payments, may be less than the marginal costs of execution to the debtor, given the risk of secondary costs of execution.[229]

This third "cause" of excessive execution is related to what I have called the second cause, lack of information about creditors' and debtors' circumstances and intentions. No matter how attractive execution is to a creditor, if substantial secondary costs will result, a debtor commonly will be better off by making the creditor an even more attractive offer of settlement. Obviously, I believe debtors make such offers less often than they should from a perspective of personal wealth maximization. This failure can be partly attributed to an information problem of miscalculating where personal advantage lies. The fact that the creditor bears so few of the costs of execution may contribute to this information problem, by inducing creditors to insist on settlement offers that are higher than many debtors consider reasonable.[230]

To the extent that substantial costs of execution will be borne by non-parties to the transaction,[231] execution may be in the joint interest of the creditor and debtor even though not in society's over-

229. I have argued on similar grounds in favor of discouraging repossesion of motor vehicles, in hopes of encouraging more refinancing and informal settlement. Whitford & Laufer, *Wisconsin Consumer Act, supra* note 4; Grau & Whitford, *The Impact of Judicializing Repossession: The Wisconsin Consumer Act Revisited*, 1978 WIS. L. REV. 983 [hereinafter cited as Grau & Whitford, *Wisconsin Consumer Act Revisited*]. In theory, debtors could protect themselves by contract from this type of inappropriate execution, but I have previously argued that it is unrealistic to expect them to so behave.

230. I know of virtually no evidence to support this statement, yet it seems intuitively sound. To restate the proposition, if creditors were forced to bear more of the debtor's costs of execution, there would be fewer executions and more settlements. In such circumstances, the total (joint) costs of execution have not changed. Thus, the number of situations in which settlement is, objectively, more consistent than execution with the parties joint interests should also remain unchanged. Still, I suspect that debtors would more readily perceive acceptable settlement offers (which would be lower in amount than previously) as in their self-interest.

Perhaps some evidence in support of this intuitive judgment comes from experiences I have had in teaching Creditors' and Debtors' Rights. Early in the course, I regularly make the point that it would commonly be in a debtor's interest to offer a creditor in a settlement more than the latter could gain by execution, or even more than the outstanding debt if it were the only way to prevent execution. Many students respond with some considerable amazement, suggesting that a debtor would never offer such an amount. Of course, unless a creditor expects credibility gains from execution, or is simply interested in vengeance, a debtor with bargaining skills ought to be able to strike a better deal. My students' views, however, reflect in part a sense either that debtors would never understand sucb large payments to be in their self-interest or that the pride of debtors would require them to bear the pains of execution rather than the shame of agreeing to a perceived unfair settlement.

231. For a description of externalities of coercive execution, see text accompanying notes 96-97 *supra*.

all interest. Given the presence of externalities to execution, therefore, the distribution of costs of execution is an independent cause of excessive execution.[232]

D. The Informal Processes

I have argued that, in general, informal collection and voluntary settlement is more beneficial than coercive execution. The premise of this argument is largely the heavy costs of the execution process. Yet there are also many well known costs of informal collection. Moreover, if resort to coercive execution is made more difficult, the incentives to creditors to abuse informal collection may increase. It is appropriate, therefore, to now critique informal collection practices.

First, it is possible to analyze the informal bargaining and settlement process on wealth maximization grounds. The usual and desired outcome of the informal process is either a lump sum payment of a delinquency or a refinancing agreement. Ordinarily, such outcomes are maximizing—after all, if debts were not customarily paid, there would inevitably be substantial restriction of the availability of credit. In special circumstances, however, payment of a debt can be non-maximizing. For example, in order to pay a debt, a debtor might forego medical treatment for a family member. In these circumstances, although non-payment will impose costs on other persons (as creditors pass on their losses through higher credit costs or restricted credit availability), those costs will likely be less than the costs of payment to the hard-pressed debtor.[233] In circumstances like these, a principal purpose of the Bankruptcy Act and exemption statutes is to excuse debt payment.[234] But these protections are quite likely to be inadequate because many

232. For this reason, what I have identified as the first cause of excessive execution—priority rules—is independent of information effects. Quick execution to gain priority is a way for a creditor to prevent being victimized by a possible future execution by another creditor. The future execution might, for example, induce job loss or bankruptcy. Insurance against these possibilities might be so valuable to the creditor that no "bribe" by the debtor consistent with his or her self interest (*i.e.*, cheaper than undergoing execution) would be sufficient to dissuade the creditor from execution.

233. This argument is premised on the rather narrow wealth maximization conception I defined earlier. *See* text following note 89 *supra*. A more general resource allocation analysis would require interpersonal comparisons of utility. Although such comparisons are sometimes said to be necessarily subjective and hence improper, I presume that all but a few extremists would permit such comparisons to the extent required to conclude that needed medical treatment would be of greater overall benefit than whatever effects on the cost and availability of credit would be gained if more debts were paid by foregoing needed medical treatment.

234. For a discussion of the inadequacies of these protections in protecting needy debtors from the rigors of coercive execution, see notes 207-12 *supra* and accompanying text.

debtors will not know of them and will be persuaded by creditors to make payments out of needed exempt assets.[235]

In addition to the costs of improvident debt repayment there are a number of other costs associated with the informal settlement of debts. Analogous to what I have called the secondary costs of coercive execution are psychic costs. These costs, such as anxiety, are commonly aggravated by informal creditor harassment.[236] Another occasional cost of the informal bargaining process occurs when a debtor arranges an informal loan from a relative or close friend in order to pay a creditor. When a relative or close friend is motivated by a desire to save a debtor from injury threatened by a creditor, the creditor, whether intentionally or not, is exploiting the compassion of relatives or friends to make them de facto co-signers of the debtor's obligation. This result seems unfair if the relative or friend would not have been willing to become a co-signer when credit was extended.[237] Moreover, to the extent creditors can rely on transferring delinquent debts to friends or relatives in significant volume, creditors have less incentive to avoid risky credit extensions. Strictly from a wealth maximization perspective, the result may be an over-extension of credit.[238]

These examples indicate that, although the informal collection system may be inconsistent with wealth maximization values, it is virtually impossible to know whether corrective regulation would increase consistency with these values. For example, informal creditor collection practices, sometimes prohibited by recent national legislation, include telephoning repeatedly at inconvenient hours

235. Empirical evidence indicates, as one would expect, that debtors who pay voluntarily often must reduce their standard of living. *See* CAPLOVITZ, *supra* note 8, at 286-89. We do not know, however, how often debtors reduce disposable income to substandard levels by voluntary payments, though surely some such instances must occur. I have earlier argued that there are some informal creditor leverages that even the savvy debtor finds it difficult to counteract. *See* notes 72-73 *supra* and accompanying text. In these circumstances, obviously the bankruptcy and exemption statutes inadequately protect the hard-pressed debtor from payment.

236. *See* Anderson, *supra* note 124. For evidence that anxiety caused by creditor harassment can cause health problems, see CAPLOVITZ, *supra* note 8, at 280-86; JACOB, *supra* note 10, at 105.

237. Recent reform legislation provided greater protection to the voluntary co-signor by requiring extensive disclosure at the time of contract of the obligations undertaken. *See, e.g.*, WIS. STAT. § 422.305 (1977); Proposed FTC Trade Regulation Rule on Credit Practices, § 444.2(b), 42 Fed. Reg. 52,439 (Sept. 30, 1977) [hereinafter cited as FTC *Proposed Rule on Credit Practices*]. Obviously these reforms do not apply to and cannot help the involuntary co-signor described in the text.

238. On the other hand, if there is already an undersupply of credit, due to some other market failure, the market failure discussed in the text may simply counteract the effects of the other market failure, with the result that there is an optimal extension of credit. This point just further illustrates the inherent indeterminateness of a wealth maximization analysis of consumer credit problems. *See generally* text accompanying notes 91-102 *supra*.

and notifying a debtor's neighbors or relatives of the debt.[239] Such regulation may reduce the anxiety resulting from informal collection, and by doing so may reduce improvident debt repayment as well. But, by inhibiting informal collection, the regulation may also increase coercive execution, with all its costs. Furthermore, if the regulation reduces collections, a likely result will be an impact on the cost or availability of credit.

Objectives other than wealth maximization may also be used to evaluate informal collection activity.[240] After all, if whipping was a common collection tactic, most people would probably support regulation on the ground that whipping was in some sense unfair or inhuman, regardless of whether such regulation would maximize measurable wealth. The increasing concern with protecting individual privacy can justify regulation of informal creditor practices for similar reasons.[241]

Misrepresentation by creditors of the consequences of non-payment has long been the subject of regulatory activity.[242] For example, a collection agency may impersonate a real or fictional government agency, and imply that some vague, undefined official sanction will be visited on the debtor if payment is not forthcoming. But regulation of misrepresentation does not necessarily constitute a distinct regulatory objective. Since, in any collection situation, a debtor is deciding between payment of the debt and some other use of the money, regulation of collection misrepresentation can be justified on the same wealth maximization bases which justify the common law of fraud and misrepresentation.[243]

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239. Fair Debt Collection Practices Act, 15 U.S.C.A. §§ 1692(c)-(d) (1978 Supp.). The Act applies only to persons collecting debts on behalf of another. *Id.* § 1692 (a)(6).

240. The strengthening of exemption statutes, so that informal collection does not constitute such an evident "loophole," has surface appeal as an objective other than wealth maximization. But preventing a debtor from voluntarily making exempt assets available to a creditor would be an intolerable interference with the debtor's liberty, given such possible consequences of non-payment as diminished creditworthiness. The problem becomes, therefore, one of determining what creditor activities are permissible in attempting to persuade a debtor to make payments out of exempt assets. Exemption statutes can provide no solution for this problem.

241. The provisions of the Fair Debt Collection Practices Act, 15 U.S.C.A. § 1692(b) (1978 Supp.), concerning collection of "location information" are an example of regulations providing greater protection of individual privacy.

Some informal collection practices are presumably regulated on the ground that one should not be permitted to threaten action that, if taken, would be illegal. Hence, the reasonably common prohibition of threats of physical violence. *See, e.g., id.* § 1692(d)(1).

242. *Id.* § 1693; FTC, Guides Against Debt Collection Deception, 16 C.F.R. § 237 (1979).

243. *See generally* POSNER, *supra* note 146, at ch. 4. I do not imply that a debtor necessarily has a common law cause of action for misrepresentation in these circumstances. If the effect of the representation is to induce payment of a debt legally due, at a minimum a consumer may have difficulty in proving damage. But whatever the view of the law, it is

A truly distinct regulatory objective, eliminating creditor behavior *solely* having *in terrorem* effects, is seen in some recently enacted regulation, particularly regulation focusing on creditor harassment.[244] To be sure, all of credit collection consists largely of implicit and explicit creditor threats to take action disadvantageous to a debtor unless payment is forthcoming. These threats can and do have *in terrorem* effects. Frequently, however, as with threats of coercive execution, they also warn a debtor of what might really happen if payment is not made. Furthermore, the threatened action, if taken, will often directly benefit a creditor. Garnishment, for example, commonly yields some money. But outright creditor harassment, such as telephone calls at inconvenient hours, is different.

Creditor harassment always conveys, implicitly or explicitly, the threat that the conduct will be repeated unless payment is forthcoming. In some respects, then, the creditor is warning the debtor of possible consequences of non-payment. But the action threatened cannot be of direct benefit to the creditor except as it produces a response from the debtor to avoid even more harm. If this analysis provides a sufficient basis to distinguish different types of creditor threats,[245] then prohibition of behavior characterized as *solely* hav-

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obvious a consumer can be hurt if "tricked" into paying even a valid debt by misrepresentation. For example, a debtor would lose the opportunity to gamble that the creditor would not actually resort to coercive execution, instead abandoning the debt if informal collection is unsuccessful.

244. For example, recent regulation has prohibited threats of coercive execution when such execution is not specifically intended or is not engaged in as a matter of regular practice. Fair Debt Collection Practices Act, 15 U.S.C.A. § 1692(e)(4) (1978 Supp.); WIS. STAT. § 427.104(1) (1977). Such threats can be seen as misrepresentations if coercive execution is extremely unlikely, even though permissible, their prohibition might be justified on that ground. Prohibition of such threats might also be justified on the ground that they seek to impose mostly *in terrorem* leverage. I have some concern, however, that if such regulation has any effect on collection behavior at all (it might, of course, just be ignored, given the improbability consumers will ever seek private redress), it may tend to increase the incidence of coercive execution. Threats of coercive execution may be such a valuable collection technique that, rather than give them up, some creditors may insure their truthfulness by regularly executing when threats fail to induce voluntary payment. Some conversations with collection agents in Wisconsin have suggested to me that this has been an effect of this type of regulation in that state.

245. This analysis may be insufficient in one respect. The suggested standard appears at first glance to prohibit threats to contact credit bureaus, though I doubt many people would want to prohibit such threats if contacting a credit bureau is a likely consequence of non-payment (*i.e.*, if there is no misrepresentation). Perhaps, however, threats to report debtors to credit bureaus might be justified on the principle suggested in the text. Creditors reporting debtors to credit agencies do benefit from such action indirectly, in a way qualitatively different from obtaining debtor payment in order to avoid future harassment. The reporting of delinquent debtors to a credit bureau by a creditor can be seen in part as a *quid pro quo* for the willingness of other creditors to so report. All creditors potentially benefit from increased reporting to credit bureaus.

ing *in terrorem* effects, including excessive harassment,[246] might be justified on some kind of humanistic value. For example, to permit solely threatening behavior may be inconsistent with the kinds of relations between people our society wishes to foster. We call it "extortion" when payments are made in response to illegal threats of harm. Is the ethical situation all that different when the threatened conduct is legal, but can benefit the creditor only in that it harms the debtor?[247]

The objective of disallowing solely *in terrorem* behavior not only justifies regulation of creditor harrassment, but also justifies related reform efforts in the consumer credit field. For example, there is an increasing tendency to prohibit creditors from taking non-purchase money security interests in certain exempt property, principally low value household goods.[248] In addition, cross-collateral security clauses are now commonly regulated to make it more difficult for creditors to maintain security interests in a wide range of goods.[249] Such regulation might be justified on several grounds;[250] one usual ground is that the only effect of securing such security interests is to provide the creditor with *in terrorem* leverage. The resale value of most used household goods is so low that no creditor is likely to repossess for the purpose of collection.[251] But the threat to repossess often exerts powerful leverage. The expense and inconvenience visited on the debtor by repossession can be sub-

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246. Harassment, particularly excessive harassment, is not easy to define. The standard suggested in the text provides a heginning approach. This approach distinguishes those contacts with the debtor that are legitimately and reasonably intended to elicit information, such as contacts regarding the debtor's intentions with respect to voluntary payment, from those contacts that are intended only to threaten the debtor with further inconvenience or harm.

247. An analogous ethical question is presented by the common litigation practice of engaging in discovery for the sole purpose of harassing the other party. Such conduct is considered professionally unethical. ABA CODE OF PROFESSIONAL RESPONSIBILITY DR 7-102(A)(1).

248. *See, e.g.*, WIS. STAT. § 422.417 (1977); FTC *Proposed Rule on Credit Practices*, *supra* note 237, at § 444.2(a)(4); UNIFORM CONSUMER CREDIT CODE § 2.407 (1968 text). The Uniform Consumer Credit Code has been adopted in several jurisdictions.

249. *See, e.g.*, WIS. STAT. § 422.418 (1977); UNIFORM CONSUMER CREDIT CODE § 2.408 (1968 text).

250. For example, the prohibition of some security interests in exempt property can be seen as reinforcement of the policies underlying exemption statutes. To be sure, exemption statutes do not and should not prohibit the sale of exempt property. *See* note 240 *supra*. It may not be practical, however, to teach the majority of consumers that they risk loss of exempt property if they grant a security interest in exempt property. For this reason, it is consistent to argue both that debtors should be able to sell exempt property and that they should not be able to grant certain security interests in such property.

251. Again, Williams v. Walker-Thomas Furniture Co., 350 F.2d 445 (D.C. Cir. 1965), is an excellent example. *See* note 209 *supra*.

stantial, particularly if the debtor attaches sentimental value to the goods.

One difficulty in effectively regulating creditor harrassment is that, because there is a broad variety of creditor behavior potentially having objectionable effects, regulation must define prohibited conduct in broad and general terms.[252] The problem with broad regulations is that it is unclear whether a regulation applies to a particular action. This uncertainty seriously complicates the problem of obtaining compliance with the regulation.

Given the large number of creditors and collection agencies, effective public enforcement of regulation of informal collection practices will be difficult and expensive.[253] On the other hand, private enforcement presents the difficulty that unrepresented debtors are unlikely to know about available remedies. Moreover, because of vagueness in the regulations, a private lawsuit is likely to raise a contested liability issue, making the suit lengthy and expensive.[254] Also, damages present serious litigation problems for a private litigant because many courts are reluctant to compensate mental anguish unaccompanied by physical injury.[255]

One attempted solution to the enforcement dilemma, used in a wide variety of consumer protection statutes, is to permit a victorious debtor litigant to collect punitive damages plus attorney fees.[256] But this approach has not successfully stimulated private enforcement.[257] I suspect one problem is that the punitive damages

252. Many states, for example, rely solely on general propositions of tort law to regulate creditor harassment. *See* Greenfield, *Coercive Collection Tactics—An Analysis of the Interests and the Remedies*, 1972 WASH. U.L.Q. 1. Where statutory regulation exists, the prohibitions are frequently drawn in broad terms. For example, the Fair Debt Collection Practices Act prohibits debt collectors from conduct "the natural consequence of which is to harass, oppress, or abuse any person . . . ." 15 U.S.C.A. § 1692d (1978 Supp.). The statute defines certain specific conduct as harassing, but carefully indicates that the specified examples do not detract from the overall generality of the provision quoted. Another section of the Act, moreover, prohibits the FTC from acting by trade regulation rule to expand the list of specified conduct prohibited. 15 U.S.C.A. § 1692l(d) (1978 Supp.).

253. In the hearings preceding adoption of the Fair Debt Collection Practices Act, the Federal Trade Commission testified that public enforcement is unlikely to be effective with respect to informal collection practices because of the large number of small operators in the field. H.R. REP. No. 131, 95th Cong., 1st Sess. 7 (1977).

254. *See* Note, *Private Enforcement Under the Fair Debt Collection Practices Act*, 28 CASE W. RES. L. REV. 710 (1979) [hereinafter cited as Note, *Private Enforcement*].

255. *See, e.g., Harned v. E-Z Finance Co.*, 151 Tex. 641, 254 S.W.2d 81 (1953). *See generally* W. PROSSER, TORTS 56-57 (4th ed. 1971).

256. One of the first consumer protection statutes to adopt this approach was the Truth in Lending Act, 15 U.S.C. § 1601 (1976). The Wisconsin Consumer Act adopts this type of remedial structure in nearly all its provisions. WIS. STAT. § 425.301 (1977). *See generally* Rice, *supra* note 176.

257. *See* Note, *Private Enforcement*, *supra* note 254. An exception to this general proposition exists with regard to class action suits. Where it is possible to recover punitive damages

obtainable are typically modest in amount. An alternative approach to stimulating private enforcement is to permit recovery for emotional anguish resulting from prohibited collection activities, even though there is no accompanying physical injury.[258] Since there are few objective measures of emotional harm, under this approach the assessment of damages may have to be left to the unfettered discretion of juries, and juries can often be expected to award substantial amounts to debtors.

The possibility of substantial recoveries through punitive damages or compensation for emotional injury may deter violation of harassment standards. But if the standards are vague, the deterrent may be too effective. The damage potential may well persuade a creditor to avoid using collection techniques not considered unlawful or undesirable.[259] The result is likely to be greater reliance on coercive execution, which remains a legitimate way of gaining leverage and, in effect, conveying threats. Such an effect is probably undesirable, for reasons I will develop more fully in the next secton.[260]

Another possible solution to the enforcement dilemma is suggested by the recent federal provision prohibiting collection agents from communicating with any debtor after that debtor has advised

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for all members of the class, the potential recovery is large enough to stimulate private enforcement. *Id.*

258. The Wisconsin Consumer Act contains such a provision. WIS. STAT. § 427.105(1) (1977).

259. There has been no systematic empirical study of the impact of WIS. STAT. § 427.105(1). The possibility for impact is enhanced by the fact that the prohibition is coupled with some very broadly phrased prohibitions of informal creditor practices. WIS. STAT. § 427.104 (1977).

Professor Stewart Macaulay and I have had several conversations with lawyers and collection agents about the impact and use of these provisions. *See* Macaulay, *Lawyers and Consumer Protection Laws: An Empirical Study*, 14 LAW & SOC. REV. ___ (1980) (forthcoming). The general impression we get is that there have been few actions initiated by consumers for damages. In one case, despite a clear violation of the Act, the jury awarded no damages for mental anguish, apparently lacking sympathy for a debtor refusing to pay a clearly just obligation. On the other hand, we have learned of numerous instances in which debtors have asserted claims for improper collection in settlement negotiations concerning alleged debts. A common outcome, of course, is a settlement more favorable for a debtor than otherwise could have been expected.

In my conversations with collection agents, they emphasized that they strive to avoid violation of the statute. I formed the definite impression that remedial provisions have significantly contributed to their attitude. One collection agent told me that he believed the statute had actually helped the collection agency business. The statute applies to creditors collecting for themselves as well as to collection agencies. The collection agent believed that the statute had intimidated many creditors from engaging in much informal collection themselves. Consequently, they were turning delinquent accounts over to collection agencies more quickly than previously. In other words, this informant believed the statute had contributed to the professionalization of collections.

260. *See* text accompanying notes 264-69 *infra*.

the collector in writing that he or she refuses to pay or desires no further communication.[261] The provision has been in effect for only a short time, and consequently there is no reliable information available on how it has worked.[262] Because the conduct prohibited is defined so precisely, however, the usual problems in obtaining compliance with a broad prohibition may not arise. Moreover, there is much to be said for letting a debtor decide, after delinquency, whether he or she prefers coercive execution to further informal harassment. Many of the costs of harassment take the form of psychological harm to the debtor, and debtors react quite differently in this regard. This regulation has the advantage of stopping informal harassment when it can be psychologically most costly. At the same time, it would not prematurely force collection into a coercive execution mode when further efforts at informal collection would not cause the debtor substantial injury. Furthermore, a debtor is permitted to make his or her decision after delinquency, rather than at the time of contract. Attention then is more likely to be focused on the specific consequences of different types of collection.

IV. REFORMING THE SYSTEM

In this section I will consider possible solutions to the many problems with the present consumer credit collection system. The solutions considered here are simply "reforms." They do not involve discarding the basic assumptions underlying the present system, as did the "radical" proposals considered in the second section of the article. I will attempt in this section to integrate the various partial analyses of the previous section, emphasizing how a possible solution of one problem interacts with another problem. As I have repeatedly emphasized, there is inadequate empirical information to permit any dispositive conclusions about what legal rules will best serve any particular value, including the value of the wealth maximization that so frequently underlies analysis. Hence the conclusions drawn in this section are frequently based on what I hope is well-informed intuition.

261. 15 U.S.C.A. § 1692c(c) (1978 Supp.). One ambiguity in this provision is whether, in the coercive execution proceedings that will commonly follow a debtor's order to cease communication, a collector can propose settlement. After repossessing collateral, for example, may a creditor propose a workout which includes return of the seized goods? Alternatively must the creditor proceed to sell the collateral—typically at a very low price—and then try to collect any deficiency, again perhaps only through coercive execution?

262. I suspect that few consumers have exercised their rights under the provision. Unfortunately, there is no mechanism provided in the Act for informing consumers of their rights. Perhaps over time, however, there will be greater awareness of this provision.

A. *Encouraging More Informal Bargaining and Settlement*

The fundamental issue regarding moderate reform of the consumer credit collection system is whether the incidence of coercive execution should be increased or decreased.[263] It is not clear which appoach would best reduce creditors' collection costs. Because creditors sometimes initiate execution when it would be more cost effective to pursue further informal settlement opportunities,[264] discouraging coercive execution might actually reduce creditor collection costs. But even if creditor collection costs should increase, discouraging coercive execution may be desirable from a wealth maximization perspective. Such discouragement should reduce many of the costs of execution, especially secondary costs, which are not borne by creditors. On the other hand, discouraging coercive execution will induce increased creditor efforts at informal settlement. These increased efforts raise new costs to consider, such as invasion of privacy and emotional injury from harassment.

Balancing all these factors, my guess is that society as a whole would be better off with less coercive execution. I recognize that decreasing the incidence of coercive execution will lead to increased reliance on informal collection practices. But many of the harms resulting from such practices, particularly emotional injury, are at least equally, if not more serious consequences of coercive execution.[265] Moreover, as previously discussed, there may be some potential for direct regulation of informal practices to limit the worst abuses.[266] Nonetheless, in part to guard against abuse of informal collection practices, and also to avoid extreme increases in creditors' collection costs, my proposal here is only to decrease the incidence of coercive execution, not to eliminate it entirely.

Another important justification for reducing the incidence of coercive execution can be developed by distinguishing two different uses of execution. Often a creditor primarily seeks the direct transfer of wealth through coercive execution—for example, when it repossesses an automobile with substantial resale value. In other in-

263. One might increase the incidence of coercive execution by restricting exemptions, limiting the right to go bankrupt, or making informal collection more difficult or risky.

264. The priority rules encourage such behavior. *See* note 75 *supra* and accompanying text. It is also possible for regulation to jar creditors out of a bad habit of not maximizing their returns in collection by not fully exploiting tbe potential of informal collection. For one illustration of this effect, see Whitford & Laufer, *Wisconsin Consumer Act, supra* note 4, at 649-50.

265. *See* text accompanying note 236 *supra.*

266. *See* text accompanying notes 252-62 *supra.* Particularly interesting in this regard is the new federal provision that requires collection agencies to cease informal collection activities when so requested by the debtor. *See* text accompanying notes 253-54 *supra.*

stances, however, coercive execution is employed primarily to gain bargaining leverage, by demonstrating to the debtor what can happen if a satisfactory workout is not arranged. Repossession of household possessions with little resale value, for example, must usually be instituted with the latter objective in mind.

An especially strong case can be made for reducing the use of coercive execution to gain bargaining leverage. Creditors have other ways to persuade debtors to pay debts—more telephone calls or home visits, for example. Moreover, creditors can always induce more informal settlements simply by offering more liberal refinancing terms.[267] These alternatives to coercive execution will presumably increase creditors' costs; that is why creditors now prefer coercive execution. But the alternatives will, in most instances, impose fewer costs on debtors than coercive execution does.[268] Thus, the total costs from use of the alternatives are likely to be less than the total costs of the coercive execution they replace. Discouraging coercive execution for purposes of leverage is therefore consistent with a wealth maximization objective. Also, a policy of discouragement is consistent with the objective, suggested earlier, of disfavoring solely or largely *in terrorem* leverage techniques.[269]

The next subsections discuss different ways of discouraging coercive execution, particularly execution for the primary purpose of gaining bargaining leverage. No effort will be made to canvas all possible techniques; nor is it my position that there is a single best technique. Rather, I see a reform program as including a number of complementary techniques.

1. REQUIRING MEDIATION

Professor Leff has suggested that the incidence of coercive execution would be decreased by the establishment of a state subsi-

267. It is sometimes suggested that even if coercive execution remedies were removed, there would be little increase in the incidence of settlements, since, it is asserted, creditors are already willing to arrange workouts, including refinancing agreements, with all acceptable risks. *See* Johnson, *supra* note 30; Scott, *supra* note 89. On theoretical grounds, this argument can only be valid if there are sharp discontinuities in the risk qualities of debtors in initial default—that is, if there are debtors who are reasonably good risks for a workout, debtors who are such bad risks that creditors would not agree to a workout in almost any circumstance, and very few debtors in between these extremes. It seems highly unlikely that such discontinuities exist.

268. One of the reasons for this is that creditors normally have a positive incentive to choose a coercive execution remedy that imposes extensive costs on the debtor, in order to gain bargaining leverage. *See* text accompanying notes 191-93 *supra*. Except for debtors especially sensitive to creditor harassment, without the availability of coercive execution I doubt that creditors will find it as easy and inexpensive to impose similarly extensive costs on debtors.

269. *See* text accompanying notes 245-46 *supra*.

dized mediation service specializing in creditor-debtor problems.[270] His proposal was derived from his perception that one reason for excessive execution is that creditors and debtors often misperceive the likely outcome of coercive execution.[271] The principal purpose of a mediation service would be to cure this information problem by providing debtors and creditors with disinterested estimates of the likely outcome. A disinterested mediator, Leff argued, ordinarily would be better able than a debtor to convince a creditor that the debtor is judgment proof or a "can't pay," and thus not worthy of further collection efforts. Similarly, a disinterested mediator usually would be better able than a creditor to convince a debtor that an alleged defense would not be recognized in court, or that a creditor would indeed resort to coercive execution if necessary. As repeatedly stated throughout this article, if creditor and debtor share a perception of the likely outcome of a failure to settle, settlement is virtually certain.

Professor Leff admittedly sketched his proposal only in rough terms, and to my knowledge nobody has subsequently attempted to implement it. Although his idea has the potential to cure one of the common causes of execution, there are potential difficulties with a mediation program. The first is that it would probably be necessary for the debtor to actively participate in the mediation process for the mediator to acquire enough information, at acceptable cost, to play a meaningful role. Yet active participation by large numbers of consumers is unlikely. As previously noted, debtors typically default in creditor initiated court actions, even when they believe they have defenses.[272] This problem is not likely to be resolved simply by making processes more informal and less alienating to consumers. Small claims courts were set up with this purpose in mind but they have largely failed to attract consumers to litigation.[273] In part because of this failure, there have been many proposals and some experiments in the past ten years with consumer-merchant arbitration of disputes.[274] But these programs have not been notably successful in settling large numbers of disputes.[275] Moreover, there is reason to doubt they can ever be successful with respect to disputes which

270. Leff, *Coercive Collection*, *supra* note 4, at 38-46.

271. *See* text accompanying notes 224-27 *supra*.

272. *See* notes 166-68 *supra* and accompanying text.

273. *See* Yngvesson & Hennessey, *supra* note 168.

274. *See, e.g.*, Eovaldi & Gestrin, *Justice for Consumers: The Mechanisms of Redress*, 66 Nw. U.L. Rev. 281 (1971); Resnick, *Consumer Arbitration As an Alternative to Judicial Preseizure Replevin Proceedings*, 16 Wm. & Mary L. Rev. 269 (1974); Comment, *Nontraditional Remedies for the Settlement of Consumer Disputes*, 49 Temple L.Q. 385 (1976).

275. *See* McGonagle, *Arbitration of Consumer Disputes*, 27 Arb. J. 65, 72-75 (1972).

require resolution of issues which must be determined on the basis of factual evidence,[276] such as the many creditor-debtor disputes in which a debtor is asserting defenses.

Another difficulty with mediation relates to the role of the mediator. It is outside the traditional concept of mediation for a mediator actively to help one party strengthen his or her case.[277] Hence, where consumers are not aggressively pressing their interests, a mediator may do little more than suggest that a debtor pay. Furthermore, since mediators would have continuous relationships with large creditors, there is real danger that a mediator would function as a virtual collection agency, while cloaked with officially sanctioned neutrality. The result may be more settlement and less execution, which is desirable in itself, but also fewer defenses realized and less creditor compromise, which is objectionable on substantive or distributional grounds.[278]

As astute an observer as Professor Leff is well aware of these problems. He hoped to overcome them by scheduling mediation sessions at convenient places and times for consumers—(*e.g.*, in the evening)—and through the development of semi-professional, non-attorney agents to assist consumers in mediation sessions at modest cost.[279] These ideas have the potential to induce consumers to participate in a real way in mediation, but we cannot be at all certain that the potential will be realized.[280]

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276. *See* Whitford & Kimball, *Why Process Consumer Complaints? A Case Study of the Office of the Commissioner of Insurance of Wisconsin*, 1974 WIS. L. REV. 639, 716-18.

277. For a sensitive portrayal of the difficulties faced by a small claims court judge in trying to assist *pro se* litigants appearing before him, while simultaneously maintaining neutrality, see Murphy, *D.C. Small Claims Court—The Forgotten Court*, 34 D.C. BAR. J. 14 (1967).

278. For a perceptive survey of possible distributional consequences of decentralized, informal justice systems see Abel, *Delegalization: A Critical Review of its Ideology, Manifestations and Social Consequences*, 14 LAW & SOC. REV. ___ (1980) (forthcoming).

279. Leff, *Coercive Collection*, *supra* note 4, at 44 n.135.

280. Consumer credit counseling services, present now in many communities, have the potential to perform many of the functions Leff assigns to mediation services. Tbese services offer advice to debtors and often help arrange informal composition or extension plans with creditors. They also frequently advise debtors of the futility of non-payment, as well as help secure creditor agreements to forego coercive execution during performance of the informal plan. *See* Felsenfeld, *Consumer Credit Counseling*, 26 BUS. LAW. 925 (1971).

Debtors typically must take the initiative to request the services of a counseling service; thus, debtor cooperation is virtually assured. It is unlikely credit counseling services would function nearly so well if creditors could effectively require debtors to participate, as Leff in effect proposes. What is more, there is no data of which I am aware establishing tbat credit counseling services, even as now organized, yield benefits—in the form of fewer bad debts and less coercive execution—greater than their costs of operation.

2. CHANGING THE PRIORITY RULES

The rules governing priorities between unsecured creditors encourage coercive execution.[281] The obvious solution is to change the priority rules so the first creditor to initiate coercive execution does not by that action necessarily obtain an advantage over other creditors. Two such proposals have previously been made. In the 1930s, Dean Wesley Sturges suggested a system that would determine priority among unsecured creditors by date of credit extension.[282] A more recent proposal borrowed on the innovation of Article 9 of the Uniform Commercial Code in suggesting creation of a filing system for unsecured creditors, with priority determined by date of filing.[283]

Both proposals were motivated largely by a desire to discourage overextension of credit to consumers rather than to affect collection practices. The authors of the proposals believed that a common cause of consumer insolvency and bankruptcy was an overextension of credit by professional lenders relying on quick initiation of coercive execution to gain priority in available assets over earlier lenders. The authors believed that the consumer "victims" of this practice frequently would be able to meet their debts were it not for the final, overbearing extension of credit. In addition, the authors stressed the injustice of the practice to earlier creditors.

This rationale for changed priority rules suggests that new priority rules would make some credit less available to marginally creditworthy consumers. The earlier writers would have applauded this result, but I have argued throughout this article that, from a wealth maximization perspective, it is impossible to determine whether restricted credit availability is desirable.[284] Nevertheless, an alternative or additional rationale for changing priority rules can be based on the anticipated effects on collection practices. It seems almost certain such a change would lessen the incidence of coercive execution, particularly the incidence of quick resort to coercive exe-

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281. *See* text accompanying notes 75-77 *supra*.

282. Sturges, *A Proposed State Collection Act*, 43 YALE L.J. 1055 (1934) [hereinafter referred to as Sturges, *Proposed Collection Act*]; Sturges & Cooper, *Credit Administration and Wage Earner Bankruptcies*, 42 YALE L.J. 487, 513-25 (1933).

283. Wenk & Moye, *Debtor-Creditor Remedies: A New Proposal*, 54 CORNELL L. REV. 249 (1969).

284. There must be consumers victimized by predatory overextension of credit who would not have accepted the overextension if they fully understood the risks involved. Moreover, overextension can compromise the interests and expectations of earlier creditors. Nonetheless, some consumers are benefitted by the credit extensions that would be deterred by a change in the priority rules. For example, such an extension can sometimes provide the "breathing space" needed to resolve pre-existing financial problems. Where the balance of advantage lies is indeterminate.

cution before the possibilities for satisfactory settlement have been fully explored.[285]

A fundamental change in the priority rules between unsecured creditors will create many problems. One major problem would be whether to date priority under the new system by the date of credit extension or by date of filing in a newly created filing system. Alternatively, all unsecured creditors could share pro-rata in any assets obtained from the debtor in an execution proceeding initiated by a single creditor.[286]

The date-of-credit-extension principle[287] presents a difficulty regarding later creditors. Those creditors, unaware of earlier interests, may have relied on their presumed priority in the debtor's unencumbered assets. Article 9 of the Uniform Commercial Code adopted a filing system precisely to solve this problem for secured creditors.[288] But a filing system almost surely favors the professional lender, who can be expected to file routinely at the time of credit extension. The customary provider of goods and services, such as a small merchant or a doctor, is not likely to file until collection problems arise. Favoritism for professional lenders is difficult to justify.[289] Perhaps some exception, however, could be built into a filing system to protect creditors who cannot be expected to file routinely.[290] The pro-rata principle has the difficulty that the first creditor in time could still have its interests compromised by later improvident extensions of credit. Moreover, under a pro-rata princi-

285. *See* text accompanying note 79 *supra*.

286. A few states have procedures permitting other creditors to join in some types of execution proceedings and share the proceeds pro-rata with the initiating creditor. *See, e.g.*, IND. CODE ANN. §§ 34-1-11-31, -37 (Burns 1973). I am not aware of any study of the impact of these "underfiling" procedures on the incidence of coercive execution.

There is a small possibility that a statute providing for pro-rata distribution would be considered unconstitutional under the Supremacy Clause, as infringing on the federal government's exclusive prerogative to enact bankruptcy laws. *See In re* Wisconsin Builders Supply Co., 239 F.2d 649 (7th Cir. 1956), *cert. denied*, 353 U.S. 985 (1957).

287. Special provisions should determine when credit extension occurs under revolving charge plans; otherwise revolving creditors would almost always have priority under this proposal. The special provisions regarding cross-collateral clauses could provide useful analogies for revolving charge plans. *See, e.g.*, WIS. STAT. § 422.418 (1977). *See also* Wenk & Moye, *supra* note 283, at 262 n.34.

288. *See* 1 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 15.1 (1965).

289. The present first-to-levy priority system contains some of the same favoritism, I suspect, because the professional creditor is more likely to resort to quick execution. The favoritism is probably less extensive under the present system because of the presence of collection agencies, which can advise non-professional creditors when suit would be advantageous. *See* text accompanying notes 5-6 *supra*.

290. *Cf.* U.C.C. § 9-302(1)(d) (providing for perfection of purchase money security interests in consumer goods without filing). By analogy, a priority for providers of goods and services might date from credit extension, while other unsecured creditors would be required to file to establish priority. *See also* Wenk & Moye, *supra* note 283, at 262.

ple, execution proceedings would often become complex. Unless the proceeds would be shared only by judgment creditors, it would be necessary to adjudicate the validity of the claims of all unsecured creditors seeking assets. Under other priority systems, it is usually only necessary to adjudicate the validity of the claim of the creditor claiming priority.

A second problem in devising new priority rules relates to the traditional concern that debtors be deterred from avoiding payment by concealing assets or absconding.[291] A principal policy justification for the present first-to-levy priority rules is to reward the "diligent" creditor who undertakes the effort necessary to search out an absconding debtor or to locate concealed assets.[292] Determining priority on the date of credit extension, or the date of filing, however, would provide an incentive to be "diligent" to only one creditor, the one entitled to priority, rather than to all creditors, each of whom, under the present system, could possibly be the first to levy. If there were many creditors, a pure pro-rata principle would provide little incentive to anyone.

I doubt that abandonment of the first-to-levy priority principle would affect the frequency with which non-absconding consumer debtors successfully conceal assets. It is my strong impression (in the absence of relevant empirical studies) that even under existing priority rules, few creditors expend many resources to locate concealed assets of such debtors. Usually, a creditor only attempts a supplementary proceeding or a creditor's bill, discovery procedures that are cheap and that would remain available under new priority rules.

Providing incentives to locate the absconding debtor, or "skip," is a much bigger problem. Some creditors expend considerable sums to locate "skips." A new priority system probably should provide special incentives for locating skips to creditors not otherwise entitled to priority in execution. For example, such creditors could receive absolute priority for investigative costs and perhaps for parts of their claims as well.[293]

3. CREATING COST BARRIERS TO EXECUTION

A classic American way to discourage undesired conduct is to tax it. Of course, any tax on coercive execution, even though paya-

291. Debtors who use these methods to avoid payment add to the cost of extending credit and thus become a hurden on those debtors who do repay.

292. *See generally* Distler & Schubin, *supra* note 16.

293. This suggestion is similar to Dean Sturges' proposal for providing incentives to execute where needed. Sturges, *Proposed Collection Act*, *supra* note 282.

ble initially by creditors, will be passed on to debtors, most likely in the form of higher interest rates or reduced credit availability. Nonetheless, a lowering of the incidence of coercive execution should result, provided the tax is initially paid by creditors. A creditor able to resolve a higher percentage of collection problems informally would then have lower costs than competitors because of lower execution taxes and consequently would have a competitive advantage.[294]

Politically, it seems unlikely that a tax on coercive execution will ever be adopted. A similar effect could be obtained, however, simply by limiting the proportion of present costs of coercive execution that creditors can transfer to debtors. To some extent this is already happening as states increasingly invalidate contract provisions requiring debtor reimbursement of creditor attorney fees incurred in collection.[295]

Another way to increase a creditor's costs of coercive execution is to eliminate cheaper forms of coercive execution, making available only more expensive forms. In this context, I return to the subject of provisional remedies. Earlier analysis suggested that abolition of provisional remedies would do little to preserve consumer defenses unless coupled with provision of free legal services to all consumer debtors, a proposal both politically infeasible and difficult to defend in policy terms.[296] But provisional remedies are among the cheapest forms of coercive execution, partly because they permit execution before a judgment on the merits. The abolition of these remedies would thus increase the costs of coercive execution and encourage more informal settlement.[297] Where provisional remedies are used primarily to gain settlement leverage, the case for their

294. In theory, the frequency of execution should decline if the tax were paid by either creditors or debtors. If it fell on debtors, and they appreciated fully the consequences of execution, they would adjust their settlement positions so as to induce creditors to agree to more workouts. As a practical matter, however, many debtors would not appreciate the significance of the tax. To discourage execution substantially, it would be necessary to tax executing creditors.

295. *See* authorities cited in note 24 *supra*. Professor Wallace has argued for the disallowance of all post-default charges designed to compensate the creditor for the costs of informal collection, such as special delinquency charges. His argument is that such charges are inevitably deceptive in that consumers do not understand or appreciate them at the time of contract formation. Wallace, *The Uses of Usury*, *supra* note 93, at 466-68.

296. *See* text accompanying notes 169-78 *supra*.

297. I have elsewhere concluded that the aholition of traditional self-help repossession of automobiles in Wisconsin has had precisely this effect. Whitford & Laufer, *Wisconsin Consumer Act*, *supra* note 4; Grau & Whitford, *Wisconsin Consumer Act Revisited*, *supra* note 229. Technically, Wisconsin has not prohibited self-help repossession of automobiles, but such repossession can legally occur only with prior judicial authorization, which will be granted only after notice to the debtor and an opportunity for a hearing. WIS. STAT. § 425.206 (1977).

abolition is especially strong.[298]

One difficulty with total abolition of provisional remedies is presented by a secured creditor whose collateral is a motor vehicle. This type of creditor is one of the few that regularly uses coercive execution as a direct means of collection, partly because there is a well established market in used motor vehicles. Reluctant to abandon an important direct means of collection, creditors will continue to rely on repossession as a collection technique even if a prior judgment on the merits is required. But there will be a considerable cost difference between repossession as a provisional and as a post-judgment remedy.[299] Because these cost differences will affect interest rates and credit availability, prejudgment repossession of motor vehicles might be excepted from a general ban on provisional remedies.[300] On the other hand, the costs of prohibiting pre-judgment repossession may not be so great as to require an exception to a general ban.[301] Even creditors with security interests in motor vehicles have alternatives to repossession — refinancing agreements, for example.[302] Moreover, self-help repossession has secondary costs, just like any other form of coercive execution. These costs will be reduced if the incidence of such repossession can be reduced by making it more expensive.

Another difficulty with total abolition of provisional remedies

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298. *See* text accompanying notes 267-69 *supra.*

299. This is partly because, as a provisional remedy, repossession of motor vehicles is typically possible by self-help without the necessity of going to court at all, or even hiring an attorney. U.C.C. § 9-503 (1972).

300. The policy considerations are considerably different with respect to pre-judgment repossession of goods that generally must be seized by a replevin procedure, particularly household goods. Because resale value of such goods is low, repossession is typically undertaken in the hope that the debtor can in this way be persuaded to resume voluntary payments (in order to get back the repossessed goods). Faced with cost barriers, creditors in these situations ought to be quite receptive to switching to techniques other than repossession for persuading debtors to resume voluntary payments. Though this too will increase creditors' collection costs, the increase ought to be considerably less than it would be if creditors maintained the same frequency of repossession. Moreover, creditors usually need an attorney to effectuate even pre-judgment repossession when replevin procedures must be used. Therefore, the cost differential between pre-judgment and post-judgment repossession would not be nearly so great as with motor vehicles.

Constitutional law has already distinguished two types of repossession through the state action doctrine. *See* text accompanying notes 159-63 *supra.* Using the state action doctrine to make an exception from a general ban on provisional remedies, however, creates too broad an exception. Many types of self-help repossession are clearly engaged in for leverage purposes, as the resale value of the goods seized is quite low. The facts of Flagg Bros. v. Brooks, 436 U.S. 149 (1978), provide one clear example.

301. In Wisconsin, I could find no evidence of dramatic impact on interest rates or credit availability after prejudgment repossession of motor vehicles was prohibited. *See* authorities cited in note 297 *supra.*

302. When Wisconsin prohibited pre-judgment repossession, creditors placed greater reliance on alternatives. *See* note 297 *supra* and accompanying text.

stems from the need to provide creditors some recourse when they legitimately fear a debtor will abscond or conceal assets before they obtain a judgment. Provisional remedies have been the traditional recourse in this circumstance. It is not clear, however, that this practice can be continued while still discouraging use of provisional remedies primarily for leverage purposes. Commonly, creditors seeking provisional remedies have been required to make a showing of special need for the remedies — for example, showing that there is actual reason to believe the debtor is about to conceal assets.[303] But since such showings are of necessity made by ex parte affidavit, this approach is notoriously ineffective. A more promising approach was contained in a proposal considered, but not adopted, when Wisconsin recently revised its provisional remedy statutes.[304] The proposal was to limit ex parte provisional remedies for unsecured creditors to what was called an "immobilization" order against tangible property. "Immobilized" property would have remained in the debtor's possession, and could have been used by a debtor. But immobilized property could not have been alienated, removed from the jurisdiction, or otherwise concealed or wasted.[305] Since the debtor would have retained possession and use of the property, an immobilization order usually would not give a creditor much additional leverage. Whether an immobilization order would adequately protect a creditor legitimately fearing that a debtor would abscond or conceal assets is more debatable.

4. MAKING EXECUTION LESS EFFECTIVE

In addition to creating cost barriers to execution, the legal system could encourage informal settlement by making coercive execution less effective, especially as a leverage device. Coercive execution is effective as leverage because of the harm visited on the debtor, largely due to secondary costs, and because one execution always impliedly threatens another. In the next section, where I discuss what forms of coercive execution should continue to be permitted, I will discuss possible ways to limit secondary costs. But there is a paradox to be noted here. Limiting secondary costs will not only reduce the effectiveness of coercive execution as a leverage technique. It will also make the *threat* of coercive execution less

303. *See* RIESENFELD, *supra* note 18, at 250-51.

304. Wis. S. Bill 562 (1977).

305. A debtor violating an immobilization order would have been subject to contempt of court penalties. If a debtor appeared likely to conceal property even after an immobilization order, a court could order pre-judgment seizure of the property, but only after a hearing. *Id.* at § 69 (proposed WIS. STAT. § 810.06). Also, a court could prohibit a debtor from leaving the state. *Id.* at § 69 (proposed WIS. STAT. § 810.10).

effective as leverage, as debtors will come to realize that execution itself has become less painful. As the threat of coercive execution becomes less effective, some dehtors presumably will he less willing to pay voluntarily. Although creditors can react in several ways—for example, hy offering more attractive settlements—one reaction is likely to he an increase in coercive execution, to collect what is available by that means.

I can discern no escape from this paradox. By making coercive execution less effective, we discourage its use in some ways while encouraging it in others. Moreover, I doubt that it will ever be possible to design an empirical study that will determine clearly whether we gain more than we lose in minimizing the secondary costs of execution.[306] In any event, at present one can rely only on intuition. My own intuition favors minimization of the secondary costs, in large part because of my distaste for gaining settlement leverage by threatening harm to another.[307]

In general, I do not favor liberal exemption statutes as another way to discourage coercive execution. There is inevitably a class dimension to generous exemption statutes.[308] Such statutes do nothing to protect debtors of modest means from secured creditors. But a special problem is presented by property having substantial sentimental value. The potential "lost value" in such circumstances is so great that the mere threat to execute will often suffice to induce settlement. Where it does not, the temptation to make the threat credible by initiating execution must he overwhelming. This use of execution can be largely foreclosed if exemption statutes are drafted to allow a debtor some choice in selecting which property is exempt.[309] A debtor would presumably choose to exempt property having a low market value but high sentimental value.

5. REGULATNG INFORMAL SETTLEMENT

Earlier I rejected complete abolition of coercive execution as a viable reform, in part because it might lead to excessive creditor

306. *See* text accompanying notes 188-90 *supra*.

307. *See* text accompanying notes 244-47 *supra*.

308. *See* text accompanying notes 216-17 *supra*.

309. There are two basic types of exemption statutes: a "described assets" statute which lists specific types of property, and a "debtor's choice" statute which permits the debtor to select any property as exempt up to a monetary limit. Many jurisdictions have hybrid exemption statutes, with some features of each type. The basic advantages and disadvantages to each basic type of statute have been canvassed elsewhere. *See, e.g.*, Karlen, *Exemptions from Execution*, 22 BUS. LAW. 1167 (1967). Karlen, in my judgment, does not give proper emphasis to the difficulties "debtor's choice" statutes commonly create by requiring a debtor to take the initiative to claim exemptions.

abuse of informal leverage techniques.[310] A program of making coercive execution more difficult and less effective runs similar risks. Permitting some coercive execution may decrease the worst abuses of informal leverages by providing creditors an alternative method of collection. Nonetheless, the program advocated here must be coupled with an attempt to directly regulate informal collection practices.[311]

6. SUMMARY

I advocate reduction of the incidence of coercive execution as a primary regulatory objective. I particularly emphasize discouraging coercive execution for the primary purpose of gaining bargaining leverage. I do not advocate any particular technique as *the* best means of achieving this objective. Rather, a reform effort should use several complementary techniques. For example, a change in priority rules coupled with elimination of provisional remedies seems a promising reform program to me. Because information about the effects of various reforms is not available, however, experimentation by the states is undoubtedly desirable.

B. Reducing the Costs of Execution

Earlier, I discussed the possibility that making coercive execution very costly to debtors would increase the efficiency of the overall consumer credit collection system. The threat of coercive execution would then be very effective informal leverage, while the incidence of coercive execution would presumably decrease. Nonetheless, for the reasons given earlier,[312] I assume that limiting the costs of coercive execution, particularly the secondary costs to the debtor, is a desirable objective.

Though perhaps unintentionally, a state's laws governing coercive execution will tend to channel coercive execution into one or very few forms of execution, by making some forms more efficient than others to creditors. This point is illustrated by Professor Caplovitz in his famous study of judgment debtors. He reported that in New York, where wage garnishment was a cheap and simple form of execution, repossessions under security interests occurred less frequently than in Detroit, where wage garnishment was more cumbersome.[313] Though such correlations cannot in themselves

310. *See* text accompanying notes 124-34 *supra*.
311. *See* text accompanying notes 233-62 *supra*.
312. *See* text accompanying notes 188-90, 306-07 *supra*.
313. CAPLOVITZ, *supra* note 8, at 183-85, 227-32.

prove a causal relationship, a presumption of cause and effect is initituitively sensible and consistent with the data.

In this subsection I will identify the forms into which I believe coercive execution should be channeled and I will discuss ways to limit the secondary costs associated with those forms. Of course, the ability to limit secondary costs associated with a particular form will influence the decision whetber to channel execution into that form.

1. THE UNEASY CASE FOR INCOME EXECUTION

The two usual forms of execution are wage garnishment and property execution, including repossession. As between the two, strong arguments exist in favor of channeling execution towards wage garnishment.[314] The strongest argument derives from the "lost value" phenomenon that characterizes all property execution. Some of this lost value could be avoided by improvements in the procedures for property execution,[315] but much of the lost value is simply inevitable. Typically, the goods seized through property execution have a significantly higher value in a debtor's hands than they have in the market.[316] Under income execution, on the other hand, the

314. Most desirable of all would be to provide a collection method that did not require compulsory deprivation of property at all. England for many years made available an "installment order" as the initial order in a collection proceeding. An installment order directed the debtor to pay in installments, much like a refinancing agreement. If tbe debtor did not make tbe payments, the debtor risked a finding of contempt and imprisonment. *See* P. ROCK, MAKING PEOPLE PAY 51-75 (1973).

Because of its reliance on imprisonment, the English system was subject to much criticism. A special investigatory commission recommended abandonment of tbe system in 1969 and suggested instead a system resembling in many ways the system I recommend in this article. REPORT OF THE COMMITTEE ON THE ENFORCEMENT OF JUDGMENT DEBTS (Payne Commission) Cmnd. Paper No. 3909 (1969). Parliament adopted few of the Commission's recommendations. New legislation, however, has largely abolisbed imprisonment for debt and substituted wage garnisbment for the installment order system. Glasser, *Administration of Justice Act 1970: Enforcement of Debt Provisions*, 34 MOD. L. REV. 61 (1971).

There may be something to be said for an installment order system as a first order in an execution proceeding, with wage garnishment, rather than imprisonment, as the sanction flowing from non-payment. The required installments might equal the amount reachable each pay period by garnishment. But since execution proceedings do not usually begin until after the creditor has made considerable efforts to collect voluntarily, interjecting an installment order as the first step in an execution proceeding may be wasteful. On the other hand, there is some chance tbat the authority of the court would influence a significant portion of debtors to pay "voluntarily" who would not otherwise do so. Even if installment orders resulted in more voluntary payments, however, in determining the desirability of the system, the resulting gains (largely in the form of reduced secondary costs of garnishment) would have to be weigbed against tbe costs of delayed coercive execution in favor of creditors for whom installment orders did not yield voluntary payments.

315. *See* EPSTEIN, *supra* note 13, at 49-51.

316. *See* Leff, *Coercive Collection, supra* note 4, at 12-13 for an excellent discussion of this point.

ratio between value lost to the debtor and the amount of debt paid is potentially close to one.[317] Income execution also provides a certain element of justice, or at least realized expectations; even in secured credit situations, creditors and debtors alike expect repayment from future income. (This expectation is the reason why employment and salary are such important determinants of an individual's credit rating.)

The potential efficiency of wage garnishment is often not realized today, partly because of unnecessarily high court costs.[318] More troublesome are the substantial secondary costs historically associated with wage garnishment, typically because of adverse reaction by the debtor's employer. The seeming intractability of these costs has caused a number of commentators to recommend abolition of wage garnishment.[319]

The secondary costs resulting from garnishment are of a different order than the secondary costs resulting from property execution. Much of the lost value resulting from property execution is a true loss, since the goods are taken from the person who can put them to their highest use. But if a garnishment victim loses his or her job, presumably that job will be filled by somebody else. Strictly from a wealth maximization point of view, it will often be a matter of indifference to society who holds the job. If the productivity of the garnishment victim significantly exceeds that of the replacement, it is unlikely the employer would have dismissed the former in any event. And whatever happens, one worker remains unemployed.

There is still reason, however, to be concerned about secondary costs to the garnishment victim. First, if such costs are substantial and are likely to be incurred, the threat of wage garnishment becomes an extremely effective *in terrorem* leverage device—one quite

317. Garnishment does not necessarily involve execution on money. Garnishment is the appropriate form of coercive execution whenever a creditor wishes to levy on a debtor's property in the possession of a third party. What is being favored here, then, is not garnishment as such, but rather execution on money. This includes garnishment of various accounts (checking, savings, brokerage, etc.), but in consumer credit collection usually takes the form of wage garnishment.

318. Project, *Wage Garnishment in Washington, supra* note 42, at 774-75. Attorney fees are another factor that interfere with the one-to-one correspondence between money taken from the debtor and debt retired. If creditors were not allowed to transfer attorney fees to debtors—as I have recommended, *see* note 295 *supra* and accompanying text—the one-to-one correspondence for the debtor would be restored. Preventing the transfer of attorney fees does not necessarily increase the efficiency of wage garnishment in the larger sense—the costs must still be incurred. But in tbis respect, wage garnishment is no different from property execution (except perhaps to the extent repossession is possible without going to court).

319. *See, e.g.*, Brunn, *supra* note 43; Kerr, *supra* note 41. Note, *Wage Garnishment as a Collection Device*, 1967 WIS. L. REV. 759.

capable, for example, of persuading debtors to abandon defenses. Unless such effects of wage garnishment can be avoided, perhaps garnishment should be abolished as a form of coercive execution no matter how efficient it is in converting a debtor's assets into debt retirement.

Second, to avoid secondary costs, a debtor facing garnishment may declare bankruptcy, thereby imposing costs on all creditors.[320] Third, where secondary costs involve job loss, family stability and personal happiness may be jeopardized. Partly for this reason, American society today is increasingly recognizing a limited right to job security. This recognition may be inconsistent with the continued availability of wage garnishment if the latter is likely to have adverse effects on a debtor's job security.[321]

Earlier, I described the limited effectiveness of existing statutes designed to control secondary costs by prohibiting employers from dismissing debtors because of garnishment.[322] The fundamental fault is that the legislation does nothing to ameliorate those factors that traditionally have made it in an employer's interest to dismiss or take other adverse action against a garnished employee. The cost of garnishment to the employer has been primary among these factors.[323] Consequently, it would almost certainly be more effective in limiting secondary costs simply to pay an employer a sufficient fee to cover its costs in complying with a garnishment order. While it would no doubt be too cumbersome to calculate the employer's costs in each individual case, certainly the flat statutory fee could and should be raised to approximate the average cost of compliance. Not only would such reform eliminate much of the current incentive to dismiss garnished employees, but it would also eliminate the injustice of saddling the employer with the substantial costs of coercive execution.

The next question is whether it should be the debtor or the creditor who ultimately bears the burden of the enhanced compensation to the employer. Given present exemptions,[324] the amount

320. There is a well established correlation between severity of wage garnishment laws and bankruptcy rates. *See* note 76 *supra*.

321. I am asserting here only a limited or qualified right that can be eschewed on a showing that it is in society's interest to do so. *Cf.* Reich, *The New Property*, 73 YALE L.J. 733 (1964) (arguing that in modern society such rights as education, health care, and so forth, are entitled to due process protection).

322. *See* text accompanying notes 44-47 *supra*.

323. *See* text accompanying notes 40-41 *supra*.

324. There is now a federal "floor" on exemptions in wage garnishment, roughly twenty-five percent of take-home pay, with even higher exemptions for low income debtors. 15 U.S.C. § 1673 (1976). Estimates of employer costs of complying with garnishment orders range upwards from twenty dollars. CAPLOVITZ, *supra* note 8, at 237 n.10; Kerr, *supra* note 41.

realized from garnishment of a single paycheck seldom exceeds one hundred dollars and more commonly is substantially less. If the debtor pays the employer's costs, garnishment will suddenly lose the characteristic that makes it more attractive than other forms of coercive execution: for every dollar lost by debtor, nearly a dollar of debt is discharged. However, if the creditor must absorb the employer's cost, and is not permitted to transfer it to the debtor, a substantial disincentive to this form of coercive execution will result. Although I have argued that disincentives to coercive execution are desirable, this particular disincentive to wage garnishment would virtually force adoption of equivalent disincentives to property execution. Otherwise, coercive execution would be channeled to property execution, a disfavored form. Tbe net effect of all the disincentives might be to make coercive execution too expensive, thereby encouraging excessive reliance on informal harassment as a collection strategy.

A solution to this conundrum would be to reduce the costs of employer compliance with a garnishment order. In most jurisdictions today a creditor must initiate a separate garnishment proceeding each pay period, and the employer often learns of the garnishment only shortly before payday.[325] As a result, the employer must make separate calculations of the amount subject to garnishment for each pay period, often on very short notice, at considerable bookkeeping expense. One measure to reduce these costs would be to require that an employer receive notice of garnishment at a certain interval before payday. For example, garnishment orders might be effective only as to paychecks issued seven days after service on an employer, in order to avoid bookkeeping expenses attributable to the need to make sudden adjustments.[326] Another cost-saving measure, already adopted in some jurisdictions, is a "continuous garnishment" system.[327] Under a continuous garnishment system, an

325. *See* Project, *Wage Garnishment in Washington, supra* note 42, at 754-56. Garnishment is an *in rem* proceeding, the "thing" seized being the debt owed by the garnishee to the principal debtor. As a result, in many jurisdictions the amount reached by wage garnishment is the amount owed by the employer at the time of service of process on the garnishee. *See* Chaachou v. Kulhanjian, 104 So. 2d 23 (Fla. 1958); RIESENFELD, *supra* note 18, at 222-29. Sucb a rule provides an incentive for a creditor to serve garnishment process as late as possible in a pay period.

326. It would also be necessary to alter the traditional rule that garnishment process reaches only debts owing at the time of service. *See* note 325 *supra*. Many states have already done tbis with respect to wage garnishment. Wisconsin, for example, provides that garnishment process reaches all non-exempt wages owing at the end of the pay period in which process is served. WIS. STAT. § 812.18(1)(b) (1977).

327. *See* RIESENFELD, *supra* note 18, at 229 n.4. *See generally* CALIF. LAW REVISION COMM'N RECOMMENDATIONS RELATING TO WAGE GARNISHMENT AND RELATED MATTERS (1972)

order requires an employer to deduct an appropriate amount each pay period until the entire debt is retired. Such "continuous garnishment" enables the employer to make only a single set of calculations, treating garnishment like any other payroll deduction. Moreover, a creditor seeking to collect an entire debt through garnishment need bring only one garnishment action, saving court costs.

If an entire debt would be collected through garnishment, a continuous garnishment system would clearly have fewer costs than the more common "single garnishment" system. In single garnishment jurisdictions, however, debts are rarely fully collected through garnishment. Rather, after one or two garnishments, a settlement is reached or the collection problem is otherwise resolved (through, for example, bankruptcy or abandonment by the creditor).[328] In these circumstances, because the initial costs of compliance with a garnishment order ought to be similar under both systems, continuous garnishment systems would not significantly reduce employer costs. Furthermore, there is reason to suspect a higher incidence of garnishment under continuous garnishment systems. The incentive to a creditor to reach an informal settlement would decrease if a single court order required payment of the entire debt in installments.[329] Hence, continuous garnishment may be inconsistent with the general goal of regulation of the consumer credit collection system to encourage informal settlement.

In summary, the case for wage garnishment as the least undesirable form of coercive execution is uneasy.[330] Because of the lost

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[hereinafter cited as CALIF. LAW REVISION GARNISHMENT RECOMMENDATIONS] (discussion of technical problems in the administration of a continuous garnishment system).

328. For a report of a study documenting such creditor behavior, see note 10 *supra*.

329. The incentive for quick execution under a continuous garnishment system would be especially strong if there were no change in the priority rules. The first creditor to execute would be entitled to the debtor's non-exempt wages for a considerable period of time. The California Law Revision Commission, in recommending continuous garnishment, proposed to deal with this problem, as well as the injustice to other creditors of allowing one creditor to tie up a debtor's wages almost indefinitely, by permitting the garnishment process to reach wages for 120 days, or such shorter period as would be needed to settle the debt. After a garnishment had expired, the garnishor would be unable to initiate a new garnishment proceeding for ten days, though during this ten-day period other creditors could initiate garnishment, and the first to do so would be entitled to the debtor's non-exempt wages for another 120 days. CALIF. LAW REVISION GARNISHMENT RECOMMENDATIONS, *supra* note 327, at 110-12. The proposal has yet to be adopted in California.

330. There has not been much consideration in this country of the possibility of granting discretion to a judge or other neutral official to determine the appropriate form of coercive execution on a case-by-case basis, rather than leaving that decision to the creditor. Some members of a law reform commission in England made such a proposal, though it was not adopted there. REPORT OF THE COMMITTEE ON THE ENFORCEMENT OF DEBTS, *supra* note 314. Given that it is often in the creditor's interest to pursue a form of coercive execution that will cause the debtor the greatest harm, *see* note 193 *supra* and accompanying text, an

value principle, garnishment does offer the promise of avoiding the waste of debtor assets that characterizes most property execution. Yet substantial secondary costs may outweigh that apparent advantage. My tentative conclusion is that wage garnishment should be the favored form of coercive execution, providing it proves possible to limit the effects of garnishment on job security. Although there is inadequate data, I suspect extant prohibitions of dismissal for garnishment are inadequate. A more productive approach would be to ameliorate the economic burdens on employers caused by garnishment by providing compensation more closely approximating employers' costs. For garnishment to retain its unique characteristic of offering a debtor nearly a dollar of debt retirement for each dollar lost, creditors should absorb a major proportion of the increase in employers' compensation. This absorption will simultaneously also discourage coercive execution. It is critical that this effect be carefully monitored in order to determine if there is a resultant increase in excessive harassment.

The legal system can use either of two basic techniques for channeling coercive execution into the desired form of wage garnishment. Wage garnishment can be made cheap and readily available to creditors or other forms of coercive execution can be made expensive and unavailable. The first approach is inconsistent with the basic policy of encouraging negotiated settlements and should be rejected for that reason. Implementing the second approach is complicated by the basic distinction drawn in our system of execution remedies between secured and unsecured credit. Regulating secured credit is the topic of the next subsection. With respect to unsecured credit, we can most readily channel execution towards garnishment through exemption statutes. In particular, very generous exemptions for tangible property will cause most creditors to look first to wage garnishment. Simply locating non-exempt unencumbered property will typically prove too difficult.[331]

Although exemptions should be generous, I do not advocate abolition of all property execution for unsecured creditors. Not all property is subject to the lost value phenomenon. Small holdings of stocks and bonds have a recognized market, for example, and can generally be sold at execution for a value approximating their value to the debtor. There is little reason to channel execution away from

obvious case could be made to take the decision about form of execution out of the creditor's hands.

331. I argued earlier against liberal exemption statutes as a way of discouraging coercive execution. *See* text accompanying note 308 *supra*. Here, I do not argue for liberal exemption statutes across the board, but rather only for tangible property likely to "lose value" on compulsory resale in order to channel coercive execution into the desired modes.

them. Real estate probably comes closer to realizing its value on execution sale than does personalty. The case for liberal homestead exemptions, therefore, may not be as strong as the case for liberal exemptions for personalty. Finally, there should be an overall limit for property exemptions. Creditors are entitled to have some way to collect coercively from wealthy debtors having no source of income reachable by wage garnishment.

Exemption statutes presently ensure that wage garnishment is unavailable against low income debtors.[332] The policy of exemption is to guarantee debtors a minimum income for such necessities as food, shelter and clothing. While I do not disagree with this policy, when it is coupled with extensive property exemptions, the result is to exclude coercive execution by the unsecured creditor of low income persons. The predictable consequence will be a sharp restriction in the availability of unsecured credit.

2. THE PROBLEM OF SECURITY INTERESTS

A creditor can have several motives for demanding collateral for a credit extension. In insolvency, a properly perfected security interest provides the secured creditor with priority rights in the collateral over other creditors.[333] Security interests also help creditors avoid exemption laws, since collateral can be repossessed even where otherwise exempt from execution.[334] Finally, security interests commonly provide the creditor with a cheaper form of coercive execution than would otherwise be available. Moreover, because repossession is generally cheap and easy, threats to repossess are inherently credible; the presence of security interests can therefore enhance a creditor's informal bargaining power.

I have argued that, in general, income execution should be preferred over property execution. This argument applies to secured as well as unsecured credit. Lost value can result from repossession of collateral as much as from the kinds of property execution avail-

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332. Federal law imposes a minimum exemption of thirty times the minimum wage. 15 U.S.C. § 1673 (1976). States sometimes set a higher minimum exemption. *See, e.g.*, Wis. Stat. § 425.106 (1977).

333. *See* Jackson & Kronman, *Secured Financing and Priorities Among Creditors*, 88 YALE L.J. 1143 (1979).

334. It is one of the anomalies of consumer credit law that security interests in exempt property are not considered inconsistent with the purposes of exemption statutes, whereas waiver of exemption clauses in contracts with unsecured creditors are widely condemned and often prohibited. Perhaps the explanation lies in an assumption that consumers are more likely to appreciate the risks undertaken in granting a security interest than in agreeing to a waiver, especially a blanket waiver, of exemptions. This assumption may be reasonable with respect to blanket waivers, but it seems dubious with respect to waivers of particular exemptions, such as waiver of the homestead exemption.

able to unsecured creditors.[335] This reasoning suggests that repossession under security interests should be limited to situations in which a creditor can show a special need, such as situations where income execution cannot provide adequate relief.[336] Such restrictions on repossession would not interfere with a secured creditor's desire to obtain priority over other creditors where such priority is needed, usually in insolvency cases. Security interests would also remain a way to avoid exemption laws. Although security interests would no longer provide a particularly advantageous form of coercive execution, the current availability and ease of repossession of collateral may encourage quick resort to coercive execution, a result I have argued is generally undesirable.

If it were possible to draft a consumer credit collection system without consideration of history, regulation of repossession in the manner just suggested would be quite justifiable. But we have a history. The right to repossess, cheaply and conveniently, has come to occupy a pre-eminent place in the world of creditors' remedies, particularly regarding motor vehicle finance.[337] The right to repossess cheaply, and the corresponding ability to threaten repossession credibly, have undoubtedly allowed secured credit to be more available than it otherwise would have been. The overall desirability of the restriction of credit availability that would result from curtailment of the right to repossess cannot be accurately assessed.[338] But individuals deprived of credit as a result would be substantially inconvenienced, particularly in our society so dependent on the automobile. In any event the suggested restriction of the right to repossess is just too sharp a break from tradition to be politically feasible, again particularly with respect to motor vehicle finance.

A more moderate program to discourage property execution in secured credit may nonetheless be feasible. I have already urged the abolition of repossession without prior judicial determination of default. This reform would tend to make repossession a somewhat

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335. Moreover, even in secured credit situations, the parties anticipate repayment out of future income rather than out of the property. *See* text accompanying note 317 *supra.*

336. Because of the ready market for used motor vehicles, I suspect there is generally less "lost value" occasioned by repossession of motor vehicles than by repossession of other goods. Moreover, repossession of motor vehicles is an efficient means of direct collection, whereas repossession of other goods is used primarily for leverage. Consequently, an exception to this partial prohibition of repossession might be made for motor vehicles. *See* note 300 *supra* and accompanying text.

Of course, prohibition of repossession would not prevent a debtor desiring to give up the collateral from voluntarily surrendering it in partial satisfaction of the debt. *See* WIS. STAT. § 425.204 (1977).

337. *See* notes 300-01 *supra* and accompanying text.

338. *See* text accompanying notes 91-115 *supra.*

more costly form of coercive execution, and hence a little less attractive when compared to such alternatives as garnishment or informal settlement.[339] Another proposal, discussed earlier, is to prohibit the taking of security interests in many personal and household goods.[340] These goods typically have little or no resale value. Hence, repossession both promises a good deal of lost value and is a very effective *in terrorem* leverage device.

Another technique for discouraging repossession is restriction or elimination of deficiency judgments. This much discussed potential reform would induce secured creditors to forego repossession and to rely instead on wage garnishment in situations where coercive execution is necessary and where the likely resale value of the collateral is low in relation to outstanding debt. Where repossession is an important means of direct collection, however, such as with respect to motor vehicles, elimination of deficiency judgments would almost certainly cause a dramatic increase in downpayment level and a shortening of maturities. Creditors would likely be unwilling to forego repossession since it provides immediate repayment of much of the debt. Consequently, creditors could he expected to insure that, through higher downpayments and shortened maturities, repossession will be a sufficient means of collecting all or most of the entire debt. Perhaps because of a fear of this effect, most legislation has abolished deficiency judgments only if the original amount of the loan or the amount outstanding at default is below a specified amount.[341] The effect is largely to exclude credit sales of new and

339. *See id.* Wisconsin already has basically elminated provisional remedies for secured creditors. WIS. STAT. § 425.206 (1977). The Wisconsin law caused a modest reduction in the incidence of motor vehicle repossession. *See generally* Grau & Whitford, *Wisconsin Consumer Act Revisited, supra* note 229; Whitford & Laufer, *Wisconsin Consumer, supra* note 4. My impression is that repossession of household goods and similar collateral has been drastically curtailed, with creditors instead preferring wage garnishment when practical. I am not, however, aware of any study on this question.

340. *See* text accompanying notes 248-51 *supra*. Actual and proposed regulation of this type has tended to exclude purchase money security interests from the prohibition. The reason for this exclusion is not at all obvious to me, but it is consistent with the favored treatment given the purchase money creditor in many areas of the law. *See, e.g.*, U.C.C. § 2-702. Perhaps the favored status of the purchase money creditor can best be viewed as a residue of the property law origins of security law. Not too long ago it would have been said that the title to encumbered goods did not pass from the purchase money creditor to the debtor until the debt was repaid. Though this view of the secured credit relationship is now widely disapproved, there may still be a lingering sense that a purchase money creditor who repossesses is only seeking return of goods belonging to it.

341. *See, e.g.*, UNIFORM CONSUMER CREDIT CODE § 5.103 (West 1978); *Wis. Stat.* § 425.209 (1977). *See generally*, REPORT OF THE PRESIDING OFFICER, FEDERAL TRADE COMMISSION, ON PROPOSED TRADE REGULATION RULE: CREDIT PRACTICES 240-44 (1978) [hereinafter cited as FTC REPORT].

Discouraging repossession is not the only reason that can be offered for eliminating deficiency judgments. Another argument is that consumers widely assume that repossession

expensive used cars from the ban on deficiencies.

3. WAGE ASSIGNMENTS

Wage assignments are a form of security interest, but because the collateral is income rather than tangible property, the reasons given above for discouraging foreclosure of security interests do not apply. Different problems associated with wage assignments, however, have resulted in various existing and proposed regulations. One of the main problems is that wage assignments can be executed cheaply and conveniently without ever going to court. Typically, all a creditor need do is notify an employer in writing. As a result, a debtor can have difficulty preserving defenses. Moreover, because employers sometimes react adversely to wage assignments, as they often do to wage garnishments, the threat to execute on a wage assignment can be an extremely effective *in terrorem* leverage device.[342] Another problem with wage assignments is that in many jurisdictions they are not subject to exemption statutes.[343] As a result, debtors may be induced to assign a higher proportion of their income than is consistent with the purposes of exemption laws.

Several solutions to these problems are possible. Wage assignments could be prohibited.[344] Creditors could be prohibited from executing on a wage assignment until after a judicial determination of default. Adverse employer reaction to assignments could be precluded or discouraged much as I have proposed with respect to wage

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abrogates further responsibility on their part, so that the availability of deficiency judgments is inconsistent with the expectation principle underlying contract law. For the same reason, it is argued that the availability of deficiency judgments may cause consumers to undervalue the risks of credit at the time of contract formation. *See* Greer, *Creditors' Remedies, supra* note 107, at 157-58. In addition, there is well documented research establishing the difficulty of policing the adequacy of the price obtained at a resale following repossession. This price, of course, determines the size of the deficiency claim. It has been argued that rather than attempting the perhaps futile task of policing resales adequately, it is better to do away with the problem by eliminating deficiency judgments. *See* Shuchman, *supra* note 26, at 53-56.

342. Former Justice Fortas documented this use of wage assignments in his famous article on Chicago practices. Fortas, *Wage Assignments in Chicago—State Street Furniture Co. v. Armour & Co.*, 42 YALE L.J. 526 (1933). *See also* FTC REPORT, *supra* note 341, at 123-29.

343. *See* Western v. Hodgson, 494 F.2d 379 (4th Cir. 1974) (wage assignment not subject to federal minimum exemptions for wage garnishment). Exemption laws might apply, however, if an employer refused to comply voluntarily with a wage assignment and it was necessary for the creditor to sue. *See* WAGE-HOUR OPINION LETTER No. 1118 (WH-71), U.S. Dep't of Labor, Aug. 25, 1970, [1970] LAB. L. REP. (CCH) ¶ 22,501.652.

344. This is one of the proposals contained in the FTC Proposed Rule on Credit Practices, 42 Fed. Reg. 52,439 (1977). As an alternative to outright abolition, the FTC proposes abolition of wage assignments where the amount financed exceeds $300. The latter was also the recommendation of the National Commission on Consumer Finance. NCCF REPORT, *supra* note 98, at 31-32.

garnishment.[345] A primary difficulty with all these solutions is that wage assignments are commonly just a legal form of repayment of a debt by payroll deduction. Frequently there is little reason to object to this method for repaying what amounts to an advance of wages. Yet, burdening it with the expenses of a court judgment would greatly undercut its utility. The result would undoubtedly be a restriction of credit availability.[346]

A less evident but fairly common solution to the recognized problems with wage assignments is simply to provide that all assignments are always revocable at the option of the debtor. The debtor then has the power to end the assignment whenever it becomes oppressive—because, for example, of an employer's reaction to it. Yet a voluntary arrangement to pay by payroll deductions is in no way hindered. Such reform would have some impact on credit availability and cost, as some creditors today must be willing to make reasonably low cost loans only because of the excellent security offered by an irrevocable wage assignment. In the absence of bankruptcy, however, revoking a wage assignment will only force the affected creditor to collect by wage garnishment, with its attendant debtor protection. Nothing about the revocation of wage assignment would destroy the validity of the underlying debt. Since the creditor will still be seeking collection from the same source of wealth, albeit by a more complicated and expensive procedure and perhaps in competition with other creditors, the impact of making wage assignments revocable on a creditor's overall costs may be moderate. If revocability is to be a solution to the problems associated with wage assignments, debtors will have to know and exercise their rights to revoke. Yet it may not be possible ever to teach enough debtors that they have such rights.[348]

Possible additional regulation would be to require execution of wage assignments within a short time, say ten days, of their creation. After that time, they would become void. Such regulation would effectively prohibit the use of wage assignments as true security devices, limiting them to situations in which repayment by

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345. *See* text accompanying notes 322-30 *supra.*

346. *Cf.* Greer, *Creditors' Remedies, supra* note 107, at 138-40. Using econometric methods, Greer found that limitations on or prohibition of wage assignments correlated inversely with the availability of small personal loans from personal finance companies and credit unions.

347. *See, e.g.,* UNIFORM CONSUMER CREDIT CODE § 2.410 (West 1978); WIS. STAT. § 422.404 (1977).

348. Disclosure regulation would most likely be the principal means used to inform consumers of their right to revoke. For a discussion of the difficulties of educating consumers through such regulation, see Whitford, *Disclosure Regulation in Consumer Transactions, supra* note 4.

payroll deduction was contemplated. Credit unions, usually considered the financial institution most threatened by proposals to prohibit wage assignments, would thus be protected. Moreover, debtors agreeing to wage assignments that must be quickly executed presumably would better appreciate the consequences of their actions, since they must anticipate an immediate reduction in take-home pay. Consequently, it might be reasonable to expect them to protect their own interests at time of contract more adequately than debtors typically do when agreeing to other types of wage assignments.[349]

4. BANKRUPTCY

Chapter 13 of the Bankruptcy Act, providing for wage earner plans, contemplates payment from future income, rather than from existing property. During the plan, debtors are protected from coercive execution and its secondary costs.[350] Wage earner plans, therefore, already contain the principle features I have urged for a reformed consumer credit collection system. I can only applaud those provisions in the new Bankruptcy Act which make wage earner plans more available than they have been.[351]

A wage earner plan must be voluntarily initiated by a debtor. I am aware of no serious suggestions that creditors should be able to initiate a plan,[352] but it has been urged that, where feasible, an

349. The National Commission on Consumer Finance recommended that wage assignments be subject to exemptions applicable to wage garnishment. NCCF REPORT, *supra* note 98, at 31-32. Though debtors are ordinarily permitted to repay debts out of exempt property, problems of debtor ignorance may be such that debtors should not be permitted to do so through the device of a wage assignment.

350. *See* notes 81-83 *supra* and accompanying text.

351. *See* note 83 *supra* for a brief summary of the changes made in Chapter 13 by the new Act.

At first glance wage earner plans might appear an ideal solution to all collection problems, and that hence, all collection activity should be channeled in this direction. Also, in addition to the advantages noted in the text, difficulties with priority rules are avoided because unsecured creditors are paid on a pro-rata basis. Nonetheless, I do not recommend that wage earner plans become complete substitutes for coercive execution. Because these plans require reasonably extensive official involvement in a debtor's affairs, they are both intrusive on a debtor's liberty and costly to administer. If the rules for establishing priority among unsecured creditors are changed as I have recommended, see notes 281-93 *supra* and accompanying text, coercive execution in state courts may at times resemble a "mini" wage earner plan, with several creditors sharing in the proceeds of a wage garnishment. Even these proceedings, however, are likely to be less costly than a Chapter 13 plan.

352. It is not clear why the idea of an involuntary Chapter 13 proceeding has not surfaced. There are certainly situations in which a debtor's creditors would benefit as a group from some arrangement akin to a wage earner plan, with its avoidance of most of the secondary costs of coercive execution. Moreover, I believe there is widespread consensus that the pro-rata basis for determining priorities between creditors is an equitable one. Perhaps the answer is that the availability of an involuntary Chapter 13 proceeding would make little difference in practice. When debtors are in serious financial difficulty, yet have sufficient

attempt to complete a Chapter 13 plan be a prerequisite to straight bankruptcy. This latter proposal has generally been rejected on the ground of administrative impracticality. I have suggested earlier that the evidence of impracticality is inconclusive,[353] and that other, unstated reasons—including belief in a qualified right to bankruptcy—have influenced the decisions to reject prerequisites to straight bankruptcy.

Since one objective of bankruptcy clearly is to permit the heavily indebted to become productive, bankruptcy ought to offer sufficient relief from indebtedness to permit this result. In the past, bankruptcy has been inadequate in this respect; but the new Bankruptcy Act has cured many of these inadequacies.[354] There is an interrelationship between these reforms and the question of whether the right to straight bankruptcy should remain absolute. In the past, substantial disincentives to straight bankruptcy have included the inadequacy of relief and the social stigma involved. If the stigma of bankruptcy is declining, as my intuition tells me it is,[355] the more complete relief offered by the new Bankruptcy Act may lead to more frequent bankruptcy.[356] Consequently, demands for conditions on the right to straight bankruptcy may increase. Responding to these demands may produce a clearer consensus on the objectives to be served by bankruptcy law.

V. Concluding Remarks

There is obvious difficulty in writing generally about a system that has as many discrete rules as does the consumer credit collection system. It is a fundamental thesis of this article that, nonetheless, it is essential to think generally. Change in the rules governing one problem area vitally affects other problem areas *(e.g.*, making property execution more difficult will likely increase the incidence of wage garnishment). Because I have tried to think generally, I have ignored many detailed problems of specific rules. In any event,

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income to make substantial payments under a wage earner plan, they are likely to be subjected to repeated wage garnishments. In that way, they may be persuaded to initiate either a Chapter 13 proceeding or straight bankruptcy.

353. *See* text accompanying notes 220-21 *supra.*

354. *See* text accompanying notes 207-12 *supra. See also* BANKRTUPCY COMM. REP., *supra* note 84, at part 1, ch. 7.

355. Is this the explanation for the controversy about discharge of student loans in bankruptcy, which has prompted Congress to make such loans non-dischargeable in bankruptcy in certain circumstances? 11 U.S.C.A. § 523(a)(8) (1979 Supp.).

356. Probably important to the question of whether there will be more straight bankruptcies under the new Act is how freely courts confirm composition plans under Chapter 13. *See* note 83 *supra.* If composition plans are readily available, for very many debtors Chapter 13 will be even more attractive than straight bankruptcy.

many of those problems are best considered only in the context of a particular jurisdiction.

One way in which I have generalized is by treating different types of consumer credit transactions, such as automobile finance, small loans, and revolving charge cards, as essentially fungible regarding collection problems. Traditionally, the legal system has taken a similar approach. Thinking generally about collection rules has the advantage of illustrating similarities between transactions. We may, nevertheless, need special rules for specific types of transactions. Thus, it may be desirable to permit self-help repossession without prior judicial authorization while prohibiting provisional remedies for secured creditors where self-help repossession is not available. This distinction would benefit almost solely automobile finance interests.[357] Another area of specialized rules has to do with statutory liens. Because I have written generally about collection rules, I have been unable to say much about statutory liens. They inevitably raise questions whether, in particular transaction types, certain creditors should be entitled to priority over other creditors, and perhaps to quick and cheap coercive execution as well.[358]

The basic problem regarding limiting or prohibiting collection remedies is that most such regulation is likely to increase creditors' collection costs. Those increases will be passed on to consumers, most likely in the form of restricted credit availability and higher downpayments. It is extremely difficult (I suspect impossible) to determine whether consumers would prefer or would be "better off" with the kind of compulsory insurance that restriction of collection remedies thus occasions. I have tried in this article to consider what empirical data exists with respect to these issues, but mostly I have

357. *See* note 300 *supra* and accompanying text.

358. *See* notes 150-51, 154, 159 *supra* and accompanying text for previous discussion of statutory liens. It follows from the positions I have taken in this article that statutory lien procedures that permit cheap forms of coercive execution (such as sale without prior judicial authorization) ought to be limited or abolished. It is not clear, however, whether statutory liens should allow a creditor to retain possession of goods acquired consensually after the owner-debtor has requested their return. *Cf.* Adams v. Dep't of Motor Vehicles, 113 Cal. Rptr. 145, 520 P.2d 961 (1974). These possessory liens can exert great leverage on a debtor and can impose secondary costs. On the other hand, creditors entitled to possessory liens are often "involuntary" creditors, who by custom or the nature of things do not demand cash before performance (automobile mechanics, innkeepers, etc.). Perhaps for that reason there is special justification for providing them special collection leverage.

Another function of statutory liens is to provide favored creditors with priority rights in particular collateral. Because such priority rights can interfere with alienability, even non-possessory statutory liens can provide informal leverage, as any lawyer who has encountered construction liens well knows. But whether creditors favored by statutory liens should be entitled to priority over other creditors is a question on which I have no general views. Except perhaps in bankruptcy, this judgment should only be made after examination of the specific circumstances of different transaction types.

relied on educated guesses.

I have considered two "radical" reforms of our present regulation of consumer credit collection. One would essentially substitute a system of nonregulation, defended here not so much as a means of maximizing efficiency as on libertarian grounds. The other would entirely eliminate formal collection remedies. Although neither reform can be conclusively shown to be undesirable, I suggested several reasons for doubting their desirability. In any event, both are politically impractical. In their place, I have proposed other reforms which would constitute a ratber substantial overhaul of the present system.

A major objective of my proposal is to discourage, but not to prohibit, coercive execution, largely in order to avoid what I have called secondary costs. To the extent coercive execution is allowed, I suggest that it be channeled towards the least undesirable form. Because of the lost value phenomenon that so frequently is associated with property execution, I suspect tbat wage garnishment is that form, providing it proves possible to limit the serious secondary costs, particularly job dismissal, traditionally associated with garnishment. This decision to emphasize wage garnishment implies a rather drastic overhaul of the role of security interests in our consumer credit system, but they might continue to provide a means of establishing priority over other creditors in insolvency proceedings as well as a means of avoiding exemption statutes. Repossession of collateral, however, should occupy a position of relative unimportance as a technique of coercive execution.

I also conclude that the objective of preserving debtor defenses in the context of consumer credit collection—so critical to the constitutional controversy about creditor remedies—should be largely abandoned as unachievable. I nevertheless recommend substantial abolition of provisional remedies, on the ground that provisional remedies provide creditors with a very cheap and easily available form of coercive execution. But this technique of discouraging coercive execution by making it expensive increases the incentive for creditors to abuse informal collection practices. Consequently, a vital part of a reform program must be effective regulation of informal practices. One barrier to effective regulation has been lack of consensus about what informal collection behaviors are appropriate. I propose that creditors be prohibited from activities that yield bargaining advantages *solely* because they harm, or threaten harm, to debtors. In the final analysis, these activities promote human interrelationships that are insufficiently cooperative and humane.