[Florida Law Review](https://scholarship.law.ufl.edu/flr)

Volume 48 | Issue 4 Article 3

September 1996

Conflicting Interests in Trade Secrets

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Recommended Citation

Thomas F. Cotter, *Conflicting Interests in Trade Secrets*, 48 Fla. L. Rev. 591 (1996).
Available at: https://scholarship.law.ufl.edu/flr/vol48/iss4/3

RESOLVING THE CREDITOR'S DILEMMA: AN ELEMENTARY GAME-THEORETIC ANALYSIS OF THE CAUSES AND CURES OF COUNTERPRODUCTIVE PRACTICES IN THE COLLECTION OF CONSUMER DEBT

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My debt to theorists is acknowledged in the usual manner in the textual references and footnotes that follow. I have more difficultly crediting the consumer credit counselors who first interested me in the nature of their work. The casual conversations we had occurred before I took interest in writing on this subject seriously enough to ascribe credit to particular individuals. Rather than name some and omit others, I acknowledge my debt to them collectively. Though much more concerned with analysis than detailed description of the work of credit counselors, this work could not have been undertaken without the information they provided. I am indebted to Durant Abernethy, president of the National Foundation for Consumer Credit, for the insights and data he has generously provided. Rick Tuman, Executive Director of Consumer Credit Counseling Services of Mid-Florida, has been a source of continuing assistance.

Full disclosure of my relationship with consumer credit counseling agencies, whose function I evaluate in the pages that follow, requires that I note my participation, however slight, in a successful effort to bring such an agency to my hometown, Gainesville, Florida. I believe my former services as a volunteer on the Gainesville Advisory Board of Consumer Credit Counseling Services of Mid-Florida, Inc. have had no perceptible effect on the detachment I have endeavored to bring to this work. The issues present in debt adjustment kindled my interests in the work of consumer credit counseling agencies and not the other way around.

Acknowledgment of greater feats of volunteerism are due Scott Collins and Todd Watson, who have provided assistance by reading and commenting on earlier versions of the book from which this essay is derived, *Games Creditors Play: Collecting from Overextended Consumers* (1997). I have heeded much of their advice, but I followed my own beliefs when they differed from those who kindly offered comments. The usual disclaimer is therefore in order: the errors remaining in this work are my own.

Games Creditors Play was a work in progress over several years. Wendy Cousins, David Leon, Stephanie McClain, Henry Sorenson, Karen White and the library staffs of the University of Florida College of Law and Hastings College of the Law of the University of California provided research assistance when it was most needed. In addition to doing research, Wendy Cousins and Karen White provided valuable editorial and format revision assistance for earlier versions of *Games Creditors Play.* Helen Wheldon brought her skills in word processing to bear in preparing the final manuscripts of my book and this essay, allaying my fears that the glitches couldn't be removed.

I. INTRODUCTION

A. *The Problem of Counterproductive Collection Practices*

Instead of early fulfillment of the American Dream it promises, consumer credit may spin its own dream—the nightmare of overcommitment. This work analyzes the forces that drive debtors' and creditors' actions when overcommitment occurs.

Because collectors typically traffic in the misery of others, they seldom bask in the light of public esteem, even when the claims they collect are the result of debtor profligacy rather than debtor misfortune. While few collectors who work for reputable lenders remotely resemble the villains of 19th century melodramas—those who cast penniless widows and children into the stormy night—they are still sometimes identified with those actors who bygone audiences loved to hate.

Why the work of these collectors is beneficial, however, to debtors who timely honor their obligations is obvious: collectors reduce the cost and increase the availability of credit. Perhaps somewhat less obvious are the benefits that flow from collectors' work to many other debtors—those who are motivated to confront volitional imbalances in their income and expenses while they still may be corrected without bankruptcy or other financial debacle.

But the work of collectors is not always beneficial to debtors or to their creditors. This analysis of the dynamics of the collection process explores why collectors often have insisted on immediate payment when giving debtors extensions would appear to enhance prospects for recovery. The role for an intermediary in assisting certain troubled debtors and their creditors in effecting workouts without the intervention of the bankruptcy court is readily suggested by an episode in which one debtor's efforts to "go it alone" were unsuccessful.

B. *Creditors' Self-Inflicted Wounds in Microcosm—Kelly's Case*

Even the most avid reader of advance sheets or on-line computer services providing reports of cases decided by the courts will be unfamiliar with the following report of Kelly's[1] case because none of the parties in that collection tragedy ever invoked legal process. I justify my usurpation of the roles of two major institutions—a duly constituted court and the West Publishing Company—on the grounds that collection tragedies, like Kelly's, often occur in a non-judicial setting. Those that do find their way into cases reported by courts seldom analyze in any detail the ultimate issues with which I am concerned here. Relating Kelly's sad tale in some detail provides a necessary background for the subsequent analysis of creditors' behavior with which this work is concerned.

Although I derive my report of Kelly's case solely from interviews with her, I quizzed her at length and believe my report is substantially accurate. Even if Kelly's case is misstated in some respects, the important point is that there are cases, probably numerous ones, that do reflect the facts that are material to the analysis that follows.

After more than three months of unemployment, finding a job provided Kelly with only temporary relief. While her earnings were modest, her creditors' demands for full payment of all overdue accounts were not. The threats by a secured lender to repossess her car and by the electric company to discontinue service easily leveraged their claims into priority. Meanwhile, Kelly faced growing discontent from two banks located in a city 300 miles away, which had issued her credit cards. Their collection departments telephoned frequently and exacted large checks, even if postdated. In time, insinuations of vaguely

1. To protect Kelly's right of privacy, I have changed her given name, omitted her surname, and changed certain identifying details in my report of her case.

unpleasant consequences that would accompany continued arrearages gave way to veiled and then direct threats to garnish wages and send damaging reports to credit bureaus. Some of the actions of Kelly's creditors may have violated statutory and common law norms,[2] but the usual impediments to bringing judicial action loomed even larger to the impoverished debtor than to other would-be plaintiffs. Besides, Kelly wished to pay her debts, not to sue her creditors.

By turns embarrassed by her plight and resolute in her catch-up efforts, Kelly worked to convince her creditors that her need and perseverance warranted extended terms for payment. Creditors received small payments with promises of larger ones as her condition improved. Things were far from hopeless. Barring another interruption of income or the incurrence of unexpected expenses, Kelly could have paid her obligations in 18 to 24 months.

Her plan necessitated a no-frills budget. Loss of a contact lens meant resurrection of an old pair of glasses or suffering impaired vision for the one occasion she felt glasses inappropriate—her wedding. Despite the quality of her performance and the extent of her explanations, the banks adamantly refused to extend her terms for payment and relentlessly demanded more than she was able to pay. Shortly after Kelly and her equally impecunious husband had their checking account closed due to overdrafts, they moved without providing her creditors a forwarding address. In the parlance of collectors, Kelly "skipped."

While she may find new employment and resume payments, her experience is unlikely to enhance her willingness or ability to do so. A creditor may think it worthwhile to "skip trace" Kelly and sue if she can be found, but the recovery after expenses may be less than the amount Kelly would have voluntarily paid if her creditors had acquiesced in her workout plan. A more serious flaw in the pursuing creditor's calculus could cause the additional costs of collection to exceed any recovery from Kelly.

2. The Fair Debt Collection Practices Act, 15 U.S.C. §§ 1692-1692o (1994), regulates informal or nonjudicial collection practices; however, this Act applies only to actions of third-party debt collectors. Some states have extended the scope of their various legislative regulations of the debt collection process to include the actions of a creditor collecting its own claims. *See* ROBERT J. HOBBS, NATIONAL CONSUMER LAW CENTER, FAIR DEBT COLLECTION 423-28 (1987) (chart of state debt collection statutes). Moreover, tort remedies may provide redress to injured consumers. *See id.* at 215-28.

Exemption laws[3] and the debtor's concealment of non-exempt assets may thwart a creditor's attempt to collect by legal process. Creditors and their collection agencies may use self-help or judicial remedies such as discovery depositions, creditors' bills, and proceedings supplementary to execution to discover debtors' assets. No discovery procedures are costless, however, and creditors are understandably reluctant to risk throwing good money after bad.

Should Kelly feel trapped again, she may embark on yet another journey to yet another community. At this juncture, however, she will more likely go to a Federal courthouse. There she will seek, and probably obtain, discharge of her debts under Chapter 7 of the Bankruptcy Code,[4] eschewing, because of her earlier tribulations, a court protected partial or full workout under Chapter 13.

Because Kelly has no significant assets, the most obvious cost of her discharge in Chapter 7, the forfeiture of her non-exempt property,[5] will be minimal. Kelly's paucity of resources, however, also furthers her ability to play hide-and-seek with her creditors and to escape their efforts at collection without needing to invoke the protection of the bankruptcy court.

All this conjecture, which probably seems too obvious to those familiar with collections to warrant exposition, does have a purpose—to reveal a paradox worthy of serious exploration by students of debtor-creditor law. If Kelly's failure to work her way out of debt was attributable to her creditors' inflexible stance, and if that stance probably will cause those creditors to suffer a loss, why did these supposedly rational actors behave in such a counterproductive way?

Where the question is addressed to a discrete case, as it is here, an easy answer is suggested. Kelly's creditors may have had information based on their experience in collection matters that caused the present value of her promised performance to appear less than the recovery that continuing their coercive collection efforts would produce.

Kelly's case is not reported to suggest that the collectors were better informed or exercised better judgment than my account indicates. I

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3. *See generally* STEFAN A. RIESENFELD, CASES AND MATERIALS ON CREDITORS' REMEDIES AND DEBTORS' PROTECTION 289-333 (4th ed. 1987) (exploring some of the more common provisions of exemption laws that vary greatly among the various jurisdictions of the United States).

4. The grounds for denial of discharge in Chapter 7 bankruptcy are limited primarily to cases in which the debtor has been guilty of certain misconduct, or has previously obtained a discharge in a Chapter 7 case commenced within six years of filing the petition initiating the subsequent Chapter 7 proceeding. *See* 11 U.S.C. § 727(a) (1994). Certain debts may be excepted from the Chapter 7 discharge. *See* 11 U.S.C. § 523(a) (1994).

5. *See* 11 U.S.C. § 522 (1994) (providing for exempt property).

probably have less experience dealing with troubled debtors than Kelly's creditors. Doubtlessly, in many cases creditors increase their recovery by applying unrelenting pressure on debtors who need to turn their financial affairs around before it is too late. Moreover, there are debtors who are going to fail, and by their efforts, some creditors will get more than others. Nevertheless, there are other debtors against whom such pressure is counterproductive, and Kelly is offered as typifying this group.

I do not want to explain Kelly's case by arguing that each gunslinger misconstrued the facts and fired too soon, shooting himself in the foot. I think the injury to Kelly's creditors could have occurred without aberrant creditor conduct. While Kelly's case faithfully relates—even down to the melodramatic, so suspect "contact-less" wedding—some miserable events in the life of but one individual, her case is meant to be generalized. From the perspective of more than three decades of observation of consumer debt collection, I believe there have been numerous instances in which creditors have pressed debtors beyond the breaking point when it would appear to better serve their aims to enter into cooperative ventures allowing extended payments.

Of course, not all cases in which creditors refuse to grant seemingly justifiable extensions result in the failure of debtors to repay. The author of a guest column in *Newsweek* relates a story similar to Kelly's but with a happier ending.[6] Elizabeth Hudson lost her job as a press aide, and, in a state of panic, initially attempted to stonewall her creditors by ignoring their requests for payment.[7] She reported that "[s]ome collectors sounded as pleasant as a salted sea slug."[8] After sharing the secret of her job loss with one sympathetic creditor, she tried explaining her situation to other creditors and promising them full payment later.[9] Although some cooperated, many continued to press for immediate payment.[10] Elizabeth Hudson survived financially, later reentered the work force, and eventually paid her bills.[11]

While the coercive collection practices of some of Hudson's creditors did not result in loss to her aggregate creditors' claims, their coercive practices still may have resulted in unnecessary costs. These costs extend beyond the most obvious, Hudson's unnecessary suffering. Hudson reports that, except in emergencies, she now pays cash.[12] Thus,

6. Elizabeth Hudson, *I Don't Need All the Credit*, NEWSWEEK, July 14, 1986, at 9, 9.
7. *Id.*
8. *Id.*
9. *Id.*
10. *Id.*
11. *Id.*
12. *Id.*

in small measure, even in this better than worse-case scenario, the credit industry still suffers.[13]

Obviously, no claim to originality accompanies my observation that creditors' coercive collection practices may produce less recovery than creditors' cooperation in extending payment terms. Some two decades ago, the late Yale law teacher Arthur Leff characterized "American collection mechanisms and institutions" as "grossly inefficient, engendering huge amounts of unnecessary grief and loss for all participants."[14] Even then, Leff's indictment was scarcely novel.

Recast in general terms, the question posed by Kelly's case becomes, why do creditors seemingly act irrationally in many collection cases? So generalized, the question suggests its answer. When commonly observed market practices fail to comport with theory, the theory is embarrased, not the actor in the market. The theory, thus far, lacks a more sophisticated explanation to account for what otherwise appears to be irrational creditor behavior.

C. *An Overview of This Essay and the Larger Work from Which It Is Taken*

My forthcoming book, *Games Creditors Play: Collecting from Overextended Consumers* (*Games Creditors Play*), suggests that the coercive and sometimes counterproductive methods often employed by consumers' creditors are to a great extent the product of a contest among them. To be sure, a concept so long revered by the law as rewarding creditor diligence is not without strong underpinnings. Therefore, I explore both the individual and collective benefits of a system that rewards the victor rather than apportions the spoils.[15]

However, I also explore why counterproductive collection practices continue despite the existence of alternatives. To do so, I examine both legal checks and private-ordering alternatives to the rigors of unbridled competition among creditors. I then provide some explanations of why traditional means of shifting from competitive to cooperative recovery, often successfully employed in cases involving commercial debtors, have proven less successful in consumer settings.

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13. *Id.*

14. Arthur A. Leff, *Injury, Ignorance and Spite—The Dynamics of Coercive Collection,* 80 YALE L.J. 1, 1 (1970).

15. *See generally* Lawrence Berger, *An Analysis of the Doctrine That "First in Time Is First in Right,"* 64 NEB. L. REV. 349 (1985) (exploring the ancient notion of temporal priority in a variety of legal contexts and concluding that the principle of encouraging economic productivity justifies the rule).

From its beginnings in the work of Arthur Leff,[16] through the contributions of William Whitford of Wisconsin[17] and Virginia's law dean Robert Scott,[18] the "lost-value" thesis has attributed debtor loss that does not result in creditor gain to the failure of creditor and debtor to possess accurate information concerning their viable alternatives. Traders extending credit during most of humankind's existence had much better access to that information. Throughout prehistory and during most of our recorded past, people lived together in small groups. Thus, the creditor knew what the debtor was doing and what he was capable of doing to remedy any default. With that knowledge, rational creditors do not engage in unproductive or counterproductive collection practices. Our knowledge of each other's efforts and capabilities is not as easy to come by in today's mass markets. Creditors can gather facts and assess them in collection cases, but information is not costless. Operating under the cost constraints imposed by the smaller claims that typify consumer cases, creditors often fail to distinguish instances in which extensions promise greater recovery from those in which extensions are counterproductive.

Indeed, inadequate or misleading information concerning Kelly's need for concessions or her desire or ability to turn her financial affairs around may have contributed to her creditors' decisions not to accept her workout plan. This asymmetry of information between creditor and debtor does not complete, however, the explanation of the role of informational deficits in financial debacles such as Kelly's. It more likely pulled in tandem with another.

In most cases of serious overextension, the creditor who gives concessions also must know whether the other creditors of the debtor harbor similar beliefs and whether they will cooperate in a workout. Furthermore, because no workout is without risk of failure, each creditor will want the other creditors to make concessions commensurate with her own so as to equitably share that risk. To prevent cheating, the creditor must have some cost-effective means of monitoring for problems that may arise during the workout—not only for the effect breakdowns may have on the debtor but also for their effect on the actions of competing creditors. Overcoming these impediments imposes significant transaction costs that, along with those attributable to

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16. Leff, *supra* note 14, at 40-41.

17. William C. Whitford, *The Appropriate Role of Security Interests in Consumer Transactions*, 7 CARDOZO L. REV. 959, 961-66 (1986); William C. Whitford, *A Critique of the Consumer Credit Collection System*, 1979 WIS. L. REV. 1047, 1074.

18. Robert E. Scott, *Rethinking the Regulation of Coercive Creditor Remedies*, 89 COLUM. L. REV. 730, 732-33 (1989).

assessing the debtor's need for, commitment to, and ability to effect a workout, must be contained.

Information deficits and asymmetries are indeed at the heart of harmful creditor competition, but, except in a one-creditor world, they extend beyond each creditor's uncertainties about the debtor's actions. Any attempt to explain overly coercive collection must also reckon with an individual creditor's rational fears that other creditors will engage in strategic behavior, coercing the debtor to pay their claims in preference to that of the creditor granting the concession.

Competition among creditors is therefore central to understanding coercive practices that may diminish aggregate creditor recovery. Yet this phenomenon of creditor competition has received scant attention in previous analyses of consumer-credit collection practices. In the section that follows, I explore the phenomenon in some detail by employing elementary game-theoretic decisionmaking analysis, excerpted in large part from *Games Creditors Play.* This essay then summarizes the lessons that book imparts by its study of collection from a perspective that heeds the significance of controlling harmful aspects of creditor competition.

Studies in applied game theory suggest solutions to the problem of obtaining beneficial creditor cooperation, in a manner that typically serves a different purpose for a different constituency than Chapter 13 bankruptcy proceedings. Insights from these studies explain the role private-sector agencies—the various consumer credit counseling services affiliated with the National Foundation for Consumer Credit—play in resolving the overextension problems. The now palpable presence of this agency and its accessibility to most Americans should have significance to lawmakers concerned with balancing debtor and creditor rights. Qualifying debtors may now resolve their financial plight without choosing between the sting of coercive collection, the stigma of an unwanted bankruptcy, or both. Thus, the case for banning otherwise justifiable creditors' remedies to prevent their harmful use against debtors who are endeavoring to pay their obligations is considerably diminished. Debtors whose plights are beyond the pale of workouts sponsored by consumer credit counseling agencies may justifiably invoke the protection of the bankruptcy courts in Chapter 7 or 13 proceedings.

II. A GAME-THEORETIC ANALYSIS OF CREDITORS' FAILURE TO COOPERATE

A. *Modeling Creditors' Behavior as a Game of Prisoner's Dilemma*

As the analysis in the preceding section has shown, collection may involve strategies and goals in a contest in which an individual creditor's recovery is determined both by his own actions and by the actions of other creditors. Concepts from the branch of mathematics studying individuals in mutual interaction—game theory—may provide illuminating insights.[19]

The game of Prisoner's Dilemma is particularly useful in analyzing the logical structure of conflicts of interest among creditors. The name, Prisoner's Dilemma, derives from the original anecdote illustrating the game.[20] Two suspected perpetrators of a crime are caught by the police, but there is insufficient evidence to convict either of them unless one or both testify for the state. Absent such testimony, each can be convicted of only a lesser crime. The suspects are separately jailed, held and questioned by the police. They are given no opportunity to communicate with each other. Each is promised his freedom by the prosecutor if he incriminates the other, provided his accomplice does not likewise incriminate him. The prosecutor also informs the prisoners of less pleasant possibilities. The prisoner who maintains his silence when his accomplice testifies for the state will receive the stiffest sentence, five years. If both incriminate the other, each will serve a two-year sentence, twice the one-year term imposed on each if both maintain their silence and do not assist the prosecutor.

The following matrix reflects these possible outcomes. By convention, the payoffs of the horizontal row player (Prisoner A) precede those of the column player (Prisoner B).[21]

19. *See generally* JOHN VON NEUMANN & OSKAR MORGENSTERN, THEORY OF GAMES AND ECONOMIC BEHAVIOR (3d ed. 1953) (a comprehensive analysis of game theory by its formulators).

20. The telling of the Prisoner's Dilemma varies slightly from one source to another. For example, compare ANOTOL RAPOPORT & ALBERT M. CHAMMAH, PRISONER'S DILEMMA: A STUDY IN CONFLICT AND COOPERATION 24-25 (1965) with MARTIN SHUBIK, GAME THEORY IN THE SOCIAL SCIENCES 253-58 (1982).

21. *See* MICHAEL TAYLOR, ANARCHY AND COOPERATION 5 (1976).

PRISONER'S DILEMMA
(numbers in years of prison sentence)

Prisoner B

Prisoner A	Incriminate	Maintain Silence
Incriminate	2,2	0,5
Maintain Silence	5,0	1,1

Obviously, the collective good of the prisoners, from the standpoint of the minimal aggregate time to be served by both, dictates that each choose not to assist the prosecutor. This also produces an equitable result in that both prisoners serve identical terms of one year.[22] Can the prisoners' collective goal of spending the minimal aggregate time in jail be achieved by parties unable to communicate and enter into an enforceable agreement?

Each prisoner knows that if he fails to incriminate his accomplice and his accomplice incriminates him, he will receive a five-year sentence. Each prisoner also knows that his accomplice knows this, and knows that his accomplice knows that he knows this. As an examination of the above matrix will reveal, a prisoner is better off incriminating his accomplice regardless of what his accomplice does. Assuming neither prisoner is concerned with the welfare of the other or with group welfare,[23] either prisoner will incriminate the other even if he believes the other prisoner will irrationally maintain his silence.

There is empirical support for this theoretical solution. Experimental evidence indicates that anonymous, non-communicating players engaged in single play will behave in accordance with the predicted outcome.[24]

22. Ironically, the prisoners' collective good does not maximize the social good if the prisoners are guilty of the crime charged and a longer sentence for each would be just. Theorists engage in a worthier pursuit when they seek to resolve the players' dilemma in scenarios in which the players' collective good coincides with the wider social good. We cast the wider social good aside because it plays no part in the issue the game is designed to explore.

23. The assumption of individual self-interest need not deny, however, any role whatsoever to a player's concern for the group or other individuals. *See* ROBERT AXELROD, THE EVOLUTION OF COOPERATION 6-7 (1984). It is only in this broader sense that the concept of self-interest is a necessary element in the game of Prisoner's Dilemma. For a discussion of the troublesome ambiguities associated with the self-interest concept, see generally Jeffrey L. Harrison, *Egoism, Altruism, and Market Illusions: The Limits of Law and Economics* 33 UCLA L. REV. 1309 (1986).

24. *See* Gerrit Wolf & Martin Shubik, *Concepts, Theories and Techniques: Solution Concepts and Psychological Motivation in Prisoner's Dilemma Games,* 5 DECISION SCI. 153, 162 (1974).

The paradox is that this "logical" behavior causes each to serve twice the sentence he would have served if both had maintained silence.

Kelly's case and any of the many like it may be similarly modeled as the "Creditor's Dilemma."[25] This adaptation will assume that creditors must choose one of two strategies in collecting their claims. Typically, creditors face a series of decisions in collecting a particular claim. To limit the range of options for each creditor, it is necessary to reduce a series of decisions to the notion of a strategy which covers a range of choices.[26]

The first strategy, "cooperation," consists of adjusting the overextended debtor's obligation, typically by extending the term for amortization of the debt. When necessary, a creditor can supplement its acceptance of reduced payments or its grant of a temporary moratorium on payment by forgoing late charges, reducing interest rates, or forgiving payment of part of the principal if the workout is successful.

The second strategy, "coercion," consists of rigid insistence on immediate payment of all amounts in arrears. This may include demands to pay installments that are due only by the creditor's application of an acceleration clause. The creditor employing a coercive strategy often endeavors to promote his claim over others by the use or threat to use more punitive measures than his fellow creditors.

The reader familiar with the literature on the Prisoner's Dilemma will note a difference in the names assigned the strategies in Creditor's Dilemma and those conventionally used in discussions of Prisoner's Dilemma. Typically, a player's strategies are described for their effect on the other player—"cooperation" or "defection." Departure from that convention stems from the immediate focus of this study on the effect creditors' actions have on the debtor's rehabilitation efforts. From this perspective, the two choices are titled "cooperation" and "coercion." The parallels with conventional designations, however, should be readily apparent. Cooperation with the debtor, which enhances the chances of recovery by other creditors in cases in which the model of a Prisoner's Dilemma applies, equates with the conventional strategy of cooperation. A strategy of coercion with respect to the debtor in an instance in which the aggregate recovery of creditors is reduced is tantamount to the conventional strategy of defection from the perspective of other creditors.[27]

25. Sharing the same surname with the prototype of the game may initially obscure various differences in these siblings, which will require subsequent examination.

26. *See* R. DUNCAN LUCE & HOWARD RAIFFA, GAMES AND DECISIONS 6-10 (1957).

27. *See, e.g.*, AXELROD, *supra* note 23, at 7-9.

A coercive strategy does not preclude manifestation of concern—by feigned friendship instead of fear—for the debtor by the creditor employing it, provided his actions are still designed to establish his priority in payment, and he still denies needed concessions. Nor does a cooperative strategy preclude the use of uncompromising efforts to enlist and maintain the debtor's commitment to a viable workout plan in which all creditors are treated equitably. Yet the critical distinction between these two options justifies the designations chosen. One, cooperation, signifies flexibility and fit to the debtor's and creditors' collective needs; the other, coercion, is detrimental to those needs.

Quantifying the assumptions previously made in cases like Kelly's could produce the following matrix. For simplicity, assume only two creditors, with claims against their common debtor of $6000 each and with equal powers to coerce payment. Again, the payoffs to A precede those to B.

CREDITOR'S DILEMMA
(numbers in thousands of dollars)

Creditor B

Creditor A	Coerce	Cooperate
Coerce	2,2	5,1
Cooperate	1,5	4,4

If both creditors pressure the debtor by using coercive strategies, she soon reaches the point where, like Kelly, she abandons her workout efforts, and each creditor collects only one-third of his $6000 claim. The highest aggregate recovery is achieved when both creditors cooperate with the debtor's workout efforts; each recovers two-thirds of his claim or $4000. This is the second best payoff for each creditor. To obtain a slightly better payoff, either must impose substantial costs on the other and reduce the aggregate recovery. This occurs when one creditor uses coercion while the other employs a cooperative strategy.

As in Prisoner's Dilemma, a creditor with no means of entering a binding agreement with other creditors will do better using the noncooperative strategy regardless of what his opponent does. If B cooperates, A's use of coercion garners him $5000 instead of the $4000 he would have received had he cooperated. If B employs coercion, A's use of the same strategy produces $2000 compared with the $1000 recovery he would have received if he had cooperated. The same incentive to employ the coercive strategy exists when the contest is viewed from B's perspective. Recognizing the dominance of the coercive strategy, each creditor will employ it and receive only $2000, one-half of the $4000 awarded each for mutual cooperation. The dilemma is that, while each obviously prefers $4000 to $2000, neither can afford to cooperate unless he knows in advance that the other will do likewise. Thus, Creditor's Dilemma, like "Prisoner's Dilemma[,] is simply an abstract formulation of some very common and very interesting situations in which what is best for each person individually leads to mutual defection, whereas everyone would have been better off with mutual cooperation."[28]

While there are striking parallels in the Creditor's and Prisoner's Dilemmas, the former fails to replicate the latter in certain obvious respects. These distinctions require further analysis.

For ease in exposition, Prisoner's Dilemma incorporates a simple means of providing the players with needed information. In the prototype, each prisoner (1) knows the payoffs, (2) knows that the other player knows them, and (3) knows that the other player knows that he knows them. An omniscient prosecutor reveals these matters at the time he presents the options to the prisoners.

In Creditor's Dilemma, neither certainty nor dissemination of information is quite so neat. No one occupies the prosecutor's role to inform the players of the payoffs. Of even greater import is the threshold difficulty of reducing the payoffs to certainties. Values based on assessments of the debtor's future performance are difficult to ascertain with any degree of precision, and it is unlikely that creditors will assess them identically.

Still, one may conclude that in some ordinary collection cases—in which there is no agent to knowledgeably establish payoff parameters and inform the contestants of those parameters—creditors possess sufficient data to validate use of the techniques of Prisoner's Dilemma to predict their actions. To evaluate this conclusion, one must ask what requirements the payoffs contained in the 2 x 2 matrix must meet for the creditor's contest to qualify as one of Prisoner's Dilemma.

The answer is that the requirements posited by game theorists are not nearly so exacting as presentation of precise data in matrices for the game would suggest. In lieu of requiring that all players assign absolute values to payoffs, Prisoner's Dilemma mandates compliance with two rules of inequality.

In the order of outcomes, the highest reward for a creditor must occur when he chooses coercion in an instance in which the other creditor cooperates. This temptation reward (T) is paired with the lowest

28. *Id.* at 9.

outcome, the sucker's payoff (S), which is thrust upon the cooperating player on the same play. Among the two intermediate payoffs, both of which result from choices of the same strategy by each creditor, the reward for mutual cooperation (R) must exceed the punishment for mutual coercion (P). Hence, the first rule of inequality is T > R > P > S.[29] Based on this rule, a creditor contemplating S will be motivated to use a coercive strategy to get at least P, while one contemplating R will be attracted to the coercive strategy to get T.

A model based on Prisoner's Dilemma also must meet a second rule of inequality. If an even chance of receiving temptation (T) or sucker (S) payoffs—of exploiting or being exploited—produced a higher payoff than R—the reward for mutual cooperation—then the players could escape their dilemmas by relying on chance to divide the greater gains from taking turns exploiting one another in repeated contests. Creditors do engage each other in iterated games. To foreclose this resolution of the dilemma, the reward for mutual cooperation must be greater than the arithmetic mean of the sum of the temptation and sucker payoffs, or R > (1/2) (T + S).[30]

Sufficient conditions exist for Creditor's Dilemma when each player assesses the value of the four payoffs in accordance with these two rules of inequality. Increasing one payoff, however, while keeping others constant may affect the choices of actual as opposed to purely rational players, even though the revised payoffs still comport with the rules of inequality. In an experiment in which 70 pairs of college students played Prisoner's Dilemma games 300 times in succession, researchers reported that cooperative responses between players tended to increase with relative increases in R or S and decrease with relative increases in T or P.[31]

While it simplifies the presentation of Creditor's Dilemma to assume that the players assign identical values to each of the four payoffs, this symmetry is not required.[32] Moreover, neither player need assign an absolute value to any of the payoffs, provided her rank ordering of all and relative weighing of the relevant three comply, respectively, with the first and second rules of inequality.[33] Finally, it is not necessary that the players measure the value of their payoffs by the same determinants. One commentator suggests that a cooperating bureaucrat who leaks a story to a journalist might get rewarded by "a chance to

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29. *See id.* at 9-10; RAPOPORT & CHAMMAH, *supra* note 20, at 33-34.
30. *See* AXELROD, *supra* note 23, at 10; RAPOPORT & CHAMMAH, *supra* note 20, at 34-35.
31. *See* RAPOPORT & CHAMMAH, *supra* note 20, at 35, 48.
32. AXELROD, *supra* note 23, at 17.
33. *Id.*

have a policy argument presented in a favorable light," while the cooperating "journalist might [get] rewarded with another inside story."[34]

While recovery of their respective claims provides creditors a common determinant of value, one creditor may supplement his payoff from recovery of his claim with other values, which his opponent may share not at all or only nominally. When this occurs, these incremental values will be reflected in one creditor's perception of the payoff matrix, though not in the other's. For example, one creditor may be concerned with the effect of collection practices on the subsequent patronage of a rehabilitated debtor and those friends and relatives that the debtor influences. This creditor's additional increment of value may benefit more from the employment of one strategy—typically cooperation—than the other. Conversely, one creditor, but not the other, may assign additional utility to the coercive strategy for its perceived enhancement of his reputation as a forceful collector with other delinquent debtors. Of course, any creditor's projection of payoffs from all sources must still meet the tests of the two rules of inequality.

These rules are but a subset of a larger assumption of game theory—that players strive to maximize utility. But one player's utility may not conform with others' widely shared notions of the goal or goals of the contest and, thus, with the payoff matrix as commonly perceived. In some instances, that player's aberrant values may replace those shared by others. Duncan Luce and Howard Raiffa furnish an example of how these idiosyncratic values may assume paramount, even sole importance.[35] When poker is played for money, a player should choose strategies based on the money outcome, but players who enjoy bluffing for its own sake may do so with no regard for the money outcome.[36] Likewise, a creditor may wish to punish a debtor for what he perceives as that debtor's profligate ways, regardless of the effect that punishment has on the recovery of his claim. While such distortions of commonly shared goals diminish the explanatory power of a creditor's contest modeled on Prisoner's Dilemma, their incidence probably is rare. For a large, bureaucratic creditor, the bottom line on collection practices is the bottom line on the financial statement.

Simplicity in presentation alone provides sufficient reason for limiting each creditors' assessment of the values in the preceding matrix to recovery of his outstanding claim. But the exclusion of other

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34. *Id.*

35. *See* LUCE & RAIFFA, *supra* note 26, at 3-6.

36. *Id.* at 5.

considerations—and the two picked as illustrative appear to be the most significant—may be justified on other grounds as well.

The contribution of coercive practices in a single case to the creditor's reputation for forcefulness, a peripheral concern, pales when compared with the more tangible goal of maximizing actual recovery in that case. A case that otherwise clearly meets the Creditor's Dilemma tests is unlikely to be disqualified solely by the value a creditor attaches to furthering his reputation for diligent collection efforts. Concern with that reputation, however, may influence the creditor's conduct in other instances. Where mutual cooperation between creditors offers no clear promise of increased recovery and a creditor is contemplating the use of more stringent measures to increase pressure on the debtor, the creditor's decision may be influenced by the need to convince other delinquent debtors of his persistence in collecting claims. In some cases, this complementary factor may cause a creditor to invest more resources in coercive effort than is justified by the probable recovery in the case.

The second consideration beyond recovery maximization also will not influence that creditor's choice of strategies in many instances. In today's mass markets for retail finance, creditors carry thousands of consumer accounts and employ standardized procedures that permit little that is cost effective in the way of individual attention to particular accounts. In such an environment, it is difficult to conceive of any creditor ascribing significant value to the prospect of subsequent transactions with an individual who already has commanded the attention of his collection department. In a less mobile society with more parochial lenders, loss of goodwill of a consumer, her extended family, or her friends may have carried appreciable weight. Today, such considerations appear limited primarily to some extenders of commercial credit whose business is concentrated among a few customers.

The conditions that result in a commercial supplier's dependency on one large buyer may stem from institutional economies that also make the buyer dependent on the supplier. Oliver Williamson finds that these conditions exist where highly specialized inputs of production preclude other ready sources of supply but the buyer's needs are insufficient to result in equal economies of scale through self-production.[37] In consumer transactions, where there is no common parallel to this symbiosis, the parties make far less effort to sustain the business relationship. Even if the buyer has frequently recurring needs, the value of his patronage is typically no greater than that of numerous other customers. And the value of any consumer's patronage must be further

37. Oliver E. Williamson, *Transaction-Cost Economics: The Governance of Contractual Relations*, 22 J.L. & ECON. 233, 250 (1979).

diminished when, as is often the case in recent years, the credit grantor is a card-issuing bank that does not derive a profit or other income, other than the small transaction fee imposed on the merchant seller, from the sale of the goods or services.

Another factor diminishes the value a creditor assigns to his concern with the goodwill of customers and his reputation as a diligent collector. Obviously, any value assigned to one of the goals must be reduced by the value the creditor assigns the other, for the actions that further one are the antithesis of those that further the other. A creditor's need to balance customer goodwill with a reputation for collection that militates against his claim being ignored or subordinated to those of other creditors is reflected in collection systems that employ gradually increased pressure on delinquent debtors. When more stringent collection measures seem necessary, the use of a collection agency may afford the creditor some protection against loss of customer goodwill. Some customers, even some delinquent debtors who are the objects of the collection agency's harsh actions, fail to hold the creditor responsible for the actions of the agent he employs.

Any attempt at an exhaustive compendium and valuation of all factors that may influence any given creditor's perception of the payoff matrix is doomed to failure for the same reason that an attempt at a complete decision theory of human behavior would be absurd. Russell Hardin contends that "[o]nly in an assumed context can one sensibly be asked whether one's action was rational."[38] He offers two objections to expanding the calculus of an individual's decisionmaking process in regard to participation in collective action beyond the commonly recognized goals of others in his group. First, the additional factors, which could only be crudely measured because they stem from a host of motivations, would not be worth measuring since most of the relevant behavior may be explained by the narrowest assessment of costs and benefits. Second, the expanded variables may only explain the conduct of certain members of the group, not that of most of its members.

The appearance of absolute certainty in the payoffs contained in the matrix for Creditor's Dilemma must be qualified for a further reason. No outcome reflects payment of the entire $6000 claim of either creditor even though there are doubtlessly numerous cases in which creditors do recover full payment, including interest for extensions, from debtors in distress. However, all payoffs in the matrix are discounted to reflect that no intersection of strategies guarantees complete recovery for either player in a particular case.[39] They recognize only that some combina-

38. RUSSELL HARDIN, COLLECTIVE ACTION 14 (1982).

39. *See, e.g., The Business in Trouble—A Workout Without Bankruptcy,* 39 BUS. LAW.

tions hold greater promise than others. Again, the payoffs contained in the matrix for Creditor's Dilemma are meant to suggest, not to be, the perceptions of the creditors in the game.

Unlike Prisoner's Dilemma, mutual cooperation in Creditor's Dilemma produces only a probability of the best collective outcome for the creditors. As even the most promising of workouts may fail, creditors typically insist that the extensions of payment and any other concessions of any one are commensurate with those of the others. Reaching an agreement that equitably shares the risks of the workout imposes an additional dimension and further transaction costs on a cooperative solution to a Creditor's Dilemma. In consumer workouts, creditors frequently agree to pro-rata extensions of all or substantially all unsecured claims. In commercial cases, where workout may require not only extensions of existing debt but further extensions of credit and resolutions of difficult business decisions, negotiations among creditors may be highly complex.

Contests among consumers' creditors frequently arise in cases where there is no impartial agent to credibly ascertain and disseminate information on outcomes. However, the tests imposed by the rules of inequality are not so stringent as to preclude analyzing some contests as games of Prisoner's Dilemma. While the flexible rules of inequality may facilitate creditors' determinations of payoff parameters in accordance with the requisites of Prisoner's Dilemma, the ability of creditors to do so requires further elaboration.

Implicit in the concept of any game is the players' awareness of the contest and its rules. Before each creditor reasons as Prisoner's Dilemma predicts, she must know that she is engaged in a contest with another creditor and that both view the payoff parameters in accordance with the rules of inequality. She also must know that the other creditor knows that she knows this. These barriers are not necessarily insurmountable in cases where the services of a facilitating agent are absent.

A creditor may know she is engaged in a contest if a delinquent debtor tells her that the collection line has already formed. Even if the debtor fails to do so, it is difficult to conceive of a creditor so myopic as to believe that she alone extended credit to the debtor. If one creditor equates the outcomes of her collection strategies with the rules of inequality, that creditor may believe that others will do likewise.

In any case in which these assumptions hold, creditors will perceive their collection efforts as a game of Prisoner's Dilemma. This does not

1041, 1041-74 (1984) (edited transcript of a panel discussion presented on August 2, 1983, by the Commercial Financial Services Committee of the then Section on Corporation, Banking and Business Law of the American Bar Association).

mean that collectors familiarize themselves with works on that subject and expend time and effort constructing matrices or otherwise formally engaging the rules of game theory. Riding herd on those who stray from their financial obligations affords little opportunity for these harried outriders of a credit economy to pursue such abstractions. The utility of Prisoner's Dilemma is not that it furnishes its players with a guide for their actions but that it furnishes a general framework for analyzing those actions. Characterizing a collection contest as a game of Prisoner's Dilemma simply means that the creditors face the same frustrations in choosing their strategies as do the prisoners in the prototype of the game. Creditors can readily comprehend these frustrations even if they are not familiar with the concept of Prisoner's Dilemma.

The issue in Kelly's case was why her two principal unsecured lenders continued their efforts to maximize short-term recovery when their mutual cooperation in the workout she proposed held greater promise. The initial analysis of the case assumed that both banks believed that their aggregate recovery would be enhanced by cooperating in a workout. Thus, Kelly's case was first cast as a game of Prisoner's Dilemma. The explanation offered earlier—that each bank would adopt a coercive stance to prevent the other from taking advantage of a cooperative stance—did not employ and did not need to employ the language or formal rules of game theory. The coercive action of each bank was attributable to its schooling in the practical aspects of creditors' and debtors' behavior. Each knew that debtors are likely to pay more insistent creditors first. As a result, the race of coercive diligence was on.

B. *The Transaction-Cost Barrier to a Cooperative Solution of the Creditor's Dilemma*

1. The Scope of the Barrier

Before concluding that competition necessarily results in an equilibrium of mutual coercion, a significant final step in the analysis remains. Motivation for a cooperative solution is a corollary of the same forces in the matrix that frustrate choice of that cooperative solution. The players in both the Prisoner's and Creditor's Dilemma are provided an incentive, even though acting on purely selfish grounds, to cooperate with each other: the prisoners by maintaining their silence and the creditors by extending their terms of payment. Yet, the prisoners will not likely cooperate. Stone walls, barred windows and guards enforce the prosecutor's decision to separate the prisoners and prevent any communication that may result in either an enforceable agreement between them or, a likely alternative in a prison setting, credible mutual threats. Again, the rococo embellishments of the prototype parody life's more commonly encountered analogues.

The impediments to a cooperative solution to a Creditor's Dilemma, suggested earlier by Kelly's case, were transaction costs. Cost-effective means must be devised to ensure that no creditor succumbs to the lure of the temptation payoff and pairs another creditor's cooperative strategy with his coercive one. As vivid symbols of constraint, these transaction costs pale in comparison with the devices so readily available to the prosecutor. Yet the bonds they place upon actors on the economic stage may be as constraining as prisoner cells.

Transaction costs play a significant role in the analysis of both economics[40] and law.[41] To an economist explaining their effect on the market exchange of commodities, they include those costs "that stem specifically from the market process," such as expenditures incurred in the communication of offers, comparisons of alternatives, negotiation of contracts and verification of the performance of those contracts.[42] Commentators on the basic principles of law and economics also give the concept wide scope. Judge Posner defines transaction costs as "the costs involved in ordering economic activity through voluntary exchange,"[43] while Mitchell Polinsky subsumes within the term "the costs of identifying the parties with whom one has to bargain, the costs of getting together with them, the costs of the bargaining process itself, and the costs of enforcing any bargain reached."[44]

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40. *See, e.g.*, JACK HIRSHLEIFER & AMIHAI GLAZER, PRICE THEORY AND APPLICATIONS 375-87 (5th ed. 1992) (analyzing the effect of transaction costs on market equilibrium).

41. Judge Posner observes that transaction costs "are a recurrent theme" in his comprehensive study of law and economics, RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 367 (3d ed. 1986), a statement that is amply confirmed by numerous references to the subject in the index of his book, *see id.* at 665. Credit for seminal studies on the importance of transaction costs in the analysis of law goes to Ronald H. Coase. *See* Ronald H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960); Ronald H. Coase, *The Nature of the Firm*, 4 ECONOMICA (n.s.) 386 (1937), *reprinted in* READINGS IN PRICE THEORY 331 (George J. Stigler & Kenneth E. Boulding eds., 1952). In 1991, Coase received the Nobel Memorial Prize in Economic Science for his work in transaction costs. *Friction Theorist Wins Economics Nobel*, WALL ST. J., Oct. 16, 1991, at B1. Speaking at a meeting of law school professors earlier that year, Coase remarked that "the key concept in all my analytical schemes is transaction costs." Ronald Coase, Address at the Luncheon of the Section on Law and Economics of the Association of American Law Schools (Jan. 4, 1991). Other significant contributions to the study of transaction costs include OLIVER E. WILLIAMSON, MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS (1975), Guido Calabresi, *Transaction Costs, Resource Allocation and Liability Rules—A Comment*, 11 J.L. & ECON. 67 (1968), Williamson, *supra* note 37.

42. HIRSHLEIFER & GLAZER, *supra* note 40, at 378.

43. POSNER, *supra* note 41, at 231.

44. A. MITCHELL POLINSKY, AN INTRODUCTION TO LAW AND ECONOMICS 12 (1983).

The breadth of the concept of transaction costs, however, has engendered criticism of the device as an analytical tool. One commentator complained that " '[t]ransaction costs have a well-deserved bad name as a theoretical device . . . [partly] because there is a suspicion that almost anything can be rationalized by invoking suitably specified transaction costs.' "[45] While the complaint has merit, transaction costs broadly defined appear to be the sole barrier to obtaining rational cooperation by creditors in workouts that appear promising.

In recognizing transaction costs as the culprit that may prevent creditors from pursuing mutually beneficial cooperative strategies,[46] my intent is to give the concept wide meaning, including within its parameters all costs associated with obtaining concerted creditor action by agreement, tacit or formal.

For any creditor who will consider undertaking the task of sponsoring a workout, initial transaction costs include obtaining and verifying relevant data concerning the debtor's income, necessary living expenses, and obligations. After concluding that the debtor has a cash-flow problem that transcends mere reasonable curtailment of discretionary expenses, the creditor must consider whether a workout is feasible and the probability that the debtor will use any extensions given to promote her financial recovery, rather than use the relief from creditors' pressure to slip further into debt. Consideration of further data that reflect on the debtor's financial character—such as her past credit history, stability of employment, and the reasons for her overextension—may assist him in making this judgment, but in many cases the call will still be a difficult one.

Where the sponsoring creditor bases his decision in favor of an extension plan on a less than clear probability that it will enhance aggregate creditor recovery, the costs of the additional steps he must take to bring the workout to fruition will increase. The sponsoring creditor must contact the other creditors, or certainly the principal ones, and convince them of the benefits of the plan. The absence of precise criteria for measuring the workout's chance of success will increase the costs of securing the other creditors' cooperation in two ways. First, there are negotiation costs that are necessary to allocate benefits among the parties. This impediment assumes increasing importance where the benefit is questionable and difficult to measure. Second, there are costs

45. Williamson, *supra* note 37, at 233 (quoting Stanley Fischer, *Long-Term Contracting, Sticky Prices, and Monetary Policy: Comment*, 3 J. MONETARY ECON. 317, 322 n.5 (1977)).

46. *See* Whitford, *supra* note 17, at 1077 (observing that transaction costs frequently preclude resolution of conflicts between single creditors and creditors as a class through bargaining and agreement among them).

associated with mutually beneficial exchanges resolving the more fundamental issue of whether the proposed transaction offers any benefit for the parties to share.

Obviously, a creditor's estimate of the amount of his recovery in a contest with other creditors also poses a problem of valuation. However, there is a presumption, presumably empirically derived, that a creditor's recovery is generally increased by application of continuing pressure for immediate payment. In the words of one commentator, "[e]xperience has shown that there is a definite correlation between the length of time debts are unpaid and the volume of resulting bad debt losses."[47] As analysis in the next subsection will show, the burden of proof in a collection case is typically assigned to the proponent of the extension plan.

An additional element of the transaction costs of securing the cooperation of creditors in workouts is not inconsequential. Someone must continually and impartially monitor the actions of the debtor and all her creditors during the implementation of the plan to ensure good-faith compliance with its terms. Even when the sponsoring creditor is willing to undertake this additional task, an all too evident conflict of interest seriously impairs his ability to function as an impartial agent.

Obviously, transaction costs in all their facets will defeat a mutually beneficial exchange only when those costs exceed the perceived value of the exchange to the parties.[48] There are reasons, however, for believing that transaction costs impose more significant barriers on workouts than on typical market transactions, such as ordinary sales of goods or services. Judge Posner attributes high transaction costs to two primary factors: (1) a large number of parties to a transaction and (2) the inability of the parties to the transaction to deal with others, a condition economists term "bilateral monopoly."[49] He observes that "costs of transacting are highest where elements of bilateral monopoly coincide with a large number of parties to the transaction—a quite possible conjunction."[50] Both elements are typically present in workouts.

Although I have cast, for ease in exposition, only two players in my rendition of the Creditor's Dilemma, the number of parties in a workout will frequently exceed the two ordinarily found in a sale of goods or services. The certain presence in workouts of a bilateral monopoly, an

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47. ROBERT H. COLE, CONSUMER AND COMMERCIAL CREDIT MANAGEMENT 371 (5th ed. 1976).

48. *See* POSNER, *supra* note 41, at 55.

49. *Id.* at 54.

50. *Id.* at 55.

atypical condition in other market transactions, also may protract the negotiation process. Creditors are unable to deal with anyone other than each other. This gives each creditor an incentive to hold out for the promise of a more expedited payment on his claim than that made to other creditors as the price for any concessions. The creditor who holds out for preferential treatment need not appear unreasonable. He may base his claim on his real or feigned belief that the plan offers less chance of benefit than that perceived by its proponents.

The context of a workout adds a further element that magnifies transaction costs. The parties must negotiate in a setting of financial distress. This setting makes the conflicts of interest and incentives for deception present in the transaction even more acute.[51]

While transaction costs may impose insurmountable barriers on creditors obtaining the benefits of a workout, do those that were present in Kelly's case appear that formidable? So long as the assumption holds that each of the two principal creditors from whom she sought extensions believed that mutual concessions would further both of their individual recoveries, the answer would appear to be no. In our exchange economy, the perceived mutual advantage of traders overcomes the costs of the exchange process in millions of transactions every day. In these exchanges, transaction costs reduce the aggregate benefit of traders and are thus a form of market imperfection. Traders, however, often willingly incur these costs to reduce other imperfections that would impose even more significant defects on the exchange process.[52] Although the smaller claims at stake meant that the benefits of the workout in Kelly's case were of a lesser magnitude than those posited in the matrix for Creditor's Dilemma, it is difficult to comprehend how the transaction costs of either of Kelly's creditors obtaining the cooperation of the other could have exceeded the probable benefits of such action. Enough of the force that triggers voluntary undertakings should have been present even if the tradeoffs promised Kelly's creditors only the probability of small net gains.[53]

Kelly's case presents a collection setting more appealing than most for predicting her creditors' assumption of the transaction costs of a workout. The coercive practices that resulted in Kelly's abandonment of

51. *See* Stewart C. Myers, *Determinants of Corporate Borrowing*, 5 J. FIN. ECON. 147, 158 (1977).

52. *See, e.g.*, HIRSHLEIFER & GLAZER, *supra* note 42, at 377 (observing that traders on the New York Stock Exchange incur the costs of trading on the exchange to avoid individual merchandise inspection costs).

53. *Cf.* ARTHUR A. LEFF, SWINDLING AND SELLING 118-30 (1976) (discussing the most common ploy in selling, "The Squaresville Pitch," in which the seller credibly explains its marginal cost advantage and its reason for sharing that advantage with the buyer).

her repayment efforts resulted from the actions of only two of her creditors, her credit-card issuing banks. As previously noted in the report of her case, Kelly was also pursued by a utility company that threatened discontinuance of essential services and a secured lender that threatened repossession of the automobile that she needed to get to and from work. While Kelly's rehabilitation plan gave these creditors a preference in payment of arrearages over the claims of the banks, it is customary in workouts to protect assets that are vital to the success of the debtor's efforts. This practice is followed in counselor-assisted workouts where equitable treatment of creditors is otherwise the norm. While Kelly's problems with these banks were exacerbated by the fact that they were located in another state and in a city some 300 miles from her residence at the time she attempted to obtain their cooperation, this fact does not appear to be unduly significant in this age of increased mobility.

Kelly's failure to obtain the cooperation of the banks may have resulted from one or more of several factors, all of which may be subsumed under the rubric of transaction costs. Even though each bank only had to secure the cooperation of the other, the banks may not have been able to agree on how to share the risks and benefits of the workout. One or both may have insisted upon more than a pro-rata share of Kelly's payments until its claim was paid. Moreover, even if an agreement could have been reached, each bank may have feared that the other's collectors subsequently would have ignored the plan. It seems more likely that Kelly's case released the complete array of transaction costs that can defeat beneficial action by creditors, and therein lies its value as the paradigm of this study.

Abandoning the hypothesis that both banks could discern the benefits of the plan solely from Kelly's presentation of it unleashes a difficult threshold issue. Did the banks believe that they could improve their prospects for payment if both accepted Kelly's proposal? A negative answer on the part of both banks may have ended the matter. However, it is not unlikely that Kelly's self-advocacy convinced one or both banks to give the workout a chance if either of them were her only creditor, but convinced neither to accept Kelly's plan in a world requiring concessions from two creditors. Neither bank was willing to advocate acceptance of Kelly's proposal—with or without additional investigation of the facts—to the other. Nor was either bank willing to grant a unilateral extension. The use of a liberal extension by one bank, even without any extension by the other, may have provided Kelly with a means to support her workout efforts. Creditors frequently give extensions to debtors who have suffered reversals without regard to the actions of other creditors, provided the debtor's plight is not so extreme as to raise justifiable fears that he will fail. Ironically, so far as the debtor is concerned, only when extensions are most needed do they appear to be conditioned on the additional, often difficult burden of obtaining concerted creditor action.

Before summarizing how to best systematically contain all transaction costs of resolving a Creditor's Dilemma within the severe cost constraints that characterize the collection of consumer debt, the next subsection further explores the effects of a creditor's failure to properly discern the nature of the contest. Inadequate or incorrect data, judgmental error, or both may distort a creditor's perception of the setting that dictates her choice of collection strategies.[54] Altering that creditor's erroneous perception to comport with reality imposes further transaction costs, which must also be readily contained in any cost-effective resolution of a Creditor's Dilemma. This work introduced the causes of this misperception problem in its analysis of Kelly's case by relaxing the initial assumption that her creditors discerned the benefits of their mutual cooperation. Following a similar relaxation of that assumption, this subsection has further explored the problem in the context of the elements of transaction costs. What remains is to explore, with further assistance from game-theoretic analysis, how creditors' misperceptions of the collection setting almost invariably lead to their choice of coercion over cooperation. The following subsection will address how the strategies dictated by those misperceptions foreclose resolution of the Creditor's Dilemma by misguided, chance applications of cooperative strategies.

2. A Closer Look at Creditors' Misperceptions of the Collection Setting: Zero-Sum Games and No Contests

While the players of Prisoner's Dilemma are in conflict with each other, there is an important difference between the nature of their relationship and the relationship of the players in a significantly different contest that creditors frequently play—the zero-sum game. In the zero-sum game, the winnings of one player are the losses of another, so that the algebraic sum of the payoffs to each player always equals zero.[55] Players of zero-sum games face no dilemma in formulating a strategy. Because a pure conflict of interest exists, each player unambiguously acts in her self-interest by picking the strategy designed to maximize her payoff. Cooperation plays no role because the players cannot increase their aggregate recovery. Examination of the dynamics

54. *Cf.* Charles J. Goetz & Robert E. Scott, *Principles of Relational Contracts*, 67 VA. L. REV. 1089, 1115 (1981) (observing information costs may render ineffective the enforcement of a best-efforts obligation by the standard contract suit).

55. *See* RAPOPORT & CHAMMAH, *supra* note 20, at 13-14.

of a zero-sum game will not only illustrate the futility of cooperation by creditors in such a contest but will highlight the unique role the incentive for cooperation may play in resolving a creditors' contest that is a game of Prisoner's Dilemma. While the pure conflict of interest present in a zero-sum game is of little psychological interest, the partly coincident and partly opposed interests of the players in Prisoner's Dilemma provides a study in internal conflict, which captures the imagination of students of psychology and serious literature.[56]

The following matrix presents a zero-sum contest between two creditors. The matrix contains payoffs to the horizontal row player (A) from the column player (B). Because the game is zero-sum, the payoffs to B from A are the same as those to A from B with the opposite sign attached. A receives payoffs greater than zero, and B receives those less than zero. Obviously, the debtor makes the payments to both creditors, and neither creditor pays the other. To present the game, however, as one between rival creditors from a common debtor, the payoffs, although made by the debtor, represent percentages of the "paying" creditor's pro-rata share of the debtor's payments to both creditors that are diverted to the other player in her stead. To illustrate, when A employs strategy a1 and B uses strategy b2, A will receive all of her pro-rata share of the debtor's payments plus 10% of B's share. As the game is zero-sum, B pays for A's larger recovery by receiving 10% less than her pro-rata share of the debtor's payments to both creditors.

THE TWO-CREDITORS', ZERO-SUM GAME
(numbers in percentages of "paying" creditor's pro-rata share)

	B's Strategies			
A's Strategies	b1	b2	b3	Row Minima
a1	-10	+10	+60	-10
a2	-40	-10	+50	-40
a3	-60	-40	-10	-60
Column Maxima	-10	+10	+60	

56. *Cf. id.* at 13 (observing that the seemingly irrational choices of participants in a Prisoner's Dilemma forces a "reexamination of [the] concept of a rational decision," creating a "potential contribution by game theory to psychology and to behavioral science in general").

The payoffs in the matrix reflect the principle that relative diligence reaps its reward. Each party's first strategy, al and bl, therefore consists of more coercive collection measures than his second, and his second more than his third. The least coercive strategy, a3 or b3, may consist of nothing more than the creditor's refusal to grant extensions. In employing his intermediate strategy, a2 or b2, the creditor may supplement this stance with repeated demands for payment. The creditor may act in the most coercive manner, a1 or b1, through threatened or actual seizure of the debtor's property.

A may achieve his best outcome by resort to strategy a1. He may recover all of his pro-rata share of the debtor's payments to both creditors plus 60% of B's share. A's use of his most coercive strategy, however, will only produce this result if B opts for strategy b3. For example, B will capture all of his pro-rata share of payments plus 10% of A's share by employing strategy bl against A's use of a1.

Upon reflection, any competent player in a game with an experienced opponent will realize that his concern is with the least payoff that he will receive from his choice of any particular strategy.[57] Therefore he will select the strategy that contains the best of these least payoffs. To illustrate this point, matrices for zero-sum games typically provide payoffs in which a player's choice of strategy to minimize loss differs from the strategy that, in the absence of rational play by his opponent, he would choose to obtain his maximum payoff. Stating the payoffs in The Two-Creditors' Zero-Sum Game in that manner, however, would ignore the principle of relative diligence: one player scores on the other by using more coercive measures than his opponent.[58] The least payoffs to A for each of his three strategies are contained in the horizontal row minima. Seeking the maximum of the row minima, the "maximin,"[59] A selects strategy a1. On the same basis, B, whose gains are measured by numbers less than zero, is attracted to the minimum of the column maxima, the "minimax,"[60] and he chooses strategy b1.

The point at which the maximin equals the minimax is known as the "saddle point."[61] One theoretician concludes that most games will have no saddle point in pure strategies, such as that posited for The Two-Creditors' Zero-Sum Game.[62] He illustrates such games by "matching

57. *See id.* at 21-22; Oskar Morgenstern, *Game Theory: Theoretical Aspects*, *in* 6 INTERNATIONAL ENCYCLOPEDIA OF THE SOCIAL SCIENCES 62, 64 (1968).

58. *See* RAPOPORT & CHAMMAH, *supra* note 20, at 21-22; Morgenstern, *supra* note 57, at 64.

59. *See* Morgenstern, *supra* note 57, at 64.

60. *See id.*

61. *Id.*

62. *See id.* at 64-65.

pennies," a contest in which A wins only if the side of his coin presented matches that of B's.[63] In this game, A will certainly lose if B is able to predict A's choice of heads or tails.[64] A must employ a chance mechanism to prevent B from doing so, one which selects either side of his coin with equal probability.[65] Such randomization may be achieved by flipping the coin before each showing of it.[66] The importance of relative diligence in most collection contests dictates, however, that a depiction of the typical creditors' contest contain a saddle point in pure strategies, each player's choice of his most coercive strategy. Each player will choose the strategy producing this result because he can do no better against a knowledgeable, self-interested opponent. While A will lose 10% of his pro-rata share of the debtor's payments to B for his use of strategy a1 against B's employment of b1, A's choice of either other strategy would result in even greater losses against B's use of b1.

The payoff matrix need not reflect one creditor's priority over another in a contest of both's ultimate coercive strategies as a necessary element in a creditor's zero-sum game. But neither is the outcome in the matrix in this respect an aberrant one. It merely reflects a common fact in collection cases: that some creditors, whether based on their secured status or their employment of more imaginative collectors, are able to project a more commanding posture than others.

Of what utility is the preceding model of The Creditors' Zero-Sum Game in informing our understanding of strategic choices in actual collection contests? With what frequency do such contests fit within the theoretical model? To pattern real contests on the model, certain conditions must exist.

Doubtlessly, there are cases where the debtor's distress is beyond relief, financial failure is imminent, and the sole issue is how competing creditors will distribute a finite pool of assets amongst themselves. Given the priority generally accorded superior methods of coercion, it seems highly unlikely that any creditor in such a contest would perceive her maximin (or minimax) as dictating anything other than employment of her most coercive strategy. Thus, there are collection contests that are zero-sum games with saddle points that lie at the intersection of the contestants' most coercive strategies.

The zero-sum model assumes wider applicability to creditors' contests when the limits of the requirement that creditors perceive the

63. *See id.*
64. *Id.* at 64.
65. *Id.*
66. *Id.*

contest as one for a limited pool of assets are explored. This characteristic is fundamental in distinguishing zero-sum games from those of Prisoner's Dilemma, for, as the preceding analysis has shown, the basic difference in the types of conflict experienced by the contestants in these two games stems from the futility of their cooperation in the former contest and the promise of that action in the latter.

Zero-sum games have a satisfactory solution because the interests of the parties are diametrically opposed, whether a saddle point results from the use of pure or random strategies. No gain for one player can occur without a corresponding loss for the other because no concerted action by the players can increase the pool of assets out of which their claims will be paid.

Previous examination of the Creditor's Dilemma matrix established, however, that the noncooperative equilibrium of mutual coercion provides only the third-best recovery for each party in that contest. In all other outcomes, it is not possible to make one creditor better off without making the other worse off. Thus, the equilibrium point for a noncooperative game of Creditor's Dilemma is the only one of the four payoffs that is not Pareto-optimal. Pareto-optimality occurs when it is impossible "to make anyone better off without making someone else worse off."[67] Both creditors could double their payoffs if they each substituted their cooperative strategies for their coercive ones.

In accordance with this basic distinction in the two types of games, the matrix for The Two-Creditors' Zero-Sum Game assumes that the creditors cannot increase the debtor's aggregate payment on their claims by joint cooperative action in their recovery efforts. This assumption is necessary to pattern the creditors' contest on the model of a zero-sum game. The matrix, however, need not necessarily assume, as it does for the sake of simplicity in presentation, that the debtor's aggregate payments cannot be increased by the unconcerted recovery actions of his creditors.

There are doubtlessly collection cases, probably numerous ones, in which creditors believe that their individual actions will result in some further application of the debtor's resources to payment of their claims. These cases too may qualify as zero-sum games. To do so, however, they must be viewed by creditors as contests with other creditors. If creditors believe that their individual collection efforts will produce payments in an amount sufficient to pay all the debtor's obligations, they will not perceive the collection setting as presenting a contest and game theory will have no relevancy in predicting their actions. To qualify as zero-sum games, these cases must be ones in which creditors

67. PAUL A. SAMUELSON, ECONOMICS 136 (15th ed. 1995) (emphasis in original).

believe that they can expand the pool of assets available to pay them, but that they cannot expand the pool sufficiently to pay all the claims. This subsection will subsequently examine the propensity of creditors to employ increasing pressure on debtors in collection cases that are not perceived as contests with other creditors.

What effect on the predictive power of the zero-sum model results from this recognition that creditors may enhance their aggregate recovery by their unconcerted collection efforts? To the extent that the effect is significant, it appears to be a positive one. The unconcerted action that creditors perceive as conducive to increasing the resources devoted to payment of their claims is likely to be more and not less coercive tactics. Thus, the action dictated by this theoretical impediment to modeling collection contests as zero-sum games will typically serve merely to reinforce creditors' choices of their most coercive strategies as predicted by application of a zero-sum model that ignores the creditors' ability to increase aggregate recovery by unconcerted action.

One further aspect of the requirement that creditors by joint action cannot increase aggregate recovery in a zero-sum game is worthy of note. Although the gross payoffs in The Two-Creditors' Zero-Sum Game afford no possibility of the creditors increasing the aggregate recovery by agreement among themselves, those creditors may be motivated to cooperate in their efforts when they consider the effects of collection costs on their net recovery. To illustrate this point, the matrix provided for the contest has been designed to reflect the same distribution of the debtor's aggregate gross payments among his creditors from each creditor's choice of his least coercive strategy (a3 and b3) as from each creditor's choice of his most coercive strategy (a1 and b1), the saddle-point equilibrium. If a more coercive strategy is more costly—and typically it will be—each creditor's net recovery could be increased by an agreement among those parties to use their least coercive strategies.

Although this observation qualifies the theoretical application of the zero-sum model in some creditors' contests, it probably has little significance in reducing the model's predictive value in actual cases where creditors will not perceive their payoffs in the precise manner contained in the matrix. Even if creditors have this perception, other considerations appear to diminish the erosive effects of this cost-reduction factor on the applicability of the model.

Creditors will typically have far less incentive to cooperate in choosing collection strategies when they direct their effort solely to the reduction of collection costs than when that effort is motivated by the probability of increasing aggregate recovery from the debtor, as in a Creditor's Dilemma. As the transaction costs of securing cooperative creditor action often defeat that action in a Creditor's Dilemma, it seems that these costs will pose an even more significant barrier when measured against the smaller benefits at stake in a zero-sum contest. Additionally, creditors' propensity to perceive the pool of assets directed to payment of claims as being expandable by their employment of more coercive strategies will militate against agreements by creditors to employ less coercive strategies merely to curtail collection costs.

To what extent does the zero-sum model reflect the vast amount of collection activity in this country? While no empirical data exists to support my conclusion, I believe this model explains the actions of collectors in far more cases than one based on Prisoner's Dilemma. Why?

Cooperating creditors collect more in a collection case that is properly modeled on a Prisoner's Dilemma because the debtor commits, to a far greater extent than in a zero-sum game, his subsequent earnings and possibly other subsequent income and acquisitions of property to payment of creditors. Nevertheless, the case is properly modeled on a Prisoner's Dilemma only if the debtor is committed to a workout and the workout is feasible. Cases of significant overextensions of credit pose a substantial risk that a debtor will resort to bankruptcy or find other means to immunize assets acquired after creditors get serious in their collection efforts.

Once a debtor's basic-comfort level of current consumption is threatened, each additional dollar diverted from current consumption to debt service will result in greater hardship to the debtor than that resulting from the dollar diverted immediately before it.[68] The increasing marginal costs of these losses in disposable income will tend to defeat the workout efforts of all but the most serious-minded and self-disciplined of debtors who are significantly overextended.

The rigors of this elementary economic principle seem most pronounced when a debtor's overextension results solely from volitional expenditures. After having grown accustomed to spending more than his income, he must adjust his present consumption to an amount that is less than that income, often considerably so, in order to fund the workout. Still, even when overextensions result from non-volitional expenses or temporary suspensions of income rather than a propensity to overconsume, living within the strictures of a workout may exceed the abilities of many debtors. The zero-sum model does more, however, than explain creditors' use of coercive measures in those many contests that would fall within its boundaries if information were costless and

68. This principle is the converse of the rule of diminishing marginal utility. *See id.* at 74 (observing that the concept of diminishing marginal utility recognizes that the extra utility added by each additional unit of consumption tends to decrease).

creditors based their strategic choices on an objective assessment of all relevant facts. The very frequency with which it may be properly applied engenders, I suspect, a presumption by creditors that most cases of serious overextension are controlled by the behavior the model predicts. The mind-set of creditors is no less a product of their environment than that of any other occupational group. They are witnesses to far too many financial tragedies to be other than skeptically disposed toward the ostensible benefits of granting extensions to debtors who are already in serious arrears.

To be sure, the presumption in favor of the zero-sum model is rebuttable, but the burden of doing so is placed upon the proponent of a Creditor's Dilemma model. Some of the difficulties of meeting this burden of proof were previously explored in Kelly's case.

Information supplied solely by the debtor concerning his willingness and ability to successfully complete a workout is suspect, at least for its objectivity if not also for its veracity. While a creditor can often easily verify certain facts relative to the debtor's ability to pay, such as his salary, that creditor may face more difficulty or incur greater costs confirming other data, such as the extent of the debtor's obligations to other creditors. However, it is probably not as much the debtor's representations of fact as it is his promises—his willingness to persevere in the workout—that most concerns creditors. What is needed is some basis for assessing the debtor's perseverance, and that often requires a greater investment of time and effort than a single creditor can economically justify.

Even if these obstacles can be surmounted, a final significant obstacle remains. The creditor who contemplates sponsoring the workout must believe that the other creditors can be convinced, as he is convinced, of the relevancy of the Creditor's Dilemma model. If the other creditors do not share that belief, they will be playing a zero-sum game in contests in which the debtor is seriously overextended and will invariably counter the sponsoring creditor's cooperative strategy with their most coercive ones. If the sponsoring creditor's own decision in favor of the merits of a workout is a close call—and in many cases it will be—predicting the actions of the other creditors presents the greatest hazard of all.

To the extent that the presumption in favor of the zero-sum model controls, it contributes significantly to understanding creditors' failure to exert greater effort on behalf of workouts in cases where a workout might enhance their recoveries. If creditors view the contest not as one of Creditor's Dilemma but as a zero-sum game, they have no incentive to seek mutual cooperation.

The earlier analysis of factors that defeated Kelly's attempt at a workout, one that did not directly invoke the insights of game theory, reached the same conclusion as the foregoing exploration of collection practices that result from misapplication of the zero-sum model. Competition among creditors presents the central problem to overcoming overly coercive methods of collection. Moreover, the need to successfully compete accounts for the dilemma faced by creditors without a cooperative solution to contests that they do recognize as ones of Creditor's Dilemma.

Applying game theory, both the zero-sum game and the Prisoner's Dilemma, to collection cases does more than reinforce the conclusion reached previously in the analysis of Kelly's case. Recognizing creditors' contests as flawed or pure games of Prisoner's Dilemma provides the foundation for exploring solutions to creditors' problems in the larger context of applied game theory's concern with securing beneficial cooperative action in all instances in which the need for cooperative action may arise. Before summarizing, however, these solutions to the generalized problem of collective choice, another type of creditor misperception of the collection setting deserves recognition for the important role it plays in thwarting beneficial collective action by creditors.

The universe of a creditor's perception of any given collection case is not limited to a choice of the zero-sum or Prisoner's Dilemma models. If there are instances in which a creditor uses coercion because she believes the debtor will soon fail, and she wishes to reap a larger share than her fellow creditors of the limited assets that will be devoted to payment of the debtor's obligations, there are also other instances, probably more numerous in the early stages of the collection process, in which a creditor does not perceive her employment of coercive measures as visiting any harm on her fellow creditors. If a debtor has just commenced his slide into profligacy, firm demands, even legal action, by a collector may provide the impetus to turn the debtor around, not only to the benefit of the disciplining creditor but to that of the debtor's other creditors as well.[69]

Certainly, initial collection efforts often must be guided by the presumption of a need to instill financial discipline in the debtor. Here too, the manner of doing so is not to indulge the debtor's requests for extensions but to demand that defaults be promptly cured.[70] Thus, even

69. *Cf.* 4 ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 423 (Edwin Cannan ed., Random House 1937) (1776) (observing that, by operation of the "invisible hand," a self interested action can benefit persons other than the actor).

70. *See* COLE, *supra* note 47, at 371.

before the creditor knows that she is engaged in a contest with other creditors, a pattern of coercive collection often has been established, one which may later bias the creditor toward applying even more stringent coercive strategies based on the model of a zero-sum game.

Any compendium of the possible misperceptions of a Creditor's Dilemma as an activity not involving a contest with other creditors would be incomplete without one further recognition. In some instances, but probably not many, the creditor's mistaken assessment may lead to her erroneous employment of a cooperative strategy. Creditors often make extensions of consumer debts without regard to whether other creditors are adjusting the terms of their loans. This action will prove advantageous to the creditor granting the extension, as well as the debtor, if the latter's financial condition is not such as to preclude the debtor's financial recovery without concessions from his other creditors. In a case in which the cooperation of more than one of the debtor's principal creditors is required to avert financial failure, a creditor who mistakenly grants an extension when others do not is vulnerable to their employment of coercive strategies. While asymmetries of information and mistaken judgments may result in some creditors making this error, it seems probable in most cases that by the time the debtor is in serious default, all creditors will perceive the matter as a collection contest and employ coercive strategies as predicted by the preceding analyses of Creditor's Dilemma and zero-sum games.

III. RESOLVING THE CREDITOR'S DILEMMA

A. *The Emergence of Consumer Credit Counseling Agencies as Major Participants in Resolving Consumer Debt Problems*

In my analysis in *Games Creditors Play,* placing creditors on the playing fields of game theory does more than reinforce conclusions regarding creditor behavior reached independently by earlier recognition of the race-of-diligence motive for coercive collection. Use of the Prisoner's Dilemma framework serves an additional and equally important function. Analysts who recognize creditors as participants in Prisoner's Dilemmas have a broader base for examining remedial measures than those analysts who fail to generalize the creditors' problem. Once the problem of securing beneficial collective action by creditors is recognized as a subset of a broader issue—the problem of obtaining collective action in all the social, economic and political contexts in which joint participation by individuals is required to achieve a common goal—the basis exists for exploring solutions to the narrower issue by applying the revelations of theorists studying the broader one.

The insights of these theorists contribute to an understanding of why a systematic resolution of the Creditor's Dilemma, outside of bankruptcy proceedings, has required the fashioning of unique private-sector instrumentalities—non-profit consumer credit counseling agencies affiliated with the National Foundation for Consumer Credit. These agencies, which exist throughout this country and are now accessible to most Americans, obtain needed extensions in the debtor's payment terms in instances in which both creditors and the debtor are likely to benefit from the extensions. I focus on the work of the non-profit counseling agencies because of the extent of their operations, their dramatic growth rate, the relative uniformity of their operations, and the availability of information concerning them. The first of these non-profit agencies formed with the support of creditors appeared in this country only some four decades ago.

By early 1996, consumer credit counseling offices of agencies affiliated with the National Foundation for Consumer Credit were located in nearly 1200 cities and towns in the United States and Canada, having increased six-fold from only some 200 locations in only 12 years.[71] Many of these offices perform credit counseling only, while others are part of multi-service agencies such as Family Services or Catholic Charities.[72] Officials of the National Foundation for Consumer Credit estimate that 90% of the U.S. population now has reasonable access to a main or branch credit counseling office.[73] These officials estimate that during 1996 over 1.8 million debtors will contact member counseling agencies for assistance in avoiding bankruptcy and that those agencies will counsel 972,000 of those debtors.[74] Of those counseled, 34% will be assisted by the implementation of debt management plans in which the agencies persuade creditors to extend payment terms, disburse the debtor's payments to creditors, and otherwise administer the workouts they sponsor.[75] Another 34% will be instructed by the agencies in self-help through learning budgeting skills.[76] An additional 25% will be advised that some additional measure such as obtaining

71. Durant Abernathy, National Foundation for Consumer Credit, Bankruptcy Trends and Alternatives (Nov. 1996) (presentation at CCUL Annual Meeting & Convention, on file with author); Telephone interview with Bill Furmanski, Director of Communications of National Foundation for Consumer Credit and Melony Branbon, Assistant to the President of the National Foundation for Consumer Credit (Dec. 5, 1996) [Abernathy presentation and interview with Furmanski and Branbon together hereinafter NFCC].

72. NFCC, *supra* note 71.

73. *Id.*

74. *Id.*

75. *Id.*

76. *Id.*

additional income through another job will be required before a debt management plan will be feasible.[77] The remaining 7% will seek relief through bankruptcy.[78] The 972,000 debtors that will be counseled in 1996 are a substantial increase in the 254,000 counseled only eight years earlier in 1988.[79] Moreover, according to the data provided by the National Foundation, the number of debtors seeking the services of credit counseling offices during this eight-year period has grown at a faster rate than that of debtors seeking relief in bankruptcy, where 526,000 petitions were filed in 1988 and some 1.1 million are expected to be filed in 1996.[80] Finally, active debt management plans administered by the agencies have grown dramatically in number and dollars returned to creditors in recent years.[81] The 418,000 active debt management plans administered by the agencies in 1996 is a dramatic increase from the 49,739 active plans they administered in 1983, and the dollars returned to creditors from those plans has increased 242 million in 1987 to an estimated 1.575 billion in 1996.[82]

As the foregoing data reveal, in many instances consumer credit counseling agencies need provide no further assistance to debtors than helping them establish workable budgets. The description that follows, however, focuses on the additional task that data revealed the agencies perform when dealing with more seriously troubled debtors, those for whom budgeting alone is inadequate.

In this role, the agencies obtain creditors' acquiescence to plans that extend the debtor's time for payment. The extensions must be necessary for the debtor's rehabilitation, and the debtor's proposed performance under the plan must be feasible. Counseling agencies only attempt extension plans after the debtor and counselor have fully explored the debtor's financial affairs and have determined that payment of all but long-term debt, such as the debtor's home mortgage and sometimes his car note, can be made over a period that typically does not exceed four years. The agency will sponsor the workout only when the counselor believes that the debtor is committed to the plan and able to live within its confines.

Counseling agencies also administer the plans they sponsor. This duty includes disbursing the debtor's payments to creditors and monitoring the performance of the parties. The debtor must fund the

77. *Id.*
78. *Id.*
79. *Id.*
80. *Id.*
81. *Id.*
82. *Id.*

plan as agreed, although counselors will work further with debtors who fall behind in payments so long as they think these debtors are seriously committed to the workout. Creditors must not undermine the workout by continuing their individual recovery efforts.

The distinctive feature of credit counseling as a private-sector remedy is that it accomplishes its functions within the severe cost constraints that distinguish most consumer collection cases from large commercial ones. By working with distressed debtors day in and day out, credit counselors hone their skills in assessing whether debtors need extensions and whether they will use them to increase the aggregate recovery of their creditors. The repetitive nature of the credit counselor's work provides the specialization and division of labor upon which economies of scale are often based. By also working with the principal creditors in the community on a daily basis, the counseling agency acquires the trust and confidence of those creditors in the agency's role as monitor of the performance of the debtor and creditors in a workout. In this latter function, economies of scale are most significant because, once a creditor's trust is established, the cost of securing her cooperation in subsequent cases is greatly reduced.

The affiliation of counseling agencies with the National Foundation for Consumer Credit further extends these economies of scale. A newly formed agency that has received the approval of the National Foundation may trade on the goodwill of long existing agencies in establishing its own reputation. Established agencies dealing with geographically remote creditors may trade on the reputations of agencies that operate in that creditor's usual trade area.

B. *Contrasting Workouts Under Consumer Credit Counseling Plans with Bankruptcy Proceedings*

Creditor cooperation, which consumer credit counseling agencies effect by earning the confidence of creditors, may be provided simply and certainly with cost-effectiveness by governmental edict. The automatic stay of any action by individual creditors to collect their claims other than by proceedings in the bankruptcy court, which is imposed upon the filing of a petition in bankruptcy,[83] is a clear recognition by lawmakers of the benefits that may be derived from substituting collective for individual creditor action at that point in the collection process. Yet creditors do not feel their interests are typically as fairly treated in bankruptcy proceedings as they are in counselor-assisted workouts, and I believe they harbor this belief for good reasons.

83. *See* 11 U.S.C. § 362 (1994).

Because bankruptcy law protects creditors in various ways, creditors' belief that credit counseling provides a more palatable alternative to them, and to debtors who wish to pay their obligations, than bankruptcy as often practiced in this country warrants further examination. I turn to the provisions of first Chapter 7 and then Chapter 13 that attempt to equitably balance the rights of debtors and creditors.

First, the gates to Chapter 7 of the Bankruptcy Code are no longer open to just any debtor who comes calling. Creditors are probably most offended by those Chapter 7 cases in which a debtor with income in excess of reasonable current living expenses receives a discharge upon surrendering nonexempt assets of little value to his creditors.[84] As creditors count primarily on a consumer debtor's regular income and not liquidation of assets of little market value, creditors and some theorists have argued that debtors with significant disposable incomes should be required to commit at least some of their future income to the payment of creditors as the price of their discharge.[85] This principle is now reflected in a provision of Chapter 7 of the Bankruptcy Code that empowers the bankruptcy court "on its own motion or on a motion by the United States trustee" to dismiss a voluntary Chapter 7 case filed by an individual "whose debts are primarily consumer debts" upon a finding of "substantial abuse" of the provisions of Chapter 7.[86] While the vague statutory standard of "substantial abuse" does not expressly incorporate a test based on the ability of the debtor to make substantial payments from future income, a significant number of judicial decisions applying the standard have imposed that test.[87] However, the standard is admittedly vague, and survey results reveal significant disparity in the frequency of use of substantial-abuse motions by various bankruptcy judges and U.S. Trustees.[88]

When a debtor loses access to Chapter 7, however, she is not precluded from filing a Chapter 13 bankruptcy petition. But bankruptcy law provides some protection of even unsecured creditors in Chapter 13

84. *See* ROBERT L. JORDAN & WILLIAM D. WARREN, BANKRUPTCY 670 (4th ed. 1995).

85. *See* Theodore Eisenberg, *Bankruptcy Law in Perspective*, 28 UCLA L. REV. 953, 980 (1981) ("Repayment plans that draw upon future earnings more accurately reflect a debtor's ability to pay than do liquidation plans. We live to a great extent in a cash flow world.").

86. *See* 11 U.S.C. § 707(b) (1994).

87. *See, e.g., In re* Walton, 866 F.2d 981, 985 (8th Cir. 1989); Zolg v. Kelly, 841 F.2d 908, 914 (9th Cir. 1988). While these cases hold that a debtor's income in excess of expenses, standing alone, constitutes a substantial abuse of Chapter 7 justifying dismissal, Green v. Staples, 934 F.2d 568, 572-73 (4th Cir. 1991), holds that the debtor's ability to repay is the primary but not sole factor to be considered in applying the "substantial abuse" test.

88. Wayne R. Wells et al., *The Implementation of Bankruptcy Code Section 707(b): The Law and the Reality*, 39 CLEV. ST. L. REV. 15, 42 (1991).

cases. While unsecured creditors as a class or classes do not get to vote on confirmation of a plan in Chapter 13 as they do in a business reorganization in Chapter 11, they are protected by the requirement that the plan must be proposed in "good faith" and, further, by the "best interests" test that requires each creditor receives at least as much as she would have received in a Chapter 7 bankruptcy of the debtor.[89] Of greater significance, however, is that since 1984 Chapter 13 has provided that any unsecured creditor may block confirmation of a plan that provides for less than full payment of her claim, unless "the plan provides that all of the debtor's projected disposable income to be received in the three-year period beginning on the date that the first payment is due under the plan will be applied to make payments under the plan."[90] For the purpose of applying the rule, the term "disposable income," means, in the context of a consumer debtor, "income which is received . . . by the debtor and which is not reasonably necessary to be expended for the maintenance or support of the debtor or a dependent of the debtor."[91]

Thus, it may appear that even unsecured creditors in Chapter 13 cases, while not necessarily being promised payment in full, receive in one important sense the equivalent of what they get in counselor-assisted workouts. Arguably, creditors in both instances get the best the debtor can do in a long period—three years in Chapter 13 and 4 years in workouts—of curtailing expenses in order to pay obligations. Yet if the protection of creditor interests is essentially equal, my conclusion that creditors perceive Chapter 13 as less protective of their interests than counselor-assisted workouts is either erroneous or inexplicable. There are, however, differences between the two methods that explain the better treatment accorded creditors by counselor-assisted workouts.

The two types of collective undertakings first vary in the degree of commitment a debtor must bring to each. Under the bankruptcy standard, what is necessary for the support of the debtor and his dependents is a flexible standard. While there are doubtlessly some bankruptcy judges who apply that test in a manner that requires the debtor's maximum commitment to payment of his debts in a Chapter 13 plan, there probably are a large number of others who apply a far less stringent standard. One bankruptcy judge who conversed with me on the

89. 11 U.S.C. § 1325(a)(3), (4) (1994).

90. *Id.* § 1325(b)(1). To the extent that a creditor holds a secured claim, *see id.* § 506(a), he is protected in any case in which the debtor retains his collateral by the requirement that the plan provide for retention of his lien and for payments, having a value as of the effective date of the plan, of the amount of his secured claim. *See id.* § 1325(a)(5)(B)(i).

91. *Id.* § 1325(b)(2)(A).

subject of credit counseling agencies concluded unequivocally that the agencies were not needed in his district as the Chapter 13 plans that he confirmed were fully protective of creditors' claims. There are probably wide differences in the standards that are imposed on Chapter 13 plans by the various bankruptcy judges, and consequently, like divergences in creditors' views of the efficacy of Chapter 13 actions.[92]

In comparison, a debtor in a workout and his credit counselor must fashion a plan for full payment of all claims. In *Games Creditors Play,* I conclude that creditors limit counselors to extension plans, rather than also authorize them to propose compositions in which reductions in obligations will be given if the plan is completed, because doing so considerably limits creditors' costs of monitoring the cost of their monitor, the credit counselor. Regardless of the reason for this limitation on the function of credit counseling, however, debtors whose objective is full payment of their claims must be far more apt to curtail their living expenses and perhaps moonlight to increase their income than Chapter 13 debtors. The latter need only meet a test of the reasonableness of their living expenses and are subject to that lesser standard for a period that may be one year less than they would encounter in a workout. Given the greater incentive of a debtor in a workout to effect full payment—unlike Chapter 13 proceedings his debts are discharged only if he does so[93]—creditors justifiably perceive workouts, where feasible, as preferable to Chapter 13 plans.

Other reasons justify the distinction creditors make between workouts and Chapter 13 proceedings. The statute requiring that all the debtor's disposable income be directed to payments under the Chapter 13 plan[94] may produce little for unsecured creditors if the debtor directs that income in large part to payments on secured claims.

That statute does not restrict the debtor from doing so, and another provision of the Bankruptcy Code permits Chapter 13 plans to "provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due."[95] Chapter 13 encourages debtors to channel their contributions to the plan toward payments on

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92. *Compare* 5 LAWRENCE KING, COLLIER ON BANKRUPTCY ¶ 1325.08[4][b][ii] (15th ed. 1992) (concluding that a judge's determination of the debtor's disposable income should not mandate drastic changes in the debtor's lifestyle) *with In re* Kitson, 65 B.R. 615, 622 (Bankr. E.D.N.C. 1986) ("A Chapter 13 debtor who proposes to pay his creditors 38 cents on the dollar cannot expect to 'go first class' when 'coach' is available.").

93. *See* 11 U.S.C. § 1328 (1994) (providing for the discharge of debts under Chapter 13).

94. *See id.* § 1325(b).

95. *Id.* § 1322(b)(5).

these long-term debts, which are usually secured by the debtor's home, because Chapter 13 excepts such long-term debts from its discharge.[96] Secured creditors whose claims are payable before the expiration of the term of the Chapter 13 plan will not have their debts excepted from discharge. When the debtor retains the collateral, however, those secured creditors may exact a promise of payments having a value, as of the effective day of the plan, of the amount of their secured claims.[97]

Typically, the debtor's need and desire to retain his home, automobile, boat, or other encumbered property will dictate that his plan provide for payments to secured creditors—catching up on arrearages and then staying current on these obligations—at the expense of unsecured creditors. The result of these provisions is that in spite of the disposable income test, a Chapter 13 plan may be confirmed that provides for no payment to unsecured creditors.[98] A statistical study showing that Chapter 13 debtors had considerably more secured and less unsecured debt than Chapter 7 debtors[99] evinces that some consumers may be attracted to Chapter 13 not to increase the recovery of their unsecured creditors but to retain encumbered property that they might lose in a Chapter 7 proceeding.

Unsecured creditors fall far short of full recovery of their claims in Chapter 13 despite the disposable income test. Researchers have found that average proposed payments range from about one-third to one-half of unsecured claims. Moreover, in only about one-third of the Chapter 13 cases do debtors complete payments of what was promised in the plan.[100] Workouts sponsored by consumer credit counseling agencies propose full payment to creditors and have a higher success rate. The National Foundation for Consumer Credit reports that 25% of their debt management plans are completed and another 22% become self-administering when it is felt that there is no further need for the use of the counseling agency as intermediary between the debtor and her credi-

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96. *See id.* §§ 1328(a)(1), (c)(1), 1322(b)(5).

97. *See id.* § 1325(a)(5) (protecting liens of secured parties in Chapter 13).

98. *See In re* Greer, 60 B.R. 547, 549 (Bankr. C.D. Cal. 1986) (holding that absence of payments to unsecured creditors did not disqualify Chapter 13 plan where husband and wife co-debtors had a sizeable arrearage to occur on their home mortgage and chose to retain their two automobiles by making installment payments on their debts secured by the vehicles). But the Bankruptcy Code also requires that Chapter 13 plans be proposed in "good faith," *see* 11 U.S.C. § 1325(a)(3) (1994), and some bankruptcy judges have denied confirmation of plans providing for no payments to unsecured creditors on that basis. *See, e.g., In re* Lattimore, 69 B.R. 622, 625-26 (Bankr. E.D. Tenn. 1987).

99. *See* Michelle J. White, *Personal Bankruptcy Under the 1978 Bankruptcy Code: An Economic Analysis*, 63 IND. L.J. 1, 36 (1987).

100. *See* ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, THE LAW OF DEBTORS AND CREDITORS 438 (1996).

tors.[101] Counseling agencies close debt management plans for failure of the debtor to perform in 48% of their cases, and debtors leave counseling agencies for bankruptcy courts in the remaining 5% of debt management plans.[102]

In counselor-assisted workouts, a secured creditor does not normally extend terms of payment, for doing so while depreciation of collateral goes unchecked, would diminish the value of that collateral relative to the amount of the claim. In this manner, creditors participating in workouts recognize the bankruptcy principle of adequate protection of secured claims, whereby creditors in reorganizations of business entities may be entitled to periodic payments that equal the depreciation on their collateral during the period between filing the bankruptcy petition and confirmation of the plan or dismissal of the case.[103] In counselor-assisted workouts, the cost of this practice to unsecured creditors is limited by the requirement that the plan provide for payment of their claims in full. While unsecured creditors in these workouts suffer further delays to accommodate the debtor's needs to bring and keep payments on secured claims current, the promise of ultimate payment on their claims may not be a casualty of those needs.

Unsecured creditors also prefer a workout to bankruptcy because they will benefit from the absence of attorney's fees and court costs. These costs are borne by creditors except where the debtor's friend or relative pays these costs or where the debtor uses property that would not have funded a Chapter 13 plan,[104] would not have been distributed to creditors in a Chapter 7 plan,[105] or would not have been used for pre-petition payments to creditors. Even though credit counseling agencies generally succeed in their efforts to get creditors for whom they collect to defray their cost of operation—a charge of some 12 percent on collections is commonly touted as the creditor's "fair share"—workouts commonly entail lower costs than attorney's fees and court costs in a bankruptcy proceeding.[106]

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101. *See* NFCC, *supra* note 71.

102. *See id.*

103. *See* 11 U.S.C. § 361 (1994). Methods other than periodic payments to defray depreciation exist, such as providing the secured creditor additional collateral.

104. Chapter 13 plans are generally funded by the debtor's salary or wages earned after the filing of the bankruptcy petition. The Bankruptcy Code's general provisions define property of the estate primarily in terms of the debtor's prepetition property. *See* 11 U.S.C.A. § 541 (1994). To accomplish its goal, Chapter 13 supplements these general provisions by including the debtor's postpetition property including earnings as property of the estate. *See id.* § 1306.

105. In a Chapter 7 proceeding, the debtor retains his exempt property. *See id.* § 522.

106. Large creditors in a community also will support their local credit counseling agency by donations of money and in-kind contributions such as office space or equipment. While this

A final reason that unsecured creditors prefer counselor-assisted workouts to Chapter 13 actions is based not on differences in the recovery of principal but on a principle that creditors share: participation in debt adjustment by consent is generally preferable to participation by governmental command. In the closest parallel to debt adjustment in Chapter 13, a business reorganization in Chapter 11, unsecured creditors as a class do have a say in approving the plan.[107] No similar provision in Chapter 13, however, gives unsecured creditors, even by class, a negotiating stance in the formulation of the plan.[108] Chapter 13 does provide that the court may not confirm a plan unless it provides for payments to each unsecured creditor that have a present value not less than the amount that creditor would have received if the estate of the debtor had been liquidated in Chapter 7.[109] This provision, however, gives unsecured creditors little bargaining strength because Chapter 7 bankruptcies by consumer debtors often produce little or nothing for unsecured creditors.

In contrasting the treatment of creditors in counselor-assisted workouts with their treatment in Chapter 13 proceedings, attention also must be given to secured creditors in the two proceedings. While debtors, as noted earlier, may channel the disposable income they are required to commit to their Chapter 13 plans to their secured creditors in order to retain encumbered property, it does not follow that secured creditors do better or even as well in a Chapter 13 proceeding as they do in a counselor-assisted workout.

While a secured creditor is entitled to payments under the Chapter 13 plan in the amount of his secured claim plus interest over the life of the plan,[110] the amount of the secured claim, a defined term in bankruptcy, cannot exceed the value of the collateral.[111] Hence, where the value of the collateral, as determined by the bankruptcy court, is less than the amount of the creditor's claim, the debtor may retain the collateral by proposing amortization of the lesser amount plus interest thereon in payments under the plan.

support increases the costs to the donors of counselor-assisted workouts, it also testifies to the value they believe they receive from the work of the counseling agency.

107. *See id.* § 1129(a)(8). While a Chapter 11 plan may be confirmed over the objection of a class of unsecured creditors by resort to "cramdown," *see id.* § 1129(b)(2)(B), the proponent of the plan typically will find it advantageous to seek confirmation by negotiation, *see* Richard F. Broude, *Cramdown and Chapter 11 of the Bankruptcy Code: The Settlement Imperative*, 39 BUS. LAW. 441, 453-54 (1984).

108. *See id.* § 1325 (listing the requirements for confirmation of a Chapter 13 plan).

109. *See id.* § 1325(a)(4).

110. *See id.* § 1325(a)(5)(B)(ii).

111. *See id.* § 506(a).

A restriction on this right of the Chapter 13 debtor to modify secured claims protects the mortgagee of the debtor's home from this "lien stripping."[112] But security interests in motor vehicles, boats, furniture, appliances, and other personal property may be reduced to the court-determined value of the collateral, protecting secured creditor status only to the extent of that value. The balance of the creditor's claim is treated as an unsecured one. The partial stripping of a creditor's lien in Chapter 13 is a more effective device for debtors than a similar provision limited to certain tangible personal property in Chapter 7 because the latter provision requires that the debtor make a lump-sum payment of the value of the collateral to redeem it.[113] In contrast to the treatment of secured creditors in bankruptcy, secured creditors in counselor-assisted workouts may insist on their state law rights to receive full payment of their claims before loss of their security interests.

The foregoing analysis of why creditors prefer counselor-assisted workouts to Chapter 13 proceedings does not mean, however, that creditors reject any meaningful role for Chapter 13 bankruptcy proceedings in protecting their interests. To the contrary, the consumer-credit industry has worked diligently to promote the use of Chapter 13 over Chapter 7, and its lobby was influential in imposing the "substantial-abuse" test previously examined on access to Chapter 7.[114] Where full payment of claims in a counselor-assisted workout is not feasible and a Chapter 13 plan holds the promise of greater recovery than Chapter 7 or the running of the creditors' race of diligence, Chapter 13 creditors will perceive Chapter 13 as providing the best basis for the collection of their claims.

The important role that creditors recognize for Chapter 13 does not detract, however, from the role they assign the credit counselor. Creditors perceive a hierarchy of need by troubled debtors, extending from those who may still make full payments with the assistance of a counseling agency, to those who require a scaledown of their debts in a Chapter 13, to those for whom even serious effort at meaningful payment from future income will be fruitless (the proper candidates in creditors' estimation for Chapter 7 bankruptcies).

In stating the case for credit counseling agencies, I have focused on the role they play in a collection process that otherwise provides no systematic means to obtain collective action when bankruptcy may still be avoided. Systematic solutions are particularly needed in consumer-

112. *See id.* § 1322(b)(2); Nobleman v. American Sav. Bank, 508 U.S. 324, 331-32 (1993).

113. *See id.* § 722; General Motors Acceptance Corp. v. Bell, 700 F.2d 1053, 1055 (6th Cir. 1983).

114. *See* JORDAN & WARREN, *supra* note 84, at 672-74.

collection cases because these solutions make transaction costs, which must be tightly contained in these cases, manageable.

Like off-the-rack suits, however, the use of a credit-counseling agency does not always provide a good fit with creditors' and debtors' needs. For example, creditors may be harmed when a credit counselor procures extensions that do not produce increased recovery of their claims but are used by the debtor to forestall the individual collection efforts creditors would otherwise make. This type of counselor's error may also increase the cost of the counselor's services, and thus the costs of the collection process, in subsequent cases. Too many disappointing recoveries will undermine a creditor's confidence in the counselor's judgment. This may result in the counselor encountering greater difficulty in getting that creditor to forego coercive collection measures in later cases when the implementation of workout plans is clearly justified. Nevertheless, the growth of credit counseling evinces that this is not a serious problem. In large numbers, creditors, especially experienced ones, accept the work of counseling agencies and will assist those agencies in securing the cooperation of other creditors who initially fail to acquiesce in workout plans.

The remedy that counseling agencies offer also may fail in some instances to meet the needs of debtors who use it. A debtor who opts for a counselor-assisted workout without properly assessing the difficulties that the workout will entail may be better advised to file a Chapter 13 or even Chapter 7 bankruptcy action. I have talked with bankruptcy attorneys and one prolific commentator on bankruptcy law who believe that agencies that are supported by creditors are not sensitive enough to the needs of debtors. Their complaint is the converse of that of creditors who believe that attorneys channel many consumers into bankruptcy when workouts would be feasible and advantageous to the debtor as well as her creditors. Doubtlessly, there is some truth in the charges of both groups, and turf battles are bound to arise in those cases in which a good argument can be made for either form of relief.

There are unquestionably instances in which a counselor sponsors a plan that a better informed debtor would not have undertaken. Such plans will often be aborted, imposing additional costs on both the debtor and his creditors. Moreover, even when these plans are fully performed, they may impose costs on the debtor that transcend all benefits the debtor derives.

One such cost of the use of credit counseling agencies is a psychic one some debtors suffer from having to forego the sole management of their financial affairs. This factor is probably most acutely felt by prudent, well-educated people whose overextensions are the result of non-volitional expenditures or sudden losses of income and not mismanagement of debt. To avoid this humbling experience, some people will forego the use of a counseling agency and attempt to personally obtain their creditors' support for a workout. While many are likely successful, their task is typically made far more difficult by their failure to invoke the assistance of a credit counseling agency.

The costs to a debtor of entering into a counselor-assisted workout will exceed the benefits only when the debtor significantly underestimates the hardship the workout will entail. If the debtor's estimate of the hardship is more accurate, the fact that the debtor undertakes the workout when many other people similarly situated would choose bankruptcy is of no moment. The debtor is best able to assess his own costs. A debtor's taste for difficult workouts is entitled to the same respect as a taste for boiled okra or sushi.

It is all too easy to exaggerate the imperfections in the counselor-assisted workout method of systematic debt adjustment. Notwithstanding imperfections, credit counseling works better than any other method in cases that fall within its domain. As noted above, the remedy may cause harm to a debtor, her creditors, or both when it is applied to a case in which it affords no clear gain to one or both of them. The credit counseling system has, however, a significant safeguard built in to prevent its misapplication. Counselors are sufficiently motivated to objectively assess the probability of a successful workout and to decline those cases where the probability seems remote. They lose credibility with the creditors and debtors they serve, and could lose their jobs, when they sponsor too many unsuccessful cases.

From the perspective of creditors, a case is not necessarily unsuccessful if the debtor fails to make full payment of his obligations under the plan. If the counseling plan recovers an amount greater than the probable recovery from any other manner of collection, the failed plan is still a relative success for creditors. As reflected earlier in the payoff matrix for the Creditor's Dilemma, the probable benefits that justify concerted action by creditors in workouts will never accurately reflect full payment of claims because no means of collection is riskless.

One has more difficulty, however, in finding benefit to a debtor in a plan that is not completed, and here critics of counselor-assisted workouts may have cause for concern. A debtor who must seek relief in bankruptcy following an unsuccessful attempt at a workout probably has not enhanced his credit rating by the failed workout. Except to the extent that the debtor values his efforts to avoid bankruptcy, he will obtain no benefit from those efforts.

Perhaps the best answer to this criticism of counselor-assisted workouts is that any opportunity entails risks that should be carefully weighed against potential benefits. The debtor makes the final decision to undertake the workout. Credit counselors in non-profit agencies have no financial or other incentive to encourage plans that are beyond the debtor's abilities. A credit counselor may be motivated to sponsor less than promising cases if his job is threatened by a declining case load, but this problem is more theoretical than real so long as counselors, like bankruptcy lawyers, are employed in a growth industry. As a counselor's job is made considerably harder by sponsoring a plan that exceeds the debtor's abilities, any deviation by the counselor from a purely objective assessment of the debtor's probability of successfully completing the plan is likely to be one that prejudices the counselor against taking the case, not one that encourages a debtor's quixotic endeavor.

C. *Some Abbreviated Ramifications of the Resolution of the Creditors' Dilemma*

From the perspective of how counselor-assisted workouts and Chapter 13 bankruptcy are often used in this country, counselor-assisted workouts serve a different purpose for a different constituency than debt adjustments in Chapter 13. Such workouts differ even more materially from the use of proceeds from the sale of nonexempt assets to make payment of creditors' claims that occurs in Chapter 7 bankruptcy proceedings.

No serious effort previously has been made to normatively evaluate consumer collection law and practice from a perspective that recognizes the emergence of counseling agencies as major participants in addressing the problems of overextension. No attempt to set the boundaries of permissible creditors' remedies and collection practices should fail to address the impact of the work of these agencies in thwarting counter-productive collection effort.

Avoiding costs to debtors that are not perceived as resulting in corresponding gains to their creditors and therefore avoiding "lost value" has long been the primary, albeit often dubious argument for banning various creditors' remedies. The principal attacks on these remedies are explored in some detail in *Games Creditors Play*. The lost-value premise has been scrutinized and found wanting in various respects by theorists, whose analyses I review in that book, but examination of the work done by credit counselors reveals an additional reason for stemming the attack on creditors' remedies. Counselor-assisted workouts block the counterproductive use of these remedies in instances in which bankruptcy is not desired or needed. Moreover, the protection afforded by the availability of credit-counseling services provides a strong impetus for reexamining laws, often longstanding ones, that generously exempt certain property from the reach of remedies that creditors could otherwise successfully employ.

Adding the credit counseling alternative to traditional means of addressing the problem of overextension in a Chapter 7 or 13 bankruptcy action gives debtors a suitable device to block counterproductive collection practices in all the various stages of overextension in which they may find themselves. They may use counselor-assisted workouts when full payment of all claims over an extended time is feasible, and one of the two forms of consumer bankruptcy when it is not. The ability of debtors to employ these procedures to block creditors' use of coercive remedies undercuts the argument of some lawmakers and commentators that banning certain of these remedies would ensure that they are not used in instances in which they are perceived as inflicting greater harm on debtors than benefit to creditors.

For debtors with the ability to make payments on their obligations who fail to do so, creditors need effective remedies to reduce the costs and increase the availability of credit and to clearly signal that Americans respect the principle of honoring commitment. Recognizing that the majority of overextensions are primarily due to non-volitional expenses or interruptions of income beyond the debtor's control does not militate against providing creditors effective remedies to use against debtors who fail to make payment when they are able to do so. Nor does enforcement of market obligations further only materialistic values. While pursuit of the frills of the marketplace may blind us to higher cultural, intellectual, and spiritual values, loss of respect for commitment to market obligation may erode these higher values as well as the fundamental tenet upon which our credit economy is based.

The argument for giving creditors more effective remedies against debtors who stonewall their collection efforts is not meant to impugn, however, the need for bankruptcy relief in the many cases of overwhelming indebtedness that arise in this country. Whether these cases result from interrupted income, non-volitional expenses, or financial mismanagement, more than loss of the impetus for future economic effort on the part of the debtor can result from the bondage of previously incurred debt. We are more than mere economic actors and need freedom from income-generating activity to pursue other aspects of our being.

In cases in which the debtor's plight is serious but not hopeless, however, the arguments in favor of bankruptcy relief must be carefully balanced with those previously made for enforcing an obligation. Doing what we promised another, even when it is difficult to do so, does more than benefit the workings of markets. A higher value is at stake. Paying market debt is one of the most common forms of honoring the timeless religious, moral, and humanistic principle of treating our neighbors as we would have our neighbor treat us. While that principle encompasses the forgiveness of debt as well as honoring it, a proper balance of these opposing aspects of the same principle requires that those whose debts are forgiven first exert good faith efforts to meet them.