July, 2007

The Choice-Necessity Paradigm: Rethinking Debtor-Creditor Relationships in the Consumer Context

David Fuller

Available at: https://works.bepress.com/david_fuller/1/
The Choice-Necessity Paradigm:
Rethinking Debtor-Creditor Relationships in the Consumer Context

By: David Fuller
Abstract

The choice-necessity paradigm is a new approach to understanding the problem of rising rates of consumer bankruptcy. The choice-necessity paradigm uses an analytical structure that is a combination of the structural model and the cultural model for increased rates of bankruptcy filing, as a starting point for its analysis. The structural model emphasizes social and economic factors that cause debtors to rely on consumer credit, and that increase the risk of bankruptcy filing. Although the structural model defines the problem and identifies the risk to consumers it does not solve the problem, because it does not adequately balance risks to consumers against the reasonable expectations of creditors. In contrast the cultural model is based on the hypothesis that debtors act opportunistically, acquiring goods with debt and then discharging that debt in bankruptcy. Although this goes farther in protecting the reasonable expectations of creditors, it does not protect consumers who are legitimately subject to structural forces. This puts the structural and cultural models in tension with one another. The choice-necessity paradigm breaks that tension by combining the two models and adding an analysis of individual liberty interests in debtor-creditor relationships, and an analysis of social and political concerns related to rising rates of consumer bankruptcy.

Underlying the choice-necessity paradigm is the assumption that any treatment of debt must bring with it a principled treatment of both the debtors’ and the creditors’ liberty interests and a realization that the treatment of debt has broad social and political consequences. The concept of a principled treatment of all parties’ liberty interests is derived from the work of John Stuart Mill and Charles Fried. Additionally, it is motivated by Pierre Bourdieu’s analysis of social space and the potential for the development of oppositional class structures when movement through social space is impeded. Applying Bourdieu, Fried, and Mill to the problem
of consumer bankruptcy in this country demonstrates that as individuals’ liberty decreases, the potential for the development of oppositional class structures increases. The objective of the choice-necessity paradigm is to balance the liberty interests of individual debtors against the liberty interest of collected profit seeking individuals that make up creditors, in order to prevent the development of oppositional class structures. Concern for creditors, however, is based not on a protection of business interests per se, but of the liberty interests of the individuals that make up a creditor. This balances the structural concerns that debtors are deprived of a meaningful choice as to the acquisition of a debt when creditors intentionally exploit their decision making deficiencies and when they are subject to social forces, against the cultural concerns that debtors not be given a systemic advantage over creditors. Accordingly, the analysis looks at pre-acquisition relationships to determine if choice was constrained and if the debt represented an absolute necessity or a thing of recognized social value.

The choice-necessity paradigm employs a two part analytical structure for consumer debt, asking first if the debtor’s choice was constrained in acquiring the debt, and then asking if the debt represents either an absolute necessity or something of recognized social value. The operation of the choice-necessity paradigm is illustrated through three exemplars of debt that work together to progressively illustrate the operation of the choice-necessity paradigm. The first exemplar illustrates the liberty defeating aspects of consumer debt for both debtors and creditors and how those liberty defeating aspects may be controlled through the rebalancing of debtors’ and creditors’ relative positions. The second exemplar illustrates how a debt that represents an absolute necessity, such as healthcare debt, receives increased treatment under the choice-necessity paradigm through the addition of a preemptory discharge to the Bankruptcy Code and modifications to the tax treatment of hospitals. The third exemplar illustrates how the
bankruptcy treatment of education debt is disjunctive with its social value. In order to preserve
the social value of education, the choice-necessity paradigm shows that education debt must be
dischargeable in bankruptcy, if not peremptorily dischargeable. These three exemplars not only
show resolutions to the problem of consumer debt, but they also show how failure to address the
issues within each exemplar is ultimately liberty defeating, and has social and political
consequences. The analysis is only applied in bankruptcy, because all debt may represent a
choice constraint but only those debts that cause financial distress actually impede debtors’
liberty interests. Additionally, the necessity analysis for the preemptory discharge limits the
application of the preemptory discharge through the but-for causation requirement and the equity
cushion requirement, thereby preventing piecemeal bankruptcy and windfalls to certain debtors.
The choice-necessity paradigm does not just provide a model for solving the consumer
bankruptcy problem, it also provides a model for preserving individual liberty and the potential
for movement through social space.
# Table of Contents

I. Introduction - A Legal Solution to the Problem of Consumer Debt  
   Must Be Cognizant of the Economic, Political, and Social Issues, as Well  
   as the Legal Issues ........................................................................................................... 1

II. The Choice-Necessity Paradigm Addresses the Risks  
    to Economic and Social Liberty that the Consumer Debt Problem Presents ............... 5
       a. The Choice-Necessity Paradigm Seeks to Balance Individual Liberty  
           Rather Than Enhance One Party’s Liberty at the Expense  
           of Another Party’s Liberty ......................................................................................... 6
       b. There Are Socio-Political Consequences  
           if the Consumer Debt Problem is not Addressed....................................................... 11

III. The Problem of Consumer Debt, and Its Origins, Meaning,  
     and Potential Solutions .................................................................................................... 16
       a. Assigning Over-Consumption as the Reason for Consumer Debt  
           States the Obvious but Fails to Diagnose the Problem .............................................. 19
       b. The Jones-Zywicki Cultural Analysis Goes too far  
           in Assigning Cultural Factors  
           to The Increase in Consumer Bankruptcy Filings ..................................................... 21
       c. Structural Forces that Reflect a Lack of Meaningful Choice for Debtors  
           Are Behind the Increased Bankruptcy Filing Rate .................................................... 26

IV. Choice-Constraint is Apparent in the Terms of Consumer Credit Contracts ................... 29
    a. The Structure of Consumer Credit is Ripe for Exploitation  
       of Consumers’ Decision Making Deficiencies .......................................................... 29
    b. Exploitation of Consumers’ Decision Making Deficiencies  
       Through the Incentive Structures of Consumer Credit Contracts  
       Cause Consumers to Move from the Transacting Function  
       to the Borrowing Function ......................................................................................... 32

V. Any Solution to Problems with Consumer Credit Should Focus  
   on Equalizing the Availability of Consumer Credit  
   and the Bankruptcy Discharge ........................................................................................ 37
    a. Restricting Access to Consumer Credit Will not Solve the Problem,  
       Instead it Will Increase the Cost of Credit for Consumers ..................................... 38
    b. Equalizing Access to the Discharge and Consumer Credit  
       Solves the Debt Problem for Consumers, and Leaves  
       Lenders Free to Lend on Their Own Credit Terms .................................................... 44

VI. The Bankruptcy Treatment of Healthcare Debt Must Take into  
    Account that Consumers’ Labor Under Choice Constraints  
    when Confronted with Healthcare Costs ...................................................................... 46
    a. The Impact of Healthcare Debt on Bankruptcy Filing Rates Is  
       Masked By Other Means of Repaying the Debt, However  
       the Problem is Significant and Requires for Increased Treatment  
       of Those Debts in Bankruptcy .................................................................................... 48
b. The Preemptory Discharge Returns Debtors to The Status Quo, but Does not Create the Opportunity for Piecemeal Bankruptcy, or Windfalls to Debtors ................................................................. 49

c. In Order to Maintain Access to Healthcare, the Preemptory Discharge Must be Accompanied By Changes to Tax Law ....................................................................................... 52

d. The Preemptory Discharge Provides a Model Response to Choice-Necessity Debts That Illustrates how a Debtor Can Be Returned to the Status Quo and how to Manage Ripple Effects in Other Areas of Law ..................................................................................... 56

VII. The Social Importance of Education Is Belied By the Treatment of Education Debt in Bankruptcy ........................................................................................................... 57

VII. Ultimately The Choice-Necessity Paradigm Requires an Examination of Social Values .......................................................................................................................... 64
I. Introduction - A Legal Solution to the Problem of Consumer Debt Must Be Cognizant of the Economic, Political, and Social Issues, as Well as the Legal Issues

Americans are in an ever increasing amount of debt, but after you acknowledge that what do you do? This is the “the consumer debt question.” This question encompasses not only the question of how much debt Americans are in, but also why there is so much debt and what can be done about it. The consumer debt question has political, economic, legal, and social facets. This paper seeks to explore the legal facet of the debt question, although it will necessarily involve discussions of all the facets. This includes not only bankruptcy, but debtor-creditor law in general. Bankruptcy deals with the relationship between the debtor and creditors, when the debtor is unable to pay creditors. A legal approach to solving the problem of consumer overindebtedness should encompass not just the breakdown of the debtor-creditor relationship, but also the relationship between the debtor and creditor prior to the acquisition of the debt. Accordingly, this paper focuses not just on debtor-creditor relationships in bankruptcy but also their relationships before bankruptcy and before the debtor even became obligated to the creditor. The pre-acquisition relationship focuses on the relative bargaining power of the parties, information asymmetries, and the necessity of debt acquisition. Debtors’ choices may not be so far constrained as to make the credit contract a contract of adhesion, but certain categories of debt have choice constraints that require additional bankruptcy protections for consumer debtors.

The question of pre-acquisition choice constraint is central to the consumer debt question, because it provides a means to either prevent bankruptcy or to mitigate the effects of bankruptcy on debtors. Anytime a consumer debtor takes on a debt, there is the possibility that their choice was constrained. The first tier of analysis is whether consumer’s choices were actually constrained pre-acquisition, and to what degree the creditor is responsible for that constraint or
seeks to exploit it. In these cases it is a matter not necessarily of modifying rights in bankruptcy, but of setting the pre-bankruptcy relationship between the debtor and creditor so that neither has a systemic advantage over the other, either in creating the terms of credit or accessing the bankruptcy discharge. In these cases, it is important to distinguish between a service provider who provides a high-demand, high-priced service, such as car repair, and the creditor who might manipulate the consumer’s awareness of costs and risks prior to and during the debtor-creditor relationship.

In the case of the creditor that constrains consumer choice through manipulating debtors’ decision making deficiencies, this paper proposes that debtor-creditor law be adjusted so that the creditors’ ability to issue consumer credit matches the debtors’ ability to receive a bankruptcy discharge. The second tier of analysis examines what is required in order for a debt to receive additional modification in bankruptcy. Not only must the debtor’s pre-acquisition decision making ability be constrained, but the debt must be so large that it was the but-for cause of the consumer’s bankruptcy filing, and the debt must represent either an absolute necessity or something of recognized social value. In this way, there is a choice-necessity paradigm for the debt question: first, the effects of choice constraints are mitigated through the equalization of the position between debtors and creditors, and second, certain debts because of choice constraint plus another factor receive greater modification in bankruptcy than they do currently.

The choice-necessity paradigm for debt acquired under a choice restraint will ameliorate the effect of consumers’ reliance on credit. The Consumer Bankruptcy Project (“CPB”) shows that increasingly consumers use credit as a form of income replacement, rather than as a means to acquire frivolous luxuries. This means that debtors in bankruptcy are discharging the too

---

1 TERESA A. SULLIVAN, ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, THE FRAGILE MIDDLE CLASS AMERICANS IN DEBT 3-4 (Yale University Press 2000).
great cost of membership in the middle-class. It also means that the largest social class, considered the backbone of American society, cannot afford to maintain itself, let alone move up the social ladder. If the middle class, instead of being an upwardly mobile class becomes a stagnated class, this has broad political and social implications.\(^2\) It means that instead of a line between the moneyed powerful class and the middle class, there will be a wall. As the American economy turns away from manufacturing and towards the service sector and consumer consumption, the relationship between debt and consumption becomes vital.\(^3\) If current profits in the consumer goods and services sector are earned through consumers’ use of credit, and if that debt swallows the ability to spend in the future, then current profits will have been realized at the expense of future profits and future economic growth. A legal solution to the debt question then must seek not only to preserve the social position and political relevance of the middle class, but it must also preserve the current economic balance and not overburden the sectors of the economy that provide consumer goods and services.

The choice-necessity paradigm for the consumer debt question is best understood through three debt exemplars and how they fare under it: consumer credit, healthcare debt, and education debt. By looking at these three types of debt it is possible to understand how the choice-necessity approach to consumer credit will help to solve the consumer debt question. Consumer credit is the first and most prevalent form of consumer debt. Additionally, it is a clear example of a debt category that should be addressed under the first tier. Consumers labor under a choice constraint in acquiring consumer credit, because consumer credit is specifically designed to capitalize on their decision making deficiencies. In addition, consumer creditors currently


\(^3\) See, e.g., Conrad De Aenille, Retail Sales Could Set The Tone On Wall St., N.Y. Times, April 15, 2007, at D3.
benefit from a stronger bankruptcy position than debtors. The Bankruptcy Abuse and Creditor Protection Act ("BAPCPA") reduces the availability of the chapter 7 discharge both through the means test and increased filing requirements.\(^4\) The full effects of BAPCPA are not apparent yet, because the middle class has not gone through a recession with BAPCPA yet.

The systemic effect is clear, the bankruptcy discharge is harder to come by, but consumer credit is not. An equalizing approach to consumer credit would either make the bankruptcy discharge freely available and leave access to consumer credit unchanged, or it would restrict access to consumer credit to the same degree that access to the bankruptcy discharge is restricted. The second category of debt is healthcare debt, which debtors cannot rationally choose not to acquire because the alternative is serious disease or death. Healthcare debt includes both an extreme choice restraint and an extremely expensive form of debt. It is the but-for cause of bankruptcy in a statistically significant number of bankruptcies.\(^5\) The combination of choice constraint and tendency to cause bankruptcy should subject healthcare debt to increased modification within bankruptcy. Finally, education debt is a form of debt in which consumers’ choice is constrained. The alternative is to not take on education debt, but for many people that means forgoing further education. Although it is not necessary like healthcare debt, education debt is socially beneficial. Given the choice constraint and social value of education, education debt should at the very least be dischargeable in bankruptcy, if not given the same status as healthcare debt.

Each of these three examples illustrates how the choice-necessity paradigm for the consumer debt question operates, and illustrates how the choice necessity paradigm is able to sort debts first on the consumer’s choice constraints pre-acquisition, and second based on either the

\(^4\) See infra note 174.

\(^5\) See infra note 180.
necessity of the debt or its social value. The choice-necessity analysis of debt creates a legal context within which it is possible to address the other facets of the consumer debt question. The choice-necessity paradigm balances the relative positions of the debtor and the creditor against the necessity and social value of debts pre-acquisition, and therefore provides the best protection for consumers, while also providing predictability for creditors, so that they can make well informed lending decisions.

II. The Choice-Necessity Paradigm Addresses the Risks to Economic and Social Liberty that the Consumer Debt Problem Presents

It is possible to catalogue copious evidence of consumers’ debt problems, but that catalogue alone is insufficient to require reorientation the debtor-creditor relationship. Debtors are sympathetic but simply acting on that sympathy is to legislate based on a preference for debtors over creditors.6 This sort of preferential legislative philosophy is unprincipled and leads to incoherent legislation. Accordingly, we must look further to find a reason for a reorientation of debtor-creditor law. Perhaps the greatest, most principled reason is the debtor’s identity, the individual consumer. As a matter of principle, this nation was founded in part to “promote the general Welfare and secure the Blessing of Liberty to ourselves and our Posterity.”7 A desire for liberty is at the heart of the Constitution and likewise a desire for liberty should be at the heart of laws passed under that aegis. It is possible to draw a link between debtor-creditor law and notions of general welfare and individual liberty.

This link brings the analysis closer to a reason to enhance debtor rights, however, the risk of being unprincipled remains. It is possible to replace a preference for debtors’ rights with the statement that debtors’ individual liberty is enhanced if their rights against creditors are

7 U.S. CONST. pmbl.
enhanced. This, however, is tautological because individuals’ liberty is always enhanced if they are freed from an obligation. In addition, that tautological approach to increasing the individual liberty of the debtor infringes on the individual liberty of the collective profit seeking individuals that make up the creditor.\(^8\) If creditors’ reasonable expectations are too often overturned when they lend to consumers, then they will cease lending to consumers. Although, that would solve the problem of consumer debt - by eliminating consumer loans - it would not solve the problem of consumers’ financial distress. Consumers would go from debtors, to beggars in search of capital. Thus the problem is not only to find a principled solution, but to find a principled solution that does not infringer on lenders’ liberty or drive them out of the marketplace.\(^9\) The choice-necessity paradigm seeks to address both of these issues.

**a. The Choice-Necessity Paradigm Seeks to Balance Individual Liberty Rather Than Enhance One Party’s Liberty at the Expense of Another Party’s Liberty**

The principle behind the choice-necessity paradigm is to preserve the economic position of the so-called the middle class,\(^10\) so as to preserve their individual liberty and to prevent the formation of oppositional class structures,\(^11\) which are antithetical to liberty within republican government. Charles Fried in *Modern Liberty: And the Limits of Government* draws on the work of John Rawls and his own legal scholarship to define “modern liberty.”\(^12\) His theory of liberty

---

\(^9\) Cf. id. (the problem is that an unequal respect for liberty may discourage individuals from collaborating in the marketplace.).  
\(^10\) Bourdieu, *supra* note 2, at 11.  
\(^11\) Id. at 10-12.  
\(^12\) Fried, *supra* note 8, at 1-11. Charles Fried brings a unique perspective because of his role as prominent legal scholar, former Solicitor General during the Reagan administration, and noted conservative, however he also acknowledges “the good things that the post-New Deal world has done for almost everyone.” Fried’s discussion of liberty shows how it is possible to reconcile two divergent strands of political and economic thought in this country, namely those strands of thought that support the post-New Deal administrative welfare state and those that regard it as anathema. *Id.*
recognizes the state’s power to curtail individual liberty, but also subjects that power to rigorous discussion and testing.\footnote{Fried, \textit{supra} note 8, at 11-25.} An issue with the state’s power to curtail liberty is the tension between the individual and collective profit seeking individuals and whether one should sacrifice its liberty to the other.\footnote{See id. at 150-51, \textit{and see} Mill, \textit{supra} note 6 at 196-97. One of the principle problems that must be reconciled in any discussion of individual liberty is how the liberty of the single individual compares to the liberty of several grouped individuals. Mill writes of the tyranny of the majority, and although it is clear that the majority cannot tyrannize the individual, so to the individual cannot rob the collected individuals within the majority of their rights. The proper balance of liberties must preserve the liberty of the individual acting singly, while also preserving the liberty of individuals that collaborate with one another, at least to the extent that individuals do not lose the incentive to act collectively. In achieving this balance there must be some econometric balance between the liberty of the individual acting singly and the individuals acting collectively, because up to a certain point the diminution of the collective individuals’ rights is of less impact than the diminution of the single individual’s rights. The problem is in finding that point.} If collective profit seeking individuals’ liberty is sacrificed to the individual, then individual liberty still suffers, namely the liberty of individuals to conduct business and to see their reasonable expectations honored. This brings us to the recognition that on the one hand individuals singly have a right to liberty but that individuals collectively maintain their liberty when gathered together in order to make a profit.\footnote{See Fried, \textit{supra} note 8, at 72-74, \textit{and see} Mill, \textit{supra} note 6, at 196-97.} The choice-necessity paradigm seeks to strike the same balance between the individual consumer and lenders.

The relationship between consumer debt and individual liberty is implicated when the effect of the debt is so great that it becomes a constraint on the individual’s liberty or freedom of action. One articulation of economic liberty is that it that comes from access to property and control over property.\footnote{Fried, \textit{supra} note 8, at 69-70.} Debt is a claim on a debtor’s access to their property. Just as the debtor works for their employer, they also work for their creditor in the sense that a portion of the value of their labor is paid over to the creditor in satisfaction of a debt.\footnote{Cf. id. This is illustrated in the example of the carver and the hat maker, because the carver is the hat maker’s debtor, and the debt is specifically a debt of labor. \textit{Id.}} This is most obvious with secured debt because the secured creditor has a property interest in some of the debtor’s

---
property, to ensure that the debtor will continue to pay the creditor. It is also present with unsecured debt, although more attenuated.\(^{18}\) It is more attenuated because upon default the secured creditor may proceed directly against specific property, whereas the unsecured creditor has a general interest in repayment that upon default may only be realized through judicial process against the debtor. This relationship by itself is not liberty inhibiting, because part of liberty is the freedom to choose one thing over another.\(^{19}\) Put another way, liberty includes the freedom to choose to have cash or goods in the present, in exchange for voluntarily giving up a portion of property that the consumer is entitled to in the future. Inherent in that is the freedom to choose this relationship and to choose the terms of the relationship. If the consumer lacks a meaningful choice as to whether they will enter the debtor-creditor relationship, or if the terms of that relationship are obscured in order to influence their choice, then they have lost the ability to fully exercise their individual economic liberty.\(^{20}\)

Economic liberty takes another form that must be recognized, the form of the collective profit seeking individuals that constitute a business. One asset that an individual controls is their labor, and how they choose to use their labor.\(^{21}\) This example encompasses more than just the entrepreneur, it includes anybody in the workforce. A person chooses their workplace, regardless of how much control they have in the workplace. The worker’s choice of employer, however idiosyncratic, is an individual economic choice nonetheless. The value of the choice is qualitative rather than quantative, such that a janitor choosing among several janitorial jobs is make just as much of a choice as a the business school graduate choosing between a variety of

---

\(^{18}\) Fried, *supra* note 8, at 69-70.
\(^{19}\) *Id.* at 47-50.
\(^{20}\) *Id.* at 22.
\(^{21}\) See *id.* at 82.
hedge funds. The salary or freedom of action within the job, does not reflect the exercise of liberty, rather liberty is the exercise of the choice to work for one employer or the other. The quality of the choice is that each person has a set of deployable assets. The individual puts those assets on the employment market. When they are offered a job they choose to either take the job, take another job, or not change their employment at all, but as long as they remain in a job they are forgoing other opportunities to deploy their assets elsewhere. The decision not to deploy assets elsewhere is the cost of the choice to work for a given employer. Liberty as between the collective profit seeking individuals and the individual consumer is in harmony, as long as the collective profit seeking individuals do not take advantage of individual consumers and as long as the collective profit seeking individuals’ reasonable expectations are honored.

At the heart of any solution to the consumer debt question is the requirement that the solution not increase the liberty of one at the expense of the liberty of the other. Any response to the questions of consumer debt must respect not only the consumer’s individual liberty but also the individual liberty of collective profit seeking individuals. It is perhaps easier to see choice constraints placed on the consumer, and how they devalue the consumer’s liberty, because those constraints arise when the consumer acquires the debt and come in the form of intentional constructs that appear in the credit contract. That notwithstanding, the choice constraints on collective profit seeking individuals and the potential to devalue liberty are just as significant. The individual in a business loses the value of their choice and their nontangible inputs when a business fails. If the business fails because its reasonable expectations were overturned, rather than failing through a market function, then the choice and the freedom to make that choice were devalued by whatever overturned the collective profit seeking individuals’ reasonable

22 See id. at 46-50. Fried argues that “liberty is worth more than the sum of the goods that we are not prevented from obtaining.” Id. at 49.
23 Fried, supra note 8, at 47-48.
expectations. For instance, if we decide that the solution to the consumer debt problem is to simply erase all credit card debt, then the reasonable expectation that the debt would be repaid is overturned, provided that the debt was not acquired subject to a choice constraint. To the extent that such an action causes an individual to lose their job with the credit card company, they have been robbed of the value of their choice and there is liberty constrained. On the other hand, if a solution wipes out, or makes dischargeable all credit card debt acquired under a choice constraint, then that does not infringe upon the collective profit seeking individual’s liberty, because their liberty stops at the point that it encroaches upon the liberty of the consumer. The choice-necessity paradigm seeks to preserve the balance of liberty between the individual consumers and the collective profit seeking individuals.

This paper seeks to provide a theoretical framework within which it is possible to balance individuals’ liberty singly against individuals’ liberty collectively. Using choice constraints identifies the point at which the individual consumer’s liberty is encroached upon. At the point that the consumer lacks a meaningful choice, either through the operation of social forces or the exploitation of their decision making deficiencies, their liberty is lost. The individual has lost their liberty because their choice has been made subject to a control, they cannot evade the control, and it is not meant to prevent harm to another.

The choice-necessity analysis shows that the best response to choice constraint is negation of the constraint, rather than removal of the constraint. Removal versus negation is the difference between drastically restricting credit availability and free access to the bankruptcy discharge. Removal carries with it the risk that non-exploitative debtor-creditor relationships will be swept in with the exploitative. This is the case because all consumer credit contracts

24 Id. at 70-76.
26 Id.
have in them the elements of choice constraint, but mere the presence of choice constraints is
note enough, those elements must act upon the consumer in order to actually constrain the
consumer’s liberty. This goes to the problem of identification; potential for lost liberty does not
prove that liberty will be lost. Certain consumers may be able to overcome the choice
constraining elements of consumer credit contracts, either through conscious financial planning
or luck, and others may be in such strong economic positions that the choice constraining
elements are not strong enough to infringe upon their liberty. Simply showing the potential for
choice constraint is not enough, and only acting on the potential carries with it the risk of
infringing on the liberty of the collective profit seeking individuals. In order to balance the
liberty of both sides it is necessary to wait until it is apparent that one side’s liberty was actually
impaired. Negation balances liberty because it only operates on those relationships in which the
effect of the choice constraint is manifest. Negation solves the identification and over-breadth
problems, because it only operates once the effect of the choice constraint is obvious. In this
way, the choice constraint analysis is designed to identify the operation of a choice constraint on
consumers’ individual liberty and to treat it so that neither party loses the value of their liberty.

b. There Are Socio-Political Consequences if the Consumer Debt Problem is not
Addressed

The potential consequences of not addressing the consumer debt question include the
increased stratification of social classes and the correlative loss of social mobility. There are

---

27 Cf. Sullivan, supra note 1, at 27-32. This is a three tiered distinction building on the CBP data that
shows how debtors’ individual situations keep them out of bankruptcy. In the first tier, are consumers
who are able to save and able pay off consumer credit balances as they accrue. In the second tier are
consumers who do not consciously plan and may not be wealthy enough to overcome the choice
constraining elements but for whatever reason do not suffer under any choice constraint. They are simply
lucky. The third tier are people who earn enough to pay off their balances but are not actually managing
their money, having a lot of money and managing money well are two different things. In each of these
three tiers, a debtor may be able to stave off financial distress indefinitely, but the flipside of the coin is
that any unexpected change in income or income potential could put them at risk of financial distress. See
id.
powerful intrinsic values to individual liberty, but more important to this systemic analysis are the extrinsic values. The extrinsic values of individual liberty are found in the relationship between individual and economic liberty, and the relationship between social mobility and representative democracy.28 The concern is that as individuals lose their economic liberty, their ability to make other non-economic choices is likewise reduced. Choice constraints through the exploitation of decision making deficiencies operate directly on choices over access to property, and economic liberty.29 As meaningful access to property is reduced, so to does an individual’s ability to make other choices in other areas of their life decrease, and their access to certain opportunities likewise decreases. An example is a family that is carrying too much debt, and therefore cannot afford to move to a better neighborhood with better schools. If the debt was acquired subject to a choice constraint then the effect on their economic liberty was carried over to their ability to select a better school for their children. This in turn means that the children will have less access to social mobility through improved education. Choices over access to property are a critical component of social mobility.

Social mobility is not a goal of debtor-creditor law, but it should be a goal of legislation in general because social mobility prevents the formation of oppositional class structures. The sociologist Pierre Bourdieu, in his description of taste, described a concept of social space.30

29 See Fried, supra note 8, at 22-23.
30 See PIERS BOURDIEU, DISTINCTION A CRITIQUE OF THE JUDGMENT OF TASTE xi-xiv, 503-18 (Richard Nice trans. Harvard University Press 1984). Bourdieu’s theory is based on an empirical analysis of surveys data that he collected throughout France in the 1970’s. Although his research uses a French dataset and the descriptions of activities and positions within the social space refer to French social, cultural, and economic practices, his conclusions are applicable to any industrial or post-industrial society. The actual theoretical work that is of most value describes the phenomenon of social space. The French data simply illustrates the operation of the theory. Bourdieu argued that readers should not take a “substantialist” view of this theory of social space; in other words they should not interpret it strictly in terms of French society in the 1970’s. Instead, he argued that it was possible to apply his analytical framework to the social relations of a given society. This is perhaps most clear in his series of lectures at
Instead of thinking of social classes, he posited that individuals’ social position can be depicted on a Cartesian plane: overall capital volume changes along the \( y \)-axis, the \( x \)-axis is divided between positive cultural capital and negative economic capital to the left of the \( y \)-axis, and to the right of the \( y \)-axis are negative cultural capital and positive economic capital.\(^{31}\)

Cultural capital refers to the cultural practices and preferences of an individual. Bourdieu found that cultural capital was strongly correlated to economic attainments.\(^{32}\) He argued that that people in quadrants I and II were in opposition to people in quadrants III and IV because of greater overall cultural and economic attainments, but that people in each of the four quadrants had different cultural tastes from one another.\(^{33}\)

Most important to this paper is the idea that individuals exist independently within this social space, and over time people can move through the social space as they increase their access to economic capital through education.\(^{34}\) Additionally, members of a family can move through social space generationally, through a process of social accretion. This is a corollary of Bourdieu’s conclusion that social classes are not preexisting and naturally solidified.\(^{35}\)

Bourdieu’s theory holds that as movement through social space becomes more difficult, classes form and act in opposition to one another. When movement through social space becomes more difficult, classes form and act in opposition to one another.

---

\(^{31}\) Bourdieu, supra note 30, at 339-46.

\(^{32}\) Id. at 53-54.

\(^{33}\) Bourdieu, supra note 2, at 7-8.

\(^{34}\) See Bourdieu, supra note 30, at 13-14. Bourdieu’s research shows that capital volume, particularly economic capital, is closely related to education. Id.

\(^{35}\) Bourdieu, supra note 2, at 11.
becomes more difficult, or impossible, then a social class arises “in the Marxist sense that is a
group which is mobilized for common purposes, and especially against another class.” An
underlying question in this paper is to what extent we, as a political system, want to develop an
oppositional class structure or whether we want to preserve mobility within our social space. In
the legal literature commentators typically use terms like “middle class,” to define income and
education levels rather than to define an oppositional class structure; in this sense the legal
literature means “probable class” rather than actual class. The concern is that at a certain point
a “class” such as the “middle class,” could go from a collection of individuals within the social
space that are descriptively grouped as a class, to an oppositional class within Bourdieu’s
meaning of “class.” The transformation occurs when the cost of class mobilization is lower
than the cost of remaining in the political system as individuals in the social space. The
oppositional intent of a class is the “struggle to impose a vision of the social world or, better, a
way to construct that world.” Representative democracy can obviate the need for such an
oppositional class structure if it provides means for individuals to express their political will
within the political system at a lower cost than expressing their political will as a fully formed
oppositional social class outside the political system.

Bourdieu’s model of social space is not predictive but it is cautionary. If, within a social
space, it appears that individuals cannot resolve their needs, then there should be an increased
systemic concern that oppositional class structures will arise. The issue in this paper is how

36 Id. One class would form in opposition to other occupiers of the social space, and then those other
occupiers of the social space form a second class that is in opposition to the first. Id.
37 See Sullivan, supra note 1, at 27-74. None of the CBP data, for instance, suggests an oppositional class
structure, instead it suggests that in terms of education and household economics most people are in the
middle class. The CBP defines middle class in terms of its education and earning capacity, although it
also talks about social outlook. See id. at 36-74.
38 See Bourdieu, supra note 2, at 11.
39 See id.
40 Id.
people resolve their consumer economic needs, particularly their consumer economic needs within a debtor-creditor relationship. Returning to the analysis of individual liberty, particularly the argument that an exercise of individual liberty becomes illegitimate at the point that it encroaches on the individual liberty of another,\textsuperscript{41} there are two potentials for oppositional class formation. An uneven solution to the debt question that fails to account for all individuals’ liberty interests carries with it the risk of class formation from the top in opposition to the bottom and vice-versa.\textsuperscript{42} If the solution is to maintain the status quo, then the risk is that the classes with lower overall capital volume, particularly lower economic capital levels, would form in opposition to those with higher capital volumes. The holders of higher capital volumes are the occupiers of the social space that are exploiting the potential oppositional class’ choice constraints and decision making deficiencies. If on the other hand, the solution is overbroad and overturns contractual expectations that were not acquired subject to a choice constraint, then there is the risk that the oppositional class will form in the groups with higher capital volumes in opposition to the groups with lower capital volumes.

As it stands now, the risk is that the oppositional social class will form from the bottom in opposition to the top, because those with lower overall capital volumes are most susceptible to the liberty reducing choice constraints in consumer credit transactions.\textsuperscript{43} We, as a nation and as a society that purports to embrace liberty, must ask ourselves if we are willing to run the risk, or to bear the cost, of a social space that is not marked by movement and is instead marked by rigid oppositional class structures. The choice-necessity paradigm’s purpose is to provide a framework for examining the relationship between consumer-debtors and creditors in order to

\textsuperscript{41} Mill, \textit{supra} note 6 at 196-97, and Fried, \textit{supra} note 8, at 20-24.
\textsuperscript{42} See Bourdieu, \textit{supra} note 2, at 7-8.
\textsuperscript{43} Cf. \textit{id. and} Mill, \textit{supra} note 6, at 196-97. This conclusion combines an examination of the effects of the liberty constraints that Mill describes, on Bourdieu’s theory of social space.
determine how pre-acquisition choice constraints affect that relationship. Additionally, the choice-necessity paradigm proposes solutions to the issues of choice constraint. These proposed solutions illustrate that the effects of certain debts can be mitigated so that liberty for all parties is preserved and so that the risk of forming oppositional class structures is reduced. In this way, the proposed suggestions are meant as illustrations as much as actual proposals, because they highlight the operation of the choice-necessity paradigm.

**III. The Problem of Consumer Debt, and Its Origins, Meaning, and Potential Solutions**

Consumer debt represents the first of the three exemplars for the choice-necessity paradigm. Consumer debt represents debt that is acquired subject to a choice constraint, but is not a necessary debt under the choice-necessity paradigm. This discussion of consumer debt illustrates how choice constraints operate, and the appropriate legal response to choice constraint. Although this paper uses the term “consumer debt,” which is a defined term in the Bankruptcy Code, the choice-necessity paradigm only applies to a lender who does not provide a service other than providing ready cash. The distinction is made because a hallmark of the choice constraint in consumer lending is the difficulty in balancing the value of the thing purchased against the cost of the debt. The choice-constraint analysis is focused on the ability to judge the actual cost of purchase with credit, price of a good goes to the value of the good not the cost of the good. The second caveat is that whether consumers have decision making deficiencies is only the threshold issue; the dispositive issue is whether the decision making deficiencies are exploited.

Applying a choice constraint analysis addresses head on one of the central, recurring themes in bankruptcy reform, whether the consumer is responsible for their own bankruptcy.

---

Some commentators have argued that a decline in bankruptcy stigma, combined with the assumed “economic benefits of filing,” encourage opportunistic consumption followed by bankruptcy filing.\footnote{Edith. H. Jones & Todd J. Zywicki, It’s Time for Means Testing, 1999 BYU L. REV 177, 208 (1999).} This analysis ignores economic realities and lenders’ exploitation of debtors’ decision making deficits. Its chief failure is that the declining bankruptcy stigma argument judges consumers not just for how they purchase but for what they purchase. The contrary view holds that consumers use consumer credit because the cost of living is such that they must either use consumer credit or forgo daily necessities, and the end result is that some end up in bankruptcy.\footnote{See id. at 224 (1999).} This analysis does not focus on what consumers purchase. Instead it examines how consumers purchase, and why they purchase with consumer credit rather than ready cash. Accordingly, it is more judgment neutral.

At the heart of the question of why consumers file bankruptcy, is the question of why they acquire so much debt. Decreased stigma does not answer this question, because “stigma” is an illusory term that is so laden with cultural judgments about debtors that it does little more than expose writers’ biases towards bankrupt debtors.\footnote{See id.} Cost of living alone, does not explain the increased rate of bankruptcy filing either. It explains why consumers use consumer credit when they spend, and shows the impact of that spending, but it does not show how lenders lead consumers into a manner of spending or how to lessen the impact of consumer credit on consumers.\footnote{See Elizabeth Warren, The Over-Consumption Myth And Other Tales Of Economics, Law, and Morality, 82 WASH. U. L.Q. 1485, 1487-95 (2004).} Applying the choice constraint analysis to consumer credit avoids the pitfalls of the stigma analysis and shows that consumer lenders’ exploitation of consumers’ decision making deficiencies increases the impact of cost of living increases.
Choice constraint is judgment neutral as to debtors because it focuses on whether socio-economic circumstances or intentional exploitation of decision making deficiencies contribute to the problem of overindebtedness. This does not extend to price structures when a good or service is provided, because price in relation to value of the good is apparent to the consumer on the face of the transaction whereas the actual cost may not be. The consumer maintains their choice over price of the goods, in both the choice-constrained and unconstrained transactions through haggling with the provider, comparison shopping, and the ability to simply not buy the good. In consumer credit transactions, the consumer is presented with the value of the product in relation to the price, but the price-value comparison does not reflect the true cost. The true cost is the price of the product plus the price of credit. A consumer credit system that exploits decision making biases is designed to hide the price of credit or to encourage discounting of the price of credit. The price of the product is not part of the exploitation of decision making deficiencies, because its value as compared to the price of the product is always apparent to the purchaser. The second part of the transaction, the cost of the money used to purchase the product is not apparent to the consumer on the face of the transaction. This is the part of the transaction in which the consumer’s choice can be constrained by lending structures intended to exploit their decision making deficiencies. The judgment neutrality of choice constraint analysis, particularly as compared to the value laden bankruptcy stigma argument, provides a better picture of the impact of both cost of living and creditor behavior on the consumer debt question.

---

a. Assigning Over-Consumption as the Reason for Consumer Debt States the Obvious but Fails to Diagnose the Problem

There are three over-arching theories of over-indebtedness: strictly cultural, strictly structural, or a combination of the two. The strictly cultural approach to bankruptcy is that the rising bankruptcy rates are a function of some social phenomenon. One cultural approach to bankruptcy argues that people have lost the sense of shame that used to accompany bankruptcy, and this contributes to the increased rate of bankruptcy filing. According to this view, individuals are better aware of the economic benefits of bankruptcy and have a reduced sense of shame about bankruptcy. They feel free to use the bankruptcy system to wipe out their debts and to break their promises to creditors. The contrasting structural argument is that the increased cost of living combined with stagnation in real salaries leads to more debt, which in turn leads to increased rates of bankruptcy filing. Problems in consumer lending are described as another structural component to the increased rate of bankruptcy filing. A third approach is to look at the increase in consumer bankruptcy as a combined function of both culture and structure. The combined approach suggests that as the structural impetus for bankruptcy filing increases, the cultural factors that inhibit consumers from filing decrease. As structural forces lead more consumers into bankruptcy, it may appear that there is less stigma, but that does not diminish the underlying structural causes.

53 Jones, supra note 46, at 208-21.
54 Id. 216-19.
56 Braucher, supra note 52, at 342-46.
57 Id. at 342-46.
It is tempting to argue that culture alone is driving the increased rate of bankruptcy filings; however, it is tempting because it is simple and ignores the more complex structural causes of bankruptcy. The problem with this morality based argument is that it too quickly assigns a cause and effect, without adequately explaining the source of the cause. Simply assigning a moral failure, such as a loss of shame or a lax attitude towards the importance of promise keeping too easily skips over the structural factors that cause consumers to file bankruptcy, even though the debtor may still feel shame over their inability to pay their debts.\textsuperscript{59} A strictly cultural approach does not adequately account for debtors’ choice constraints in acquiring debt, because those choice constraints are structural.

The debtor that must choose between consumer borrowing and going without a necessity, is not making a culturally driven decision to spend and then file for bankruptcy instead they are making a decision that is informed by their economic need.\textsuperscript{60} This is not to say that the cultural aspect is entirely irrelevant. Beyond the basic necessities of life, what consumers define as a necessity is culturally defined. For this reason, the necessity prong of the choice-necessity analysis is not present in the run of the mill consumer credit transactions, and those transactions are not subject to greater modification in bankruptcy under the choice-necessity paradigm. The choice-necessity paradigm adopts the third approach to increased rates of bankruptcy filing and holds that filing rates are a function of both structure and culture, but structure ultimately has a greater influence than culture. This takes into account the strengths and weaknesses of both the purely cultural explanation and purely structural explanation for increased consumer bankruptcy filing rates.

\textsuperscript{59} Id. at 242-247.
\textsuperscript{60} Warren, supra note 49, at 1504-07.
b. The Jones-Zywicki Cultural Analysis Goes too far in Assigning Cultural Factors to The Increase in Consumer Bankruptcy Filings

The argument that rising bankruptcy rates stem from a loss of shame combined with an economic benefit to bankruptcy is ultimately unavailing. It is entirely subjective and ignores that structural factors such as cost of living or choice constraint may also influence the rate of bankruptcy filing. This argument may provide a reason that people in a given economic position choose bankruptcy over another way out of financial distress, but it does not show why people are in financial distress to begin with or why they chose bankruptcy. Based on Rafael Efrat’s study of New York Times stories on personal bankruptcy from 1864 to 2002, it appears that after 1960 there was a noticeable decrease in bankruptcy stigma.\textsuperscript{61} This shift manifests itself in the way that bankrupt debtors are described. Instead of describing debtors as “deceitful,” “manipulative,” or “fraudulent,” bankrupt debtors were described as irresponsible and as “simply rash and immature.”\textsuperscript{62} In addition, debtors were described as “hardworking, poor, struggling, and needy,” instead of attempting to show that the debtor was bankrupt because of their own moral failing.\textsuperscript{63} There is evidence that filing bankruptcy became less personally onerous and that bankrupt debtors ran less of risk of being shunned by their community. This evidence does not mean that the bankruptcy process has become so pleasant or routine that debtors routinely seek it out, when they do not really need to file bankruptcy. One survey indicated that between 4.4%

---

\textsuperscript{61} Rafael Efrat, \textit{The Evolution of Bankruptcy Stigma}, 7 THEORETICAL INQUIRIES L. 365, 385-89 (2006). Instead of using surveys of petitioners or other variables that do not directly measure the general public’s opinion of bankruptcy and bankrupt debtors, Efrat used New York Times articles. These news articles were indexed as far back as 1864 and the New York Times is a major newspaper, therefore the studied materials reflect a more national view and represent a long span of time. \textit{Id.} at 385-89.

\textsuperscript{62} Efrat, \textit{supra} note 61, at 389.

\textsuperscript{63} \textit{Id.}
and 9.6% respondents saw bankruptcy as an acceptable reason for suicide, and the stigma of bankruptcy prevents many debtors from filing bankruptcy.

Although bankruptcy stigma may have decreased, it still has a restraining effect on some debtors’ behavior. There is contrary anecdotal evidence showing that some debtors are very comfortable with filing bankruptcy repeatedly. These contrasting descriptions of stigma indicate that the evidence of stigma is almost purely anecdotal and subjective. A close look at the bankruptcy stigma argument shows that it ignores structural causes for bankruptcy filings and applies value judgments about debtors instead. According to Jones and Zywicki, once it is shown that the stigma of bankruptcy no longer constrains debtors then it is possible to argue that debtors feel free to overspend on luxuries and then use bankruptcy to escape their obligations. This point of view is based on a study showing that the greater the financial benefit of filing bankruptcy the greater the rate of bankruptcy filing, according to this study as much as 20% of the population would financially benefit from filing bankruptcy. This point of view is in tension with the theory that “debt causes bankruptcy.” Both theories argue that there is a causal connection between either financial benefit and the bankruptcy filing or a causal connection between consumer debt loads and the bankruptcy rate.

---

64 Id. at n.66.
65 Id. at n.63.
66 Jones, supra note 46, at 216-19.
67 Efrat, supra note 61, at 385-89. The New York Times data is an incomplete picture of the attitudes towards personal bankruptcy, because it only represents what the editors of a national newspaper-not devoted solely to legal, business, or bankruptcy topics-chose to publish. This makes the study based on New York Times stories as much an article about the changing editorial opinion of bankruptcy at the New York Times, combined with the inference that the changing editorial opinion accurately reflects national opinion. Still, it presents the changing opinion over 139 years.
68 Jones, supra note 46, at 210-14.
69 Id. at 211.
70 Id. at 222.
Simply looking at the cause of the bankruptcy without looking at the cause of the debts that led to bankruptcy is only addressing half of the question. The debt causation theory of bankruptcy holds that debt “piles up,” but removes the debtor as an intentional actor in its acquisition; instead it points to social and economic forces that make the debt unavoidable.\(^1\) In contrast to this, is the view that debtors are the intentional actors in debt acquisition, summed up in the statement that debtors “do not collect debt; they collect things they buy with debt.”\(^2\) This position holds that overspending is a kind of moral weakness that ultimately causes debt.\(^3\) The theory that the debtor is the primary and intentional actor in their acquisition of debt does not address the question of how to treat the debtor who must collect things that must be bought with debt.\(^4\) While it is true that no one has to have a plasma screen television, it is also true that a person must have a refrigerator,\(^5\) and many people cannot even pay cash for something as necessary as a means to keep their food from spoiling.\(^6\) Using credit to purchase necessities does not reflect a scenario in which debtors are intentionally acquiring debt; it reflects a scenario in which debtors have no meaningful choice about the acquisition of goods on credit.

The lack of meaningful choice over the acquisition of a debt is a choice constraint. The strictly cultural explanation of bankruptcy rates makes judgments based on a strict cause and effect analysis, without regard to the debtor’s actual intent. There is no allowance for the possibility that as between the decision to purchase on credit and the decision not to purchase,

\(^1\) *Id.* at 222-27.
\(^2\) *Id.* at 224.
\(^3\) *Id.*
\(^4\) See Warren, *supra* note 49, at 1504-06. Professor Warren’s research indicates that basic fixed expenses account for 75% of a families monthly income. This means that increasingly unexpected expenses, such as a car repair or the need to replace an appliance must be paid for with credit or they cannot be paid for at all. *Id.*
\(^5\) Jones, *supra* note 46, at 212-13. The authors point to refrigerators as one of the things that debtors “collect” on credit. However, it is unclear how a debtor is to prevent their food from spoiling if they can only afford a refrigerator if they finance the purchase. *Id.* at 224.
the debtor has no meaningful choice. The definition of “no meaningful” choice, includes a recognition that part of preserving individual liberty is providing individuals with sufficient economic resources to meaningfully realize their liberty. If an individual is put into an economic position such that they lack certain basic necessities, the value of their liberty decreases. Accordingly, an individual has no meaningful choice when the choice is between using credit to acquire a necessity required to realize the value of their individual liberty and choosing to forgo that necessity but sacrificing some of their liberty.

The use of “necessity” in the definition “meaningful choice” raises the definitional problem of how broadly to define the term in the context of the choice constraint analysis. This raises the question of how to systemically judge people’s purchasing decisions, and illustrates the fatal flaw in a strictly cultural approach to the consumer debt question. Any solution to increasing rates of bankruptcy filing that relies solely on a cultural explanation runs the risk of creating an oppositional class structure. This is the case because any cultural explanation ultimately rests on the judgment that certain things are not necessary. While it is certain that a plasma screen television is not necessary to an ordinary family, it is almost certain that a refrigerator or clothing are necessary. Still, what kind of refrigerator or how nice a set of clothes are necessary: is auto-defrost an untenable luxury for some but not for others; should people be required to buy more socks instead of insulated boots if they have a certain debt-to-income ratio? At a certain point these questions invokes the specter of either sumptuary laws or means testing, not chapter 7 means testing but depression era means testing in which a government board would determine eligibility for social welfare. A debtor-creditor law that includes too much judgment

77 Fried, supra note 8, at 148-49.
78 Jones, supra note 46, at 230.
79 See GEORGE ORWELL, THE ROAD TO WIGAN PIER 94 (Victor Gollanz Ltd. 1937). Orwell wrote about means testing in its original, much-maligned incarnation, “[w]hen the dispute over the Means Test was in
of purchasing behaviors, particularly one that attempts to define necessity, increases the likelihood that an oppositional class structure will arise, because one set of individuals is dictating necessity to another set of individuals.

The CBP data shows that the bulk of debtors come from people with roughly similar backgrounds. These debtors occupy roughly the same social space. These debtors, within this social space, would have a cause to “mobilize for a common purpose.” The cause to mobilize would arise in the effect a bankruptcy law based on negative judgments of what constitutes necessity spending for a debtor, even if that spending reflected a choice constraint. As Bourdieu describes it, a political system moves from “virtual classes,” to “realized classes,” when there is “something to be done,” or something to react to that is more unifying than simply coexisting in a common area of social space. The task for a rationally constructed bankruptcy law is to create a system that sorts between debts, but does not do so in a way that judges debtors to the extent that they have cause to mobilize into an oppositional class. This cannot be accomplished through a strictly cultural analyses of bankruptcy filing rates, because of the implicit social judgments. Instead, any rationally constructed bankruptcy law must recognize that although there may be less bankruptcy stigma, the reduction in stigma arises out of structural progress there was a disgusting public wrangle about the minimum weekly sum on which a human being could keep alive.” Id. During the Depression, the British working class came to deeply resent the Means Test, particularly because it meant that the government, and the social class that the government represented, were imposing terms of living conditions upon the working class. PETER CLARKE, HOPE AND GLORY BRITAIN 1900-1990 180 (Penguin 1996).

80 Sullivan, supra note 1, at 27-74.
81 See Bourdieu, supra note 2, at 11-13.
82 See id.
83 See id. The term “virtual classes” refers to the potential for the mobilization of oppositional social classes arising among the occupiers of different areas of social space, and “actual classes” refers to classes that have actually mobilized. Id.
forces that increase the rate of bankruptcy filing, and does not arise out of amoral or unethical debtor behavior.\textsuperscript{84}

This view of debtors as subject to structural forces that drives their perception of bankruptcy may account for the decline in the bankruptcy stigma.\textsuperscript{85} Bankruptcy stigma may be decreasing because bankruptcy has become necessary for more people, instead of decreasing because people feel less shame about not being able to pay their debts.\textsuperscript{86} This view of bankruptcy stigma is judgment neutral, and it reflects how structural causes have increased exposure to bankruptcy and changed consumers’ view of bankruptcy. This more accurately reflects the declining prominence of the bankruptcy stigma argument as commentators become more attuned to the risks in using cultural explanations for bankruptcy filing rates to the exclusion of structural explanations.

c. Structural Forces that Reflect a Lack of Meaningful Choice for Debtors Are Behind the Increased Bankruptcy Filing Rate

A structural explanation focusing on the consumers’ individual finances shows that consumers lack a meaningful choice over the acquisition of debt. Consumers are acquiring high levels of debt because their personal finances are stretched to the point that they cannot afford to pay their fixed monthly expenses and pay cash for other necessities.\textsuperscript{87} The CBP data shows that families fixed monthly expenses now consume 75\% of their income,\textsuperscript{88} which only leaves 25\% to use for unexpected expenses, non-fixed routine expenses such as clothes or car repairs.

\textsuperscript{84} See Sullivan, supra note 58, at 247.
\textsuperscript{85} Jones, supra note 46, at 212-13.
\textsuperscript{86} David A. Moss & Gibbs A. Johnson, The Rise of Consumer Bankruptcy: Evolution, Revolution, or Both?, 73 AM. BANKR. L.J. 311, n.50 (1999) An analysis of bankruptcy stigma is always backwards looking; it is always possible to see greater stigma in the past. If one believes a business group from 1967, there is no stigma to lose today because it was already gone in 1967. This shows that to a large degree bankruptcy stigma is in the eye of the beholder and is therefore an imprecise metric for explaining changing rates of consumer bankruptcies. See id. at 322-27.
\textsuperscript{87} Warren, supra note 49, at 1504-05.
\textsuperscript{88} Id.
Particularly important is that with the increase in fixed monthly costs families are able to save less. This means that individuals’ equity cushion is shrinking, and with that their ability to insulate against unexpected costs or income interruptions. The significance of this is twofold. In the first instance it means that large unexpected costs must be paid for with credit. This in turn increases fixed monthly expenses in the form of higher payments to creditors. Second, an income interruption makes the individual who has already used consumer credit less able, if not entirely unable, to pay their fixed monthly expenses. This in turn puts them at risk for bankruptcy or makes bankruptcy the best economic option for them.\(^9\)

Over consumption, at least as it is portrayed in the work surrounding the CBP is a symptom of a high cost of living and stagnant middle-class incomes, not a desire for material goods.\(^9\) In this context, the message to consume less functions as a message for the middle-class to lower their expected standard of living. The debtors in the CBP data include a cross-section of people who have done the “right” things. These debtors have completed high school, learned a skill, completed at least some college, and tried to save but the cost of living overtook them, not the cost of living extravagantly but the cost of living the “American Dream.”\(^9\) If these consumers are warned away from using consumer credit, or if the cost of using consumer credit becomes too high,\(^9\) then segments of the middle class will no longer be able to achieve the external markers of middle class membership. In effect, they will be middle class in education and outlook but their social position will be disjunctive with those other achievements.

The socio-political risk is that judgments about purchasing behavior and bankruptcy are the first step towards a sharper divide between upper and lower middle class, in which it is

\(^9\) See Sullivan, supra note 1, at 61-68.
\(^9\) Id. at 92.
\(^9\) Id. at 33-36.
\(^9\) Bourdieu, supra note 30, at 53 (stating that “[m]ost cultural consumption also entails an economic cost”).
possible to have all of the attainments of the middle class in terms of background, education, and outlook, but few of the external markers. 93 The cost of this is a dramatic revision of the American narrative, namely that hard work, self-improvement, and honesty do not necessarily lead to achieving the American dream. The question is which cost is too much to bear, the economic cost of bankruptcy, the cost of increased class division, or the cost of rebalancing the relative positions of individual borrowers and lenders.

The result of the structural analysis is that there is a vastly different portrait of bankrupt debtors than is seen through the stigma analysis. Based on which analysis is used, either structural or cultural, the purchase of a household item with credit takes on an entirely different meaning. 94 Under either approach there are ultimate judgments of the debtor’s behavior, either they should forgo an item if they cannot afford it or the item was acquired with credit because of structural factors such as cost of living and stagnant wages. In contrast, choice constraint analysis looks at the debtor’s ability to make meaningful choices as to whether they should acquire an item or whether they should use credit to acquire an item. If the result of not purchasing the item with credit is that the consumer is forgoing a necessity that the consumer reasonably expects to enjoy, then the consumer has little or no meaningful choice. Of course, a debtor may set the bar too high when it comes to what they should reasonably enjoy. Wherever the bar is set must take into account that too much value judgment of purchasing behavior may create an unwanted oppositional class structure. Ultimately, an application of the choice constraint analysis runs into the problem of where to set the bar for necessity. Instead of attempting to determine what is and is not necessary and attempting to dictate consumer behavior through bankruptcy legislation, the better approach is to determine reasonable credit terms and

93 Id.
94 Compare Jones, supra note 46, at 210-14, and Warren, supra note 49, at 1493-95.
allow a balanced relationship between the availability of credit and the availability of the bankruptcy discharge.

IV. Choice-Constraint is Apparent in the Terms of Consumer Credit Contracts

In the previous section, the choice constraint analysis focused on the question of whether the debtor had a meaningful choice over acquiring a certain good, now the focus shifts to the terms of acquisition. In this section the choice constraint analysis turns to the exploitation of consumers’ decision making deficiencies. This raises the question of whether consumers are able to make a meaningful choice about whether to use credit if lenders intentionally exploit their decision making deficiencies. In order for a debtor to make a meaningful unconstrained choice they must know what they are choosing. Currently consumers and lenders have an unequal relationship. Lenders are free to make virtually any lending decision that fits their business model, but consumers labor under reduced access to the bankruptcy discharge, and they are unable to make meaningful credit decisions because of the exploitative nature of consumer credit. The solution is to equalize the relationship between the parties so that either there are equal restrictions on lending and discharge or there is equal freedom in lending and discharge. Of those two solutions, the better is to allow consumers complete access to the bankruptcy discharge and allow lenders complete ability to lend. This reduces the likelihood that debtors will seek black market lenders, allows lenders to tailor their lending to their own risk tolerance, market research and monitoring abilities, and protects the economy.

a. The Structure of Consumer Credit is Ripe for Exploitation of Consumers’ Decision Making Deficiencies

In order to properly apply the choice constraint analysis, it is essential to sort between the elements of consumer credit transactions that are subject to decision making deficiencies and the elements that intentionally exploit those deficiencies. Unless that distinction is made the choice
constraint analysis will become overbroad and capture not just those transactions that infringe upon economic liberty, but also those transactions that only appear to infringe upon economic liberty but in fact do not. The opportunity for choice constraint is present in any consumer credit transaction. This is because the very nature of a consumer credit transaction carries with it the increased risk that the consumer is operating under a decision making deficiency. The basic structure of consumer credit bifurcates the transaction into enjoyment of purchase and actual costs. 

Instead of applying for a loan that will purchase a specific product, the loan is acquired before the consumer ever intends to purchase a specific product, and the terms of the loan are not related to the product purchased. Additionally, the costs are not on a fixed repayment schedule, such that the borrower must repay the specific debt within a certain period of time and during the useful life of the item purchased. The debt for the item purchased with consumer credit may be carried out through minimum payments far beyond the useful life of the item purchased.

The argument in favor of the traditional bank loan is that it has a disciplining effect on a consumer. In theory the consumer sees the value of what they are getting in comparison to the long term repayment commitment in their loan contract, and this will temper their decision making. The effect of the bifurcation is heightened by the other important facet of consumer credit, it is open ended debt. A traditional bank loan is close ended, because it is for a fixed amount and amortized, additionally it is a limited purpose debt meaning that the fixed amount is used for a single purchase or set of purchases. Consumer credit is open ended, the consumer is given a maximum amount that they can borrow, but the debt remains open as long as the limit is

---

95 See Mann, supra note 50, at 418.
96 Id.
97 Id.
98 Id.
99 Id.
100 Id.
not surpassed. 101 Once the consumer pays off part of their balance, that amount of credit is once again available. Similarly, there is no fixed or limited purpose for consumer debt; although a debtor may resolve to only use consumer credit for a single item there are few contractual limits on a consumer’s use of their credit card.102

Those elements of a consumer credit transaction go directly to the problem of optimism bias, and the risk that the consumer will not accurately weigh the long term risks associated with the transaction.103 Additionally, smaller transactions seem less risky to consumers because consumers may be more likely to think in terms of individual debts rather than aggregating the cost of all the transactions with a single lender.104 In the payday lending market, decision making deficiencies may cause a consumer not to seek better credit alternatives, but the same effect may hold true in the consumer credit market as well;105 decision making deficiencies cloud consumers’ judgment in virtually every transaction.106 This, however, does not automatically engage the choice constraint analysis under the choice-necessity paradigm. Choice constraint is only present when something external to the debtor acts upon their decision making abilities, either the lack of meaningful choice or the intentional exploitation of decision making

101 Id.
102 Bar-Gill, supra note 51, at 1398-99.
103 See Ronald J. Mann, Just Until Payday, 54 UCLA L. REV. 855, 881-82 (2007). Mann discusses consumers’ tendency to not properly weigh risks in payday lending transactions. Although the risks are lower in consumer credit transactions optimism bias still obscures those risks. In particular, optimism bias in the payday lending environment leads consumers to choose the most convenient form of credit - payday lending in this case - because they cannot accurately weigh the risks and search for better lending alternatives. Id.
104 Mann, supra note 103, at 882.
105 Cf. id. at 881-83. Mann’s analysis of decision making deficiencies should hold true with consumer credit as well as payday lending. The difference is that with payday lending the consumer might fail to look for alternatives. In the consumer credit context, consumer credit might be the most competitive form of credit but instead the risk is that the consumer will overuse it. Id.
deficiencies. The ever present decision making deficiencies are relevant, because they provide an opportunity for exploitation that allows lenders to infringe upon consumers’ economic liberty.

**b. Exploitation of Consumers’ Decision Making Deficiencies Through the Incentive Structures of Consumer Credit Contracts Causes Consumers to Move from the Transacting Function to the Borrowing Function**

The exploitation of consumers’ decision making deficiencies is manifest in the profit-loss structures of consumer credit incentive programs. Incentive structures in consumer lending increase the bifurcation of purchase and long term cost. These incentive structures are principally low introductory or “teaser” rates, no annual fees, and other offers. These structures split the costs of providing credit.\(^{107}\) The incentives to use the card are set at “below marginal cost,” maintaining these incentives actually costs credit card issuers money in the short term, but the cost is recaptured through with the “above marginal cost” structures that generate profits on consumers that carry a balance.\(^{108}\) The split in cost structures reflect the split in credit card usage. Credit cards are used for transacting and for borrowing, and with these split functions the purchase and the cost are likewise split. Transacting refers to using the credit cards in place of cash,\(^{109}\) which does not involve borrowing if the consumer does not carry a balance from month to month. The credit card issuer gives the consumer what amounts to an interest free loan for the duration of the grace period.\(^{110}\) In effect, the grace period is the bridge between the transacting and borrowing functions of credit cards. The fact that the heavily incentivized transacting function is set at below marginal cost, whereas the borrowing function is set at above marginal cost, is indicative of credit card issuers using bifurcation to their benefit.

---

\(^{107}\) Bar-Gill, *supra* note 51, at 1401-09.

\(^{108}\) *Id.* at 1377-78.

\(^{109}\) *Id.* at 1380.

Once the grace period on a transaction ends the consumer begins to use the borrowing function. During the grace period the credit card functions much like a debit card; as long as the consumer has the money to pay the balance at the end of the month there is no charge. The effect of incentive structures is that the issuer may not break even, let alone profit, with the transacting function; the profit comes from the borrowing function. The issuer profits when it can encourage consumers to use the transacting function and then hopes that a consumer will carry a balance past the grace period, creating a spillover from the transacting function to the borrowing function. Issuers promote the transacting function with zero annual fee and zero transaction costs. At the point that the consumer acquires the card or uses the card at the point of sale, the only cost incurred is the cost of an item purchased. Put another way, at the moment of sale there are no actual costs greater than the cost of using cash. If the card offers cash-back rewards or incentives such as airline miles, then the issuer is actually taking a loss on the transacting function, while the consumer is getting more than they would if they simply used cash. At the time of sale, the consumer is experiencing all of the positive effects from credit card use and will only experience the actual costs, if the amount borrowed for their purchases spills over to the borrowing function.

Incentive structures target consumers’ decision making deficiencies, particularly their optimism biases and difficulty in weighing future costs. At the time of the transaction, a credit card with a rewards program attached to it “gives” the consumer something for making a purchase. This incentivizes the use of the transacting function because the consumer will discount the future cost of the credit because they were given an immediate reward for using the credit card. This not only makes transacting with consumer credit no more expensive than using

111 Bar-Gill, supra note 51, at 1380-86.
112 Id. at 1391-92.
113 Id. at 1391.
cash, it actually provides an immediate benefit that cash does not.114 This serves to make it even more difficult for consumers to realize how much they have borrowed, or the actual cost,115 and increases the effects of hyperbolic discounting and the tendency to borrow more than is necessary.116 Rewards based incentives increase the tendency to over borrow because they increase the apparent benefit of consumer credit, which leads consumers to discount the future cost.117 Interest rate based incentives might also increase the tendency to over-borrow because they present the borrower with an immediate discount creating the illusion that the consumer would pay less overtime. The consumer “frames” the transaction as beneficial to them because the credit was “on sale.”118 Consumer credit is designed so that consumers are unaware of the total, long term cost, because their credit card statement does not state a loan repayment term,119 and teaser rates downplay the cost of credit.120 Even with non-rewards based consumer credit transactions the convenience of the credit card encourages increased use. Ease of use is exploited through billing structures that hide how long it will take to repay, and only require a minimum payment, which drags out the time of repayment and increases interest payments.121 Additionally, the longer the repayment period the greater the chance that the transacting

114 See id. at 1402-04 The author describes how rewards programs create a “per-transaction price that is negative,” which means that credit card companies are giving the consumer something in addition to just paying the cost. This means that the consumer is getting more than if they used cash for the transaction, because with cash they would only get the item purchased and not the reward. Id.
115 See Block-Lieb, supra note 45, at 1536-37. Data suggests that consumers spend more with consumer credit than with cash or checks. The authors suggest that the billing structure is partly to blame because the bill comes as much as a month after the purchase and does not demand payment in full. Id.
116 See id. 1546-47. The authors discuss consumers’ tendency to apply inconsistent discount rates over time. They argue that “consumers will borrow more than would maximize utility in the long run.” Id. at 1546.
117 See Block-Lieb, supra note 45, at 1546.
118 See id. at 1532 -33. Buyers have a preference for items that are on sale, and a discounted rate operates like a sale on credit. It is a cognitive deficiency related to how consumers “frame” transactions. Id.
119 Bar-Gill, supra note 51, at 1398-99. The information on the credit card statement is usually limited to the current month’s purchases, the interest rate, the total due, and the minimum payment. See id. at 1408.
120 See Braucher, supra note 52, at 330.
121 Bar-Gill, supra note 51, at 1408.
consumer will eventually become a borrowing consumer. All of these intentional structures capitalize on consumers’ tendency to discount the likelihood that they will use the borrowing function and their optimism about their ability to pay if they do.\textsuperscript{122} As a result lenders are willing to take a loss with incentive programs and the transacting function, in order to reap the benefits when a consumer transits to the borrowing function.

Evidence of intentional exploitation of consumers’ decision making deficiencies is found in the cross subsidization and profit structures of consumer lenders. Lost or diminished profit from the transacting function is made up with cross subsidization from the borrowing function and penalty structures.\textsuperscript{123} Notwithstanding temporary reduction in issuer profit from incentives, the borrowing function and penalties not only generate issuers’ profits but pay the costs of below marginal cost price structures of the transacting function. Cross subsidization subsidizes the costs of card users who have not yet spilled over from the transacting side to the borrowing side, and users who only use the transacting function.\textsuperscript{124} The 75\% of credit card users that use the borrowing function, are paying for the 25\% who do not borrow and therefore get free transaction services.\textsuperscript{125} The importance of financially distressed borrowers is apparent in the profit made on distressed borrowers. Approximately 8\% of issuers’ profits come from penalty fees, and default interest rates are frequently as high as 20-30\%.\textsuperscript{126} Additionally, if a consumer only makes the minimum monthly payment, then it takes longer to repay the debt and the profit from the borrowing function is increased.\textsuperscript{127} Cross subsidization and consumer credit profit structures demonstrate that there is an expectation that consumers will move from the transacting function

\begin{flushright}
\textsuperscript{122} See id. at 1396 (stating that this discounting behavior has been “consistently demonstrated in the laboratory and real-world settings.”).
\textsuperscript{123} Id. at 1403-05.
\textsuperscript{124} Id. at 1403.
\textsuperscript{125} Id. at 1403.
\textsuperscript{126} Id. at 1393.
\textsuperscript{127} Mann, supra note 50, at 416-18.
\end{flushright}
to the borrowing function. If this was not the expectation then presumably lenders would not be willing to price incentives and the transacting function below their marginal cost.\textsuperscript{128} Lenders’ willingness to defer profitability demonstrates that lenders expect consumers to transit to the borrowing function, and it provides evidence that lenders structure consumer credit contracts to exploit decision making deficiencies in order to encourage borrowing. When the price structure is examined along with the aspects of the consumer credit transactions that exploit consumers’ decision making deficiencies, it is apparent that consumer lenders are intentionally exploiting decision making deficiencies in order to encourage borrowing and generate profits.

Data shows that consumers slowly acquire debt until they reach the point that any sudden change in their financial situation leaves them vulnerable to bankruptcy.\textsuperscript{129} This refutes the opportunistic behavioral thesis for increased bankruptcy filings, and points towards exploitation of decision making deficiencies.\textsuperscript{130} Instead of focusing on consumer behavior as driving up the number of bankruptcies, it is more accurate to focus on the behavior of consumer lenders that create structures to exploit consumers’ decision making deficiencies. The data showing accretion towards bankruptcy indicates that debtors are responding to the incentive structures designed to move them from the transacting function to the borrowing function.\textsuperscript{131} Accretion towards bankruptcy is more profitable for lenders than a rapid decline, because it increases the time that the borrower spends in the “sweat box.”\textsuperscript{132} The decline towards the sweat box begins when the consumer moves from the transacting to the borrowing function by not paying their balance in full. This increases in intensity as the lender is able to charge more fees and higher

\textsuperscript{128} Bar-Gill, \textit{supra} note 51, at 1408-11.
\textsuperscript{129} Mann, \textit{supra} note 50, at 405.
\textsuperscript{130} \textit{See id.} at 410.
\textsuperscript{131} \textit{Id.} at 405.
rates, but the consumer is less able to switch lenders. This in turn means that the lender can charge even more fees and higher interests rates as the consumer tries to avoid outright default and cannot find alternative financing to relieve the pressure. This shows that creditors structure their lending relationships so that they profit more from debtors as the debtors move closer and closer towards bankruptcy. A system designed to increase the risk of bankruptcy, and then profit from the period directly before filing, is ultimately one that exploits consumers to the benefit of creditors.

V. Any Solution to Problems with Consumer Credit Should Focus on Equalizing the Availability of Consumer Credit and the Bankruptcy Discharge

Any solution to the consumer debt question must take into account the central role that consumer debt plays in the American economy. As the American economy has moved away from manufacturing and towards services and retail, consumer spending has become more important to the overall economic health of the nation. One only has to look at the news stories between Thanksgiving and Christmas that breathlessly tally how much consumers have spent in the Christmas season. The downside appears in the stories that appear after New Years describing the dread with which consumers open their credit card bill. Over-indebtedness appears to be driving the economy. This suggests that any legal solution to the consumer debt question must be cognizant of the economic consequences. There is the chance that in order to achieve less consumer indebtedness, the economy might have to go through the

---

133 Id.
134 E.g., De Aenille supra note 3, at section 3. This newspaper article highlights the importance of retail sales to the U.S. economy. It describes how retail sales were weak in the previous quarter and that the direction of retail sales will influence the stock market and overall economy. Id.
equivalent of a medically induced coma while it searches for a replacement for the income
consumer spending generated.

The flipside of this coin is that the economy appears to be doing fairly well, despite the
high level of consumer indebtedness. So the best macro-economic solution may not be to restrict
the availability of credit at all, but macro-economics are not the whole story, there is still the
individual consumer. The problem is that this economic model is hurting individuals who,
between low wages in a goods and services based economy and high cost of living, are under a
heavy debt load that they acquired subject to a choice constraint. A solution to the debt
question must therefore accomplish three things: 1) relieve the choice constraints on consumers;
2) preserve economic health or at least not hurt it unintentionally; and 3) not infringe on the
liberty of collected profit seeking individuals who are engaged in lending. The second point is
outside the scope of this paper, but the first two go to the same issue, preserving the individual
liberty of both consumers and the individuals that make up lenders. The preservation of liberty
is achieved through an intentional balancing of relative ability to either discharge debt or to write
credit contracts. The solution should not just focus on a single side of the debtor-creditor
relationship, instead it should focus on creating an equal relationship between the parties.

a. Restricting Access to Consumer Credit Will not Solve the Problem,
Instead it Will Increase the Cost of Credit for Consumers

The equalization of the debtor-creditor relationship, with equal access to discharge and
equal ability to lend, satisfies the individual liberty concerns that underlie the choice constraint
analysis. Solutions that rely on restricting access to consumer credit do nothing to relieve the
choice constraints on consumers that still have access to consumer credit. Instead of removing
choice constraints, limited access to credit walls off certain consumers from choice constraining

137 Sullivan, supra note 1, at 15-18.
138 See supra notes 6-27 and accompanying text.
transactions, on the assumption that those debtors not walled off are less likely to be harmed by choice constraints.\textsuperscript{139} This assumption does not hold true. While the cost of the credit may not be too great at the time of acquisition, later a change in financial position post-acquisition could make the cost of credit too great.\textsuperscript{140} The intentional exploitation of decision making deficiencies designed to move a consumer from the transacting to the borrowing function, are most relevant and most powerful when the consumer lacks ready cash and is therefore more likely to use consumer credit.\textsuperscript{141}

Access restriction creates two classes of consumers: those who are financially healthy enough for consumer credit and those who are not. This solution offers no protection for consumers who are granted access to credit and who ultimately cannot pay their obligations as they come due.\textsuperscript{142} Not only that, but cutting off access to consumer credit would mean that certain consumers have lost their means for meeting unexpected costs. A legislative restriction on access to consumer credit would ultimately serve as a judgment that certain consumers are per se denied access to consumer credit.\textsuperscript{143} That in turn could have the unintended consequence of increasing social stratification and the creation of an oppositional class structure.

Without access to credit, an increase in income, or some kind of expansive entitlement program, certain consumers would be cut off from anything that they could not pay for using cash, or what limited credit they had. This would have the effect of limiting certain consumers’

\textsuperscript{140} Sullivan, supra note 1, at 15-19.
\textsuperscript{141} See id. at 137-40.
\textsuperscript{142} See id. This is a legitimate concern given that an income disruption can radically change a consumer’s financial health in a relatively short period of time. Id.
\textsuperscript{143} See Furletti, supra note 139, at 447-455, and see supra notes 59-84 and accompanying text.
access to cultural capital in ways that they are not currently limited. This includes the risk that absent some new, large social program, consumers will lose access to certain types of cultural capital, and have a decreased ability to interact with occupiers of other areas of social space.

This increases the likelihood that an oppositional class structure will arise. Once again, the analysis returns to the question of what the system is willing to bear. Maintaining the status quo or restricting access to credit both run the risk of creating oppositional class structures. The remaining solutions are to increase monitoring and filtering incentives for lenders or to equalize the relative abilities of consumers and lenders.

Potential solutions that increase incentives for lenders to either monitor transactions or screen debtors seem attractive because they put the onus on the lender to reform their behavior, and they have the potential to address choice constraint issues. Currently, creditors have very little incentive to increase their screening or monitoring, because their current business model makes money despite and because of the high rate of default. Creditors will screen and monitor based purely on what is most likely to preserve their profit margins. Solutions such as taxing distressed debt or providing a cause of action for lending to insolvent debtors, would increase the costs of lending to consumers that are at risk of default. Increasing the cost of lending to high risk borrowers may not remedy the problem; instead it may magnify the effect of the choice constraint or just be unworkable.

Taxing distressed debt would increase the cost of carrying defaulting debtors. This would lead to less lending to high risk consumers, and increased costs of lending if a lender does

---

144 Bourdieu, supra note 30, at 53 (stating that “[m]ost cultural consumption also entails an economic cost”).
145 Bourdieu, supra note 2, at 10.
146 Bar-Gill, supra note 51, at 1393-94.
147 Mann, supra note 50, at 419-20.
lend to high risk consumers.\textsuperscript{148} Accordingly, a lender would have an incentive to prescreen for the consumers most likely to default and once a loan is made would have an incentive to monitor the debtor, in order to prevent default.\textsuperscript{149} As the cost of lending to certain borrowers increases, borrowers would likely pass those costs on to those borrowers. Passing on increased costs to high risk consumers would hopefully reduce their borrowing.\textsuperscript{150} But this makes too great an assumption that high risk borrowers will stop borrowing as the cost of credit increases.\textsuperscript{151} If the consumer has no meaningful choice between borrowing and not borrowing, then it would only increase the costs of the debt that the consumer must acquire.\textsuperscript{152} Instead of helping high risk borrowers it may actually hurt them, because it would simply increase the cost of credit without reducing the exploitation of their decision making deficiencies. Taxing distressed debt could actually make the effect of the choice constraint more onerous for high risk consumers in the legitimate credit market and push others into the black market where the costs are even greater.\textsuperscript{153}

A second related solution is to create a cause of action for reckless lending,\textsuperscript{154} but that solution suffers from all of the defects of taxing distressed debt and may be practically unworkable. This would encourage lenders to increase costs to borrowers, to compensate for potential liability in the event of default. Increased costs to borrowers would simply act as

\textsuperscript{148} \textit{Id.}
\textsuperscript{149} \textit{Id.} at 420.
\textsuperscript{150} \textit{Id.} at 419.
\textsuperscript{151} \textit{Cf. id.} at 413 (arguing that that usury regulation might lead borrowers into unregulated markets or black markets. This indicates that at a high enough level of choice constraint, ever increasing costs do not deter borrowers. If that is the case with cost of credit in the area of usury regulation, then there is nothing to suggest that consumers will not have a similar response to increasingly expensive credit in the area of taxing distressed debt.)
\textsuperscript{152} \textit{See supra} pp. 23-26.
\textsuperscript{153} \textit{See id.}
litigation insurance.\textsuperscript{155} Although the hope is that lenders would make more discerning credit decisions and price some more marginal but still creditworthy borrowers out of the market, the result might be the same as with increased usury regulation or taxing distressed debt, consumers who need the credit badly enough will borrow nonetheless.\textsuperscript{156} Additionally, this may not provide much meaningful protection for borrowers who are recklessly lent to, because it requires them to bring a cause of action against the lender. This means that in order for an insolvent debtor to recover they must retain counsel and litigate against a lending institution.\textsuperscript{157} The practical difficulties of this solution limit its ability to actually solve the consumer debt question.

Allowing a cause of action for reckless lending would address the choice constraint, however it does so less efficiently than the bankruptcy discharge. The bankruptcy discharge is not contingent on proving a prima facie tort case.\textsuperscript{158} A debtor, who has not done something to bar their debts from discharge,\textsuperscript{159} receives their discharge relatively quickly and with very little uncertainty. In contrast, relieving the choice constraint through reckless lending litigation forces the debtor to incur the costs, delays and uncertainty of litigation. Although reckless lending litigation is an option, the bankruptcy discharge is a better relief from the effects of choice constrained borrowing.

As long as consumers want credit they will find it; a concern with increased regulation of the lending industry is that too great a restriction on the availability of credit will drive people to

\textsuperscript{155} \textit{Cf.} id. at 410-12 (the lender would certainly restrict access to credit, but given the risk of litigation the lender might simply insure against the contingency through higher fees for borrowers.).

\textsuperscript{156} \textit{Cf.} Mann, \textit{supra} note 50, at 413 (pushing borrowers out of the legitimate credit market might well lead them into the black market shows that cost may not deter consumers who are operating under a choice constraint because they lack a meaningful choice about whether to acquire credit.).

\textsuperscript{157} \textit{Contra} Pottow, \textit{supra} note 154, at 446-51.

\textsuperscript{158} See id. at 421-30.

\textsuperscript{159} See 11 U.S.C. § 523(a) (listing the limits of discharge for a debtor).
the black market.\textsuperscript{160} This undercuts the argument that the best solution is simply to cut off access to credit for consumers who cannot afford to use it. A structural bright line is simple, because it objectively sorts between potential borrowers. Anyone on one side of the bright line is eligible for consumer credit, and anyone on the other side is not. This method is used in the so called “fringe markets.”\textsuperscript{161} This tacit line drawing between those who presumptively do and do not qualify for consumer credit is seen in the payday lending market.\textsuperscript{162}

One study focused on the so called “unbanked,” consumers who do not have a checking account, typically because they cannot afford the account fees, and who likely do not have a credit card.\textsuperscript{163} This is the group of consumers who do not or cannot access consumer credit, but this does not mean that they are cut off from credit. Instead they are forced to use more expensive forms of credit, particularly payday lenders and check cashers.\textsuperscript{164} The effect of this is to raise the transaction costs, particularly fixed transaction costs such as fees, for the unbanked consumers, which in turn means that they have less net income. This effect adds to the cost of living problems for these consumers, because the transaction costs become part of their fixed monthly costs. If consumers can only get access to credit through higher cost services then they will inferably need to borrow more to cover the increased fees, effectively forcing them to gross up their borrowing to meet their overall costs, and also increasing their debt.\textsuperscript{165} The borrowing pattern for unbanked consumers illustrates the problem with erecting barriers to consumer lending; if consumers need to borrow they will continue to borrow. The accompanying concern

\textsuperscript{160} Mann, \textit{supra} note 50, at 413 (arguing that increased regulation but stable demand only push consumers towards less well regulated lenders, which ultimately creates more problems than it solves).

\textsuperscript{161} Mann, \textit{supra} note 103, at 997.

\textsuperscript{162} Michael S. Barr, \textit{Banking the Poor}, 21 YALE J. ON REG. 121, 153-54 (2004).

\textsuperscript{163} \textit{Id.} at 130-32. One study puts the number of unbanked families at 8.4 million, and puts their median income under $25,000 per year. Approximately 86\% of the unbanked consumers do not have a credit card. \textit{Id.} at 123, 140.

\textsuperscript{164} Barr, \textit{supra} note 163, at 134-35.

\textsuperscript{165} \textit{Id.}.
is that completely restricting credit supply will simply lead consumers to extralegal and black market transactions that could result in even greater costs for the consumer.\textsuperscript{166}

The social policy concern is that this will almost certainly create an oppositional class structure, because consumers who lack a preset capital volume are forced to either forgo credit or turn to more expensive forms of credit.\textsuperscript{167} The result ultimately will be that a bright line for credit eligibility will also become a bright line between oppositional classes. The inability to obtain credit, particularly if it is needed for income replacement, is a potential catalyst for oppositional class mobilization. Accordingly, restrictions of access to credit based on income or risk of default fail because they only attempt to resolve the consumer debt question but do not address the second goal of preventing the development of an oppositional class structure.

\textbf{b. Equalizing Access to the Discharge and Consumer Credit Solves the Debt Problem for Consumers, and Leaves Lenders Free to Lend on Their Own Terms}

The effect of BAPCPA is to give debtors less access to the bankruptcy discharge but to leave lending structures untouched. This results in a disjunction between credit availability and discharge availability.\textsuperscript{168} The consumer is at a disadvantage because they are subject to all the choice constraints, but they now have less relief from exploitation of their decision making deficiencies.\textsuperscript{169} There are two potential solutions to the resulting diminution in liberty: 1) restrict access to credit and make no changes to BAPCPA, or 2) make no changes to credit access and make the discharge more widely available. The first option would equalize the relationship between debtors and creditors but it suffers from one important flaw; it does not take into account the economic importance of continued consumer spending. As long as the economy

\begin{footnotes}
\item[166] Mann, supra note 50, at 413.
\item[167] See supra notes 25-41 and accompanying text.
\item[169] Id.
\end{footnotes}
relies on consumer spending any solution that would decrease this spending must be avoided if there is a comparable solution that would maintain economically necessary consumer spending. Simply restricting creditors’ ability to exploit decision making deficiencies is not enough, because that solution would not take into account debtors who have no meaningful choice about the acquisition of debt. Debtors who have no meaningful choice as to whether they will acquire the debt normally are not be swayed by incentives to borrow, because their incentives are endogenous. The second possible solution, equal access to credit and equal access to the discharge, allows the economy to continue functioning as it is currently, this would also equalize the relationship between debtor and creditor, and take into account debtors who have no meaningful choice as to whether they will borrow.

An equalization approach requires drastically rethinking the new bankruptcy law. BAPCPA only increased the inequalities between the debtor and creditor. It came with no provisions that mitigate choice constraints on debtors, in fact it came with just the opposite. The barriers to filing increase the period of time that a defaulting borrower is paying higher fees and interest rates to consumer creditors. These delaying agents increase the period of time that the debtor is in the “sweat box.” The delaying agents include increased fees, numerous filing requirements, mandatory credit counseling and more debts that are exempt from discharge. Increased fees and filing requirements delay the debtor for as long as it takes them to save

---

\(^{170}\) See De Aenille, supra note 3, at section 3.

\(^{171}\) Mann, supra note 168, at 378.

\(^{172}\) Id.

\(^{173}\) Id. at 393-94.


attorney’s fees, plus filing fees, and to collect the required materials. Additionally, there are greater requirements on attorneys, which will likely result in higher fees for clients. The equalization approach would remove the barriers to bankruptcy filing and discharge, but it would leave the lenders’ ability to issue credit untouched. This serves to protect the portions of the economy that depend on consumer spending, but it also preserves the relative positions of the debtor and creditor. If the creditor chooses to exploit decision making deficiencies then at the point that they become too much for an individual debtor to bear that debtor has access to the bankruptcy discharge. This more accurately balances freedom of choice between the consumer and the lender, and therefore removes the liberty defeating aspects of the current debtor-creditor relationship.

VI. The Bankruptcy Treatment of Healthcare Debt Must Take into Account that Consumers’ Labor Under Choice Constraints when Confronted with Healthcare Costs

Healthcare debt is the second exemplar in the choice-necessity analysis, because it illustrates both the choice constraint and the necessity elements of the choice-necessity paradigm. The necessity element represents debts that are subject to a choice constraint and that a consumer cannot rationally refuse to acquire. Recall, that constrained choice refers to the terms of the debt acquired. Whereas necessity refers to either an individual good or service purchased or an aggregation of goods and services purchased. Additionally, the cost of the good or service purchased represents such an extreme cost that the purchase is a but-for cause of bankruptcy, and the good or service purchased is of such a necessity that it could not be rationally foregone. A debt that satisfies both the constrained choice element and the necessity element would be subject to modifications in bankruptcy in addition to the existing bankruptcy

176 Mann, supra note 168, at 395, and Lundin, supra note 174, at 68.

177 See id.
debt modifications. Healthcare debt is used to illustrate the operation of a debt subject to additional modification within bankruptcy. There is no rational way to refuse potentially life-saving medical care, it is the cause of at least a statistically significant proportion of bankruptcies, and the preemptory discharge combined with a change in medical debt tax status offers an example of one form of additional modification in bankruptcy.

The proposed preemptory discharge illustrates how a debt that fulfills both elements of the choice-necessity analysis could be additionally modified in bankruptcy. A preemptory discharge would discharge just the portion of the debt that was the but-for cause of the bankruptcy filing. It is not meant as a complete or universally available discharge. The preemptory discharge is meant to return the debtor to the status quo, if that is possible. Accordingly, but-for causation of bankruptcy is the threshold issue, but in order to receive the preemptory discharge the debtor must be capable of being returned to the status quo. After the preemptory discharge the debtor must be able to meet their financial obligations and not be likely to need further treatment under the Bankruptcy Code. Additionally, the preemptory discharge must be constructed in such a way that it does not provide a windfall to a debtor, as compared to other debtors, or allow piecemeal bankruptcy. This is accomplished with an equity cushion requirement. If post-preemptory discharge the debtor can pay their financial obligations as they come due, and has an equity cushion, then the presumption will be that they will likely not need further treatment under the Bankruptcy Code. If this is not the case then they are ineligible for the preemptory discharge and must go through the regular bankruptcy process. If there is a sufficient equity cushion then the debtor will be fully discharged of the healthcare debt. But if there is an excessive equity cushion then the debtor would be required to continue to pay until the excess equity cushion is eliminated. In this way the modification is tailored to the individual

debtor and mediates between the need to restore them to the status quo and the need to prevent windfalls or piecemeal bankruptcy.

a. The Impact of Healthcare Debt on Bankruptcy Filing Rates Is Masked By Other Means of Repaying the Debt, However the Problem is Significant and Requires Increased Treatment of Those Debts in Bankruptcy

Healthcare related debt is one of the most difficult problems in debtor-creditor law because it is a debt that is difficult to fault a debtor for incurring and is frequently a large debt. Unlike traditional consumer debt or even educational debt, healthcare debt is involuntary. A person cannot control when they will become sick or injured, and if they do not seek treatment they run a very real risk of death of permanent disability. The problem is that the high cost of healthcare puts a significant number of people at risk of bankruptcy. Compounding the problem is that many debtors who suffer from medical debt are not just burdened by treatment expenses, the source of their financial distress may also include lost wages, the cost of medication and medical supplies, or the cost of using credit to pay for healthcare. The fact that the medical debt is disguised in the form of other debts or non-treatment costs means that any one remedy will not completely address the problem.179 If a consumer cannot pay the expense - and indeed if they cannot afford adequate insurance coverage it is unlikely that they can pay large or multiple medical bills out of pocket - then there is a greater chance that they will file for bankruptcy. The implication for the bankruptcy system is that some debtors are filing petitions as the result of a single debt that makes all of their other debts unmanageable. If one goal of personal bankruptcy is to mitigate financial distress and another is to maximize creditors’ recovery, and finally if it is the case that medical costs are a significant cause of personal bankruptcy, then part of the solution to the consumer bankruptcy problem lies in how the bankruptcy system treats medical

179 Sullivan, supra note 1, at 152-55.
debts. At the intersection of medical costs, bankruptcy law, and charitable exemption law lies an argument for treating medical debt differently from other debts.

b. The Preemptory Discharge Returns Debtors to The Status Quo, but Does not Create the Opportunity for Piecemeal Bankruptcy, or Windfalls to Debtors

Preemptory discharge is a response to a debt that includes both a choice constraint and the element of necessity. The preemptory discharge is interposed between the filing of the bankruptcy petition and the creation of the bankruptcy estate. If a bankruptcy petitioner could show that but-for the cost of healthcare related expenses they could meet their obligations as they came due, then they would meet the first eligibility requirement for the preemptory discharge. Beyond that basic framework there are hard questions. The first question is how much of a debt should be discharged under the preemptory discharge. The chapter 7 discharge is total, but it is premised on the turnover of all non-exempt property. The chapter 13 discharge is likewise total, but it is premised on either a three or five year repayment plan. The preemptory discharge strikes a middle-ground that balances a lender’s reasonable expectation of repayment against the recognition that some financial obligations are so necessary that they cannot be rationally foregone. The middle-ground recognizes that the necessary costs of healthcare upset the financial status quo for a segment of consumers that are otherwise able to meet their financial obligations, and therefore the consumer should be returned to their financial status quo, without

---

180 Compare id. at 142-156, and Gail L. Heriot, Misdiagnosis: A Comment on Illness and Injury A Contributors To Bankruptcy And Media Publicity Surrounding It, 10 TEX. REV. L. & POL. 229, 236-45 (2005). These sources reach different empirical conclusions regarding the influence of healthcare costs on bankruptcy. If Heriot’s study is accepted as correct, then it may be used to establish a baseline. This baseline still shows that 28.3% of debtors list healthcare costs as a reason for their bankruptcy. See Sullivan, supra note 1, at 142-156, and Heriot, supra note 180, at 236-45.

181 11 U.S.C. § 727(b) (stating in relevant part and subject to the § 523 limitations “a discharge under subsection (a) of this section discharges the debtor from all debts”).

losing access to medical care. The middle ground is struck through a non-total discharge that requires neither the turnover of property nor commitment to a repayment plan.

The preemptory discharge requires that the debtor show in their petition that healthcare debt is the but-for cause of their bankruptcy. The but-for causation requirement means that prior to the acquisition of the healthcare debt the debtor was able to meet their financial obligations as they came due. After meeting the but-for causation test the debtor must meet the likelihood of refilling test. The likelihood of refilling test borrows the concept from chapter 11 that the preemptory discharge “is not likely to be followed by the liquidation [chapter 7 petition] . . . of the debtor.” This limits the preemptory discharge to consumers who were able to meet their financial obligations prior to the acquisition of the healthcare debt, are likely to continue meeting those obligations after the preemptory discharge, and whose present financial distress was caused by healthcare debt. Most importantly, the but-for requirement combined with the borrowed § 1129(a) (11) requirement prevents piecemeal or repetitive bankruptcy filings. If a debtor actually needs a full chapter 7 or chapter 13, the preemptory discharge should not provide the means for delaying the inevitable. This means that a debtor who prior to their medical crisis was able to meet their financial obligations, but as a result of the medical crisis suffers income loss or disruption would not be eligible for the preemptory discharge, because even with the full discharge of the medical debt they would be unable to meet their financial obligations on an ongoing basis. This is an intended effect, because the preemptory discharge is meant to return the debtor to the status quo. If a non-debt reason prevents resumption of the status quo, then the preemptory discharge is inappropriate and the debtor should file for the full discharge under either chapter 7 or chapter 13.

The likelihood of refiling test is satisfied, if after the preemptory discharge the debtor can meet their other financial obligations and has an equity cushion. This defines the boundaries of the likelihood of refilling test, and prevents it from being overbroad. The amount of the equity cushion may be set in one of two ways: a predetermined range such as 5-10% surplus of monthly income after all other expenses are deducted, or by using the debtor’s equity cushion before they incurred the healthcare expense. The actual amount of the equity cushion is not important at this point, instead the focus of the analysis is on its use to preserve the status quo in the application of the preemptory discharge. The equity cushion requirement is meant to preclude some debtors from the preemptory discharge, give others a complete discharge of healthcare debt, and only give others a partial discharge. In the first application of the equity cushion rule - preclusion from discharge - the equity cushion requirement prevents a debtor from going through piecemeal bankruptcy by getting the preemptory discharge, and hoping that discharging just the healthcare debts is enough to obviate the need file for either chapter 7 or chapter 13. This protects other creditors from a debtor who will not face facts and who may ultimately diminish the value of the bankruptcy estate to their detriment. The preemptory discharge should not create an opportunity for delaying creditors. The second application of the equity cushion rule - total discharge of healthcare debts - returns the debtor to the status quo, when they are unable to pay any of the debt but will be able to meet their other financial obligations after discharge and still have a sufficient equity cushion. The third application requires repayment if repayment is possible while still leaving a sufficient equity cushion, this prevents the debtor from receiving a windfall. If discharging the debt would leave the debtor able to meet his financial obligations and give them an equity cushion in excess of the mandated equity cushion range, then the debtor should repay the amount sufficient to bring them back within the mandated equity cushion range. This
addresses the concern that as between two otherwise equally situated debtors, the debtor that has higher healthcare costs receives more benefit than the debtor with lower but nonetheless substantial healthcare costs. If a debtor has too large an equity cushion post-preemptory discharge then they have received a windfall as compared to the debtor that is almost, but not quite, eligible for the preemptory discharge under the but-for test. Lack of equity cushion only determines dischargeability, it does not determine eligibility. In other words, a debtor could have a very small or nonexistent equity cushion but still be meeting their financial obligations, and therefore be ineligible for the preemptory discharge because the but-for test was not met. In this way, the equity cushion requirement prevents both piecemeal bankruptcies and windfalls to debtors.

c. In Order to Maintain Access to Healthcare, the Preemptory Discharge Must be Accompanied By Changes to Tax Law

From a debtor-creditor perspective part of the solution to the problem of healthcare costs in bankruptcy lies in the interaction between non-profit tax status of most healthcare providers and the preemptory discharge. Turning to the non-profit healthcare provider it is apparent that there is a legal structure in place that can provide healthcare to those that cannot afford it. Dating back to the Elizabethan charity statute, healthcare providers are given a favored tax status in return for the medical benefits that they provide the community.\textsuperscript{184} Prior to 1969, the chief benefit that a non-profit healthcare provider gave to the community was charity care. This mediated between the high cost of healthcare and consumers that could not afford healthcare.\textsuperscript{185} After 1969, hospitals and other non-profit healthcare providers were no longer required to give


charity care, provided that they gave some other community benefit.\textsuperscript{186} These other community benefits only provide a slight benefit in comparison to actual charity care.\textsuperscript{187} The first part of any solution is to reintroduce the charity care requirement in the form described in Revenue Ruling 56-185.\textsuperscript{188} This requires a hospital to provide the maximum amount of charity care, in return for its tax exemption.

In order for the preemptory discharge to work the charitable care requirement for tax exempt healthcare providers must be reintroduced. The preemptory discharge creates a great deal of risk for a healthcare provider. Any patient that requires more than routine medical care carries with them the risk of preemptory discharge and the total loss of the amount billed for their care. Absent a charity care requirement, healthcare providers would likely require what amounts to a loan application before providing anything beyond emergency care. For this reason, healthcare providers must have a reason - other than simply appealing to a sense of altruism - to provide medical care to all consumers, not just the ones who can prove that they can pay. Any charity care requirement that operates in tandem with the preemptory discharge must be based on a non-profit hospital taking all patients, regardless of their income level or ability to pay. Any less stringent requirement gives a non-profit hospital the incentive to cut off care once it provides the minimum amount of charity care required. A downside is that for-profit hospitals are not under a charity care requirement and if faced with the risk of a preemptory discharge would likely not provide any care beyond that which EMTALA requires; and even then there is

\textsuperscript{186} \textit{Id.}

\textsuperscript{187} \textit{See id.} at 245-46 (arguing that while prenatal screening provides some benefit, it is slight when compared to the benefit of outright charity care).

\textsuperscript{188} \textit{See id.} at 217-18, and see Colombo, \textit{supra} note 184, 320-21 (citing Rev. Rul. 56-185, 1956-1 C.B. 202 (requiring that “[the hospital] be operated to the extent of its financial ability for those not able to pay for the services rendered and not exclusively for those who are able and expected to pay”)).
an increased incentive for wallet biopsies. A further downside risk is that if non-profit hospitals see potentially unlimited charitable care costs, then they will convert to for-profit status and only take patients that can pay. This creates the prospect of a robust charity care requirement and aggressive treatment of healthcare costs in bankruptcy but no healthcare providers willing to subject themselves to the risk of the preemptory discharge. For-profit healthcare providers’ risk would not extend beyond the costs for providing care under EMTALA and the risk of default by apparently able to pay patients, and even the latter risk would be small since most of their able to pay patients would presumably not be self insurers.

The risk that the preemptory discharge combined with a charity care requirement will drive away non-profit healthcare providers can be mitigated by balancing the risk of loss as between for-profit hospitals and non-profit hospitals. If, in addition to the preemptory discharge and the charity care requirement, there is a charity care tax credit provided to for-profit hospitals, then not for-profit hospitals would have no incentive to change their tax status. A tax credit to for-profit hospitals would create the presumption that anytime a healthcare debt owed to a for-profit healthcare provider was discharged in bankruptcy then the full allowed amount would be recaptured through a tax credit, based either on the amount that Medicare would cover or the average amount that private insurers would cover. This should prevent non-profit hospitals from converting to for-profit hospitals for two reasons: for-profit hospitals would be indifferent to a patient’s ability to pay so they will not screen for cost and send potential non-payers to non-

---

189 See generally 40 AM. JUR. 2D Hospitals § 12 (2007) (describing the EMTALA provisions that require a hospital with an emergency room to accept a patient for emergency care, and to stabilize the patient prior to transferring the patient to another hospital).

190 Cf. John D. Colombo, The Role Of Tax Exemption In A Competitive Health Care Market, 31 J. HEALTH POL. POL’Y & L. 623, 635-40 (2006). Professor Colombo discusses using tax credits for hospitals and eliminating tax exemption for nonprofit hospitals. This would be an “entity neutral” approach. The preemptory discharge is also entity neutral, however it maintains the tax status distinction between nonprofit and for-profit hospitals. See id. at 638-39.
profit hospitals, and the cost of abandoning non-profit status would outweigh the cost of providing charity care. The preemptory discharge would not impose a cost on for-profit hospitals, because their tax credit would equal either the amount that Medicare or an average of private insurers would reimburse for a procedure. This does not give a for-profit hospital any incentive to refuse patients, and thus pass the cost of care to non-profit hospitals. Accordingly, non-profit healthcare providers would not face a sudden surge in charity care cases and the attendant surge in uncompensated costs. The rejoinder might be that non-profit healthcare provider would still convert to for-profit status, because for-profit hospitals are reimbursed for the cost of the preemptory discharge through their tax credit. This counter-argument, fails in light of non-profits ability to solicit tax free donations and their tax exempt status.\textsuperscript{191} While for-profit hospitals receive a tax credit for discharged medical debts, their profits are taxable. A non-profit could not contemplate a change in status based solely on the preemptory discharge, because as between the for-profit and non-profit healthcare providers the preemptory discharge is a zero sum game.\textsuperscript{192}

This equalizes the position between for-profit and non-profit hospitals. Non-profit hospitals must earn their tax exemption through charitable care, but in return they may solicit tax-free donations and their revenue in excess of costs remains tax exempt. For-profit hospitals are able to distribute their profits and screen patients as they see fit, however they have little incentive to screen because they are compensated for any peremptorily discharged debts. If for-profit hospitals do not suffer any loss because of a debt discharged in bankruptcy, they have no incentive to screen patients unless they know that their beds will fill with patients who will pay

\textsuperscript{192} Id. at 1434-35.
more than the amount of the tax credit. In that case, the non-profit hospital operating under the
charity care requirement will serve to catch the overflow from the for-profit hospital. This not
only serves the policy goal of providing consumer choice in medical care, it also solves the
problem of contract failure. Except in cases of for-profit hospital overflow, healthcare
consumers will be able to choose the for-profit hospital or if they do not trust the impact of
market forces on healthcare they can solve the contract failure problem and choose the non-profit
hospital, because it is less susceptible to market demands than a for-profit healthcare provider.

**d. The Preemptory Discharge Provides a Model Response to Choice-Necessity
Debts That Illustrates how a Debtor Can Be Returned to the Status Quo and
how to Manage Ripple Effects in Other Areas of Law**

The preemptory discharge response to choice-necessity debts recognizes that choice-
necessity debts overturn a consumer’s financial status quo, but it also recognizes that any
solution to a choice-necessity debt will have ripple effects outside of debtor-creditor law. While
a debt that only operates under a choice constraint may be addressed by either removing the
choice constraint or equalizing the position between debtor and creditor, a choice-necessity debt
requires more comprehensive adjustment in bankruptcy. The more comprehensive debt
adjustment recognizes that certain individuals within a social space may not be able to pay for
their choice-necessity debts, and that those debts may force them into bankruptcy. The
preemptory discharge equalizes access to medical care throughout the social space. Individuals
with higher overall capital have access to medical care through employer, or personally, funded
health plans. They pay a monthly or annual premium, and typically it is part of their
employment compensation. The preemptory discharge relieves under-insured individuals of
medical costs that they cannot pay. It does not relieve them of all medical costs, just those that
erode their equity cushion. The preemptory discharge model for resolving choice-necessity

---

193 Id. at 1418-20.
debts equalizes cost of necessity debts for all individuals and does not allow individuals to escape payment if they are able to pay at least some of their healthcare costs.

Not only does the preemptory discharge of the choice-necessity debt equalize impact of healthcare payments for all individuals, it is also responsive to concerns about ripple effects in other areas. Debtor-creditor law cannot provide a preemptory discharge without coordinated assistance from other areas of the law. By design the preemptory discharge only discharges a single class of debts - healthcare debts in this exemplar - therefore it cannot simply force the cost of universal discharge onto healthcare providers. In a traditional chapter 7 discharge all unsecured creditors take the same pro rata distribution. But in the preemptory discharge only the unsecured healthcare providers are brought under the discharge and the remaining unsecured debt is left intact. The preemptory discharge rationalizes this by looking for existing structures through which the cost may be passed. This is done by reviving the charity care requirement for nonprofit hospitals and creating a tax credit for for-profit hospitals that have healthcare debts peremptorily discharged. Without the tax component in this model there would be too many incentives for hospitals to refuse to provide care beyond what was prepaid, covered by insurance, or required by law. The preemptory discharge and the healthcare debt exemplar demonstrate not only debtor-creditor responses to healthcare costs but also a method for managing the ripple effect of the debtor-creditor response to healthcare costs.

VII. The Social Importance of Education Is Belied By the Treatment of Education Debt in Bankruptcy

The third and final exemplar uses education debt to illustrate how debt that does not represent an absolute necessity, but still has great social value, is treated in the choice-necessity paradigm. The absolute necessity requirement for the preemptory discharge is a high bar, and as a matter of theory only encompasses healthcare debt or another debt that includes something that
is absolutely required to keep a consumer alive in the near term. Anything less does not represent an absolute necessity. Too expansive a reading of absolute necessity would create a patchwork of preemptory discharges that would undermine the legitimacy of the preemptory discharge by making it into a piecemeal chapter 7 discharge. Still, there are debts that may represent such an important social value that they require at least full discharge, if not the heightened treatment of preemptory discharge.

The third exemplar, education debt, represents a form of debt that is not an absolute necessity but does represent a tangible social benefit. Post-secondary education is so expensive that without student loans many people would not be able to continue their education beyond high school. Of the three areas of debt, education debt and how it impacts access to education requires a close examination of socio-economic goals and how debtor-creditor law impacts those goals. Education represents the potential for social mobility, income enhancement, self improvement, and greater economic output from an educated workforce. Debtor-creditor law and the treatment of education debt have the potential to either advance those potentials or hinder those potentials. Taking on debt for education represents an investment in yourself, but it also represents a risk. Student loans represent up to a thirty year repayment obligation that are virtually impossible to discharge in bankruptcy. The bankruptcy treatment of education debt

---

194 See, e.g., Liz Krueger, Too Poor To Graduate, N.Y. TIMES, September 17, 2006, at section 14.
195 Bourdieu, supra note 30, at 80-92.
196 E.g., Kim Severson, ‘Top Chef’ Dreams Crushed By Student Loan Debt, N.Y. TIMES, May 8, 2007, available at http://www.nytimes.com/2007/05/08/us/08default.html?pagewanted=all#. Article on graduates of culinary schools who are not able to earn a living as cooks because their student loan payments are too high. Id.
197 11 U.S.C. § 523(a)(8) (“(a)A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual from any debt-(8) unless excepting such debt from discharge under this paragraph would impose an undue hardship on the debtor and the debtor’s dependents, for-(A)(i) an educational benefit overpayment or loan made, insured, or guaranteed by a governmental unit, or made under any program funded in whole or in party by a governmental unit or non-profit institution; or (ii) an obligation to repay funds received as an educational benefit, scholarship, or stipend; or (B) any other educational loan that is a qualified educational loan, as defined in section 221(d)(1) of the Internal
is a disincentive to post-secondary education, if the prospective borrower does not have the independent resources to either pay for school themselves or payoff education costs over time.

Education debt fits into the choice constraint analysis and therefore meets the threshold requirement for treatment under the choice-necessity paradigm. Unless a prospective student is able to pay for their education without resorting to loans, they must choose between student loans or foregoing education. The decision to forgo education is a low value choice. The potential value of education is increased earning potential, and jobs that only require a high school diploma are not particularly lucrative; so that seems to justify the risk that goes with education borrowing. The decision not to take the risk that goes with education borrowing curtails the potential for increased income and limits an individual’s social mobility, which makes the decision not to borrow for education a low value one. The debtor-creditor issue is whether the bankruptcy treatment of education debt reflects the social value of education.

The only way to discharge student loans is through the undue hardship test. The most common approach to undue hardship is found in In re Bryant which is intended to impose an “element of objectivity,” on the process of discharging student debt. The court held that the debtor must have a “minimal standard of living” in order to deny discharge, which is not attainable if the debtor’s gross income is “at, below, or near” the federal poverty guidelines. If the debtor’s income was above the guideline level, but not near the guideline level, then the debtor had the burden of showing “unique” and “extraordinary” circumstances that would require discharge. If the debtor’s gross income was “at, below, or near” the guideline level,


199 Id. at 916.
200 Id.
then the burden is on the lender to show that the federal poverty guidelines should not apply because the debtor has either failed to “maximize his resources” or there were “clear prospects for future income increases.”\textsuperscript{201} The \textit{In re Brunner} test is the other commonly applied test. It expands on the \textit{Bryant} test, but maintains the initial reliance on whether the debtor can maintain a “minimal standard of living” with their current gross income.\textsuperscript{202} The \textit{In re Brunner} court then asked if the financial situation under the first prong was likely to remain unchanged in the long term, and finally whether there was a good faith effort to repay.\textsuperscript{203} The theme that unites the tests for undue hardship is the question of whether the debtor can live at or near the federal poverty line with their gross income.\textsuperscript{204}

The undue hardship test imposes a high degree of risk on anybody planning to use student loans. The undue hardship test is an exception to the general rule of nondischargeability in § 523(a) (8). The reach of the undue hardship test was expanded in The Higher Education Act of 1998 which made federally funded student loans nondischargeable,\textsuperscript{205} and in BAPCPA which made private student loans likewise nondischargeable.\textsuperscript{206} The effect of the test is that if someone’s education does not prove to be worth as much as they hoped, or if they cannot complete it and therefore have no degree to use, then they can only discharge the debt if they are living in or near poverty. The exception to discharge also puts the student loan in strange company, among the other unsecured debts excepted from discharge are things obtained by

\textsuperscript{201} \textit{Id.}
\textsuperscript{202} \textit{Brunner v. New York State Higher Educ. Services Corp.}, 831 F.2d 395, 396 (2nd Cir. 1987).
\textsuperscript{203} \textit{Id.}
fraud,\textsuperscript{207} damages for an intentional tort,\textsuperscript{208} debts resulting from death or injury while driving under the influence of alcohol,\textsuperscript{209} luxury goods,\textsuperscript{210} and domestic support.\textsuperscript{211} The first three types of debt come as a result of the debtor’s wrongdoing, the first two for the debtor’s intentional wrongdoing. Debts for luxury goods imply that the debtor acquired something of little or no extrinsic value. Debts for domestic support obligations are debts arising from a legally recognized familial relationship that gives rise to a duty of support, either child support or spousal support, and is a type of debt that individuals often try to renege on and often do not pay unless compelled to by law. In contrast a student loan is a debt undertaken to better oneself, it does not imply wrongdoing, it is not a creature comfort, and it is not required as part of a legally recognized familial relationship. In fact, education is usually described as a social good and is something that government typically tries to encourage. Accordingly, it is strange to see student loans listed among such a rogues gallery of other debts.

The concerns over granting a discharge of education debts fall into two broad categories: judgment of debtors and protecting the student loan program. The fraud argument holds that student loans are “presumptively fraudulent.”\textsuperscript{212} This reflects the extreme value judgment that at the time a student takes out a loan they intend to defraud the lender.\textsuperscript{213} The fraud argument seems weak, both for lack of actual evidence that a broad population of student borrowers intends to defraud the government when they borrow, and because the bankruptcy code already

\textsuperscript{207} 11 U.S.C § 523(a)(2).
\textsuperscript{208} 11 U.S.C. § 523(a)(6).
\textsuperscript{209} 11 U.S.C. § 523(a)(9).
\textsuperscript{210} 11 U.S.C. § 523(a)(3).
\textsuperscript{211} 11 U.S.C. § 523(a)(5).
\textsuperscript{213} \textit{Id.} The author quotes a third circuit case that describes students as having a “spendthrift philosophy.” \textit{Id.}
bars discharge for fraudulently acquired debt.\textsuperscript{214} The less harsh, although still judgmental, argument holds that discharge should be barred over concerns about “soft fraud.”\textsuperscript{215} Soft fraud is opportunistically filing bankruptcy to dispose of student loan debt, even though the debtor can make the payments. The justification is that education debt represents the acquisition of a future income stream and the trustee cannot repossess and sell a debtor’s education during the bankruptcy; so a debtor that discharges educational debt would capture the benefit of their education without paying for it.\textsuperscript{216} The problem with this justification is not only that it prejudges student debtors, but it assumes that all educational debt represents a valuable future income stream and that bankruptcy has no cost.\textsuperscript{217}

The second class of objections to student loan dischargeability, protecting the financial viability of the student loan program, value the program over the beneficiary. The protection of the “public fisc” argument holds that as between lending to students and covering the costs of discharged student loans, it is a better use of the public fisc to lend to students.\textsuperscript{218} Additionally, the nondischargeability of student loans is meant to protect the federal lending programs which cannot set their interest rates in response to discharge rates.\textsuperscript{219} As an initial matter, these loan programs were established to aid students not to aid loan programs, therefore too much self-protection is self-defeating.\textsuperscript{220} The argument that student loan programs cannot set interest rates that respond to frequency of discharge proves nothing; legislation can change the rate structures.

\textsuperscript{214} Pottow, \textit{supra} note 212, at 251.
\textsuperscript{215} \textit{Id.} at 252.
\textsuperscript{216} \textit{Id.} at 251.
\textsuperscript{218} Pottow, \textit{supra} note 212, at 261.
\textsuperscript{219} \textit{Id.} at 262.
\textsuperscript{220} \textit{Id.} at 271-73. Simply because there are more people filing bankruptcy that does not mean that the bankruptcy law is too lenient, it simply means that there are more debtors.
as easily as it changed the dischargeability of student loans. More importantly, this debate highlights how the United States views a debt that represents a social necessity.

It is not possible to argue that student debt is an absolute necessity like healthcare, however education provides a necessary social function. Education helps people to move through social space. While a tiny minority may move upward through social space through luck such as the lottery, or raw talent such as athletic ability, the majority of people who increase their capital volume do so through education. Education also plays an important social role, preventing the development of oppositional class structures. As people move through social space this movement increases the likelihood that people from different areas of the social space will come into contact with one another. Likewise, if people believe that they can achieve movement through social space without resorting to social upheaval, then they lack the motivation to form into oppositional social classes. Access to education and access to different areas of social space through education provide just such a means of movement.221 The bankruptcy treatment of education debt is only one part of the access to education issue, and the full weight of this issue cannot rest on bankruptcy law, however it is a part of the issue and therefore should be responsive to these concerns. The inability to discharge education debts may provide a restraint on some potential borrowers, who do not want to face the downside risk of the current tests for dischargeability.

The discharge of student debt can be made responsive to both social concerns and bankruptcy concerns. Any discharge scheme that provides for total discharge, with lower requirements than those presently in place, would be more responsive than the current regime. The first potential solution is to simply repeal the 1998 Education Higher Education Act provision that made student loans nondischargeable and reinstitute a seven year waiting period.

221 See supra notes 24-41 and accompanying text.
for discharge.\textsuperscript{222} If the law included an income contingency requirement or an actual insolvency requirement, then it would be apparent whether the debtor was behaving opportunistically.\textsuperscript{223} Additionally, this would remove an important disparity between higher income students who do not have to risk the undue hardship test, should their education not pay off, and lower income students who do risk either heavy education debt for the life of their loan or a showing of undue hardship. The nondischargeability of education debt draws a line between people who can and cannot afford to take a risk on their education. This line creates the risk that an area of social space will be closed off to certain people.\textsuperscript{224} Concerns about the funding of student loan programs can be met with the study showing that fewer than 1\% of student loans were discharged in bankruptcy.\textsuperscript{225} Additionally, concerns about this cost should be met with the question as to how much we will value people’s access to education. Education maximizes liberty because it helps to insulate people from economic shocks that could deprive them of income and put them in a position such that they could not realize the full value of their liberty.\textsuperscript{226} The value of this would far outweigh the cost of discharging less than 1\% of student debts, because it would provide increased opportunity and decrease the risk that oppositional social classes would form.

\textbf{VIII. Ultimately The Choice-Necessity Paradigm Requires an Examination of Social Values}

The choice-necessity paradigm provides a framework within which it is possible analyze consumer debts. It asks two questions: was the debt acquired subject to a choice constraint and

\begin{itemize}
\item \textsuperscript{222} Pottow, supra note 212, at 268-69.
\item \textsuperscript{223} Id. The author notes that the undue hardship test “backends” an income contingency test, however it is a particularly harsh one because it requires the debtor to be at or near the poverty line.
\item \textsuperscript{224} See supra notes 27-52 and accompanying text.
\item \textsuperscript{225} Pottow, supra note 212, at 249.
\item \textsuperscript{226} Fried, supra note 8, at 148-49, and Sullivan, supra note 1, at 63-68 (CBP data showing that as education increased the proportion of debtors decreased).
\end{itemize}
did the debt represent a necessity. A debt subject to a choice constraint is liberty defeating because the consumer lacked a meaningful choice as to its acquisition either because of structural forces or because the lender exploited their decision making deficiencies. In either case the debtor should be put on an equal footing with the lender, either having free access to discharge and credit or limited access to both. A debt that meets the choice constraint requirement and also represents an absolute necessity should be subject to a preemptory discharge that returns the debtor to the status quo but does no more. Both of these were meant as illustrations as much as proposals. The choice-necessity paradigm does not just provide potential responses, it also provides a framework within which to ask questions and to analyze responses.

The ultimate question that the choice-necessity paradigm asks, and that must be answered, is how the United States wishes to treat the backbone of its society, the middle class. The data shows that the middle class is in deep financial trouble, but the response thus far has done little to help. In fact, the response has been based on value judgments that criticize debtors for making decisions in which they had no meaningful choice. As it stands today, lenders are free to make virtually any loan they want, however consumers face increased barriers to bankruptcy discharge. Additionally, consumers face the risk that an unexpected illness or injury will create debts that will drive them into insolvency. The choice-necessity paradigm shows how relationships between debtors and credits may be equalized and how debts that represent an absolute necessity, or at least a social necessity, may be treated and the consequences of the proposed treatments. The analysis of social space shows the possible consequences of not addressing the debt question. Whether any of these analytical frameworks are applied or solutions are adopted is a reflection of our commitment to protecting individual economic liberty and social mobility.