Comment on: “Responsible Bankruptcy”[1]

Introduction

“Responsible Bankruptcy” is a work typical of Professor Reifner’s writing – thoughtful, wide-ranging in scope, passionate and provocative. It poses a challenge to bankruptcy law scholars and policymakers, highlighting the limitations of this institution. It makes a confronting case that “solutions” to the problem of over-indebtedness that accept unquestionably the legitimacy of creditors’ claims to full repayment of nominal debt sums may create more difficulties than benefits. Similarly problematic are approaches that treat default and bankruptcy as exceptional events outside of the market, rather than (“hidden”) aspects of market relations. Professor Reifner argues compellingly for a rethinking of the debt contract as a “productive cooperation over time”, with a consequent reimagining of how contract law and bankruptcy law should treat debt and default. This reimagining could be built upon foundational principles of responsible lending, and the sharing of the risks of a “credit society”.

This post aims to show how convincing this critique can be, by illustrating its application to the case of legal responses to the recent and ongoing household debt crisis in Ireland. This country is a particularly important example due to the particularly heavy effect the Global Financial Crisis inflicted on it, and the role that international organisations of the “Troika” (European Commission, European Central Bank, International Monetary Fund) played in developing policy responses to the ensuing household debt emergency.

“Contract law offers little for such credit arrangements”

One might have considered that the Global Financial Crisis and Great Recession, in starkly illustrating failures in (consumer) credit markets, would have marked a point when private law departs from classical legal understandings of consumer creditor-debtor relationships. These events have provoked criticisms – ranging from critical left to mainstream economics perspectives - extending beyond specific causes of crisis, to condemn the fundamental structure of our modern financialised, debt-based, economy. Such accounts question the “seeming neutrality of the legal obligation of debt”[2] and instead highlight the “brutality”[3] and “harshness”[4] of debt. Experiences over the past decade have led to increasing recognition among international organisations that key societal problems of economic stagnation, inequality and even political instability can be traced to the centrality of debt in our contemporary economy,[5] and so to the harmful effects of the structures produced by debt contracts.[6]

---

[1] Udo Reifner, ‘Responsible Bankruptcy’ in Luca Nogler and Udo Reifner (eds), *Life Time Contracts: Social Longterm Contracts in Labour, Tenancy and Consumer Credit Law* (1 edition, Eleven International Publishing 2014).

[2] Susanne Soederberg, *Debtfare States and the Poverty Industry: Money, Discipline and the Surplus Population* (Routledge 2014) 3.

[3] David Harvey, *Seventeen Contradictions and the End of Capitalism* (Profile Books, 2014).

[4] Atif Mian and Amir Sufi, *House of Debt: How They (and You) Caused the Great Recession, and How We Can Prevent It from Happening Again* (University of Chicago Press 2014).

[5] International Monetary Fund, ‘Gaining Momentum? World Economic Outlook April 2017’ (2017); Bank for International Settlements, ‘The Global Economy: Maturing Recoveries, Turning Financial Cycles?’ (BIS 2017).

[6] Atif Mian and Amir Sufi, ‘The Macroeconomic Advantages of Softening Debt Contracts’ (2017) 11 Harvard Law and Policy Review 11.

Instead of radical response to the crisis, however, "the Great Conversation that many were expecting never took place".[7] Graeber argues that both in historical and contemporary societies, States have

> "insisted on legislating around the edges, softening the impact, eliminating obvious abuses like debt slavery, using the spoils of empire to throw all sorts of extra benefits at their poorer citizens… so as to keep them more or less afloat – but all in such a way as never to allow a challenge to the principle of debt itself." [8]

In a similar manner, Professor Reifner notes that contract law offered little by way of response to the crisis. It persisted in applying the dominant logic of "spot" transactions to the long-term relationship of the credit contract,[9] while maintaining an adversarial model of contracting under which each party is authorised and expected to pursue only self-interest, without regard to her counterpart's welfare. This criticism is supported by the example of Irish courts in post-crisis contract law cases, who have persisted with contractual orthodoxy in the face of efforts of debtors (often without representation) to raise innovative defences to creditors' claims for enforcement.

In the case of *ICS Building Society v Grant*,[10] a debtor raised an objection of unfairness to a bank's claim to recover the deficiency obligation (or shortfall debt) owing after the bank had repossessed an investment property, under a mortgage contract in respect of which the debtor had defaulted. The Irish High Court considered the debtor's argument that the bank had engaged in reckless lending in advancing the loan, and that the court should take this into account either to refuse the bank's claim or to find the bank civilly liable under a tort of reckless lending. In a short judgment, the court curtly rejected this argument both as a matter of Irish common law precedent and from the perspective of legal principle. Firstly, the court noted that "the argued for tort of reckless lending does not exist in law as a civil wrong" and that it was "not within the competence of the court to invent such… a civil wrong."[11] Secondly, the court opposed lender liability for reckless lending as running contrary to existing principles of private law, based as they are on ideas of parties reaching mutually beneficial agreements through each pursuing her own self-interest. It stated that:

> "Contract law assumes that those entering into an agreement intend that it should be legally enforceable and, unless the contrary is shown, have acted in relation to each other by their mutual choice and not out of compulsion. People can enter into bad bargains. The law never enquires into the adequacy of any consideration for a contract."

The introduction of a civil wrong of reckless lending would disrupt this conception and "would tend to remove the presumption of arm's length dealing as between borrower and bank and replace it with a new relationship based on a duty of nurture that other common law countries do not see it as their duty to put into the marketplace".[12] Finally, Charleton J found it difficult to envisage lender liability for imprudent loan transactions, since the judge considered that a borrower could not escape the contribution she apparently would necessarily have made to the alleged negligence by agreeing to the loan transaction.

---

[7] D. Graeber, *Debt : The First 5,000 Years* (Melville House 2012) 381.
[8] Graeber n 6 above, 390–391.
[9] Reifner (n 1) 553.
[10] *ICS Building Society -v- Grant* [2010] IEHC 17.
[11] *ibid 6.*
[12] *ibid.*

Similar issues arose in another case where an Irish bank - which had failed, been nationalised and restructured during the crisis - sought to recover millions of Euro loaned for property development projects. Here the court considered that the lender's claim to enforce a personal guarantee was not affected by its failure to lend with "ordinary prudence", where it had taken property as security worth much less than the value of the sums advanced.[13] The court again noted that there is no recognised tort of reckless lending, that the grounds on which a contract can be overturned due to factors such as undue influence are very limited, and that "it remains universally the case that parties to a proposed contract bargain as to its terms so that each side will benefit." The court considered simply that "anyone who borrows money from a bank must pay it back" and that while the

> "decision of the bank to lend money was foolhardy, and the decision to borrow it was as bad. Once lent, money is repayable. It is this principle which establishes, unless excluded, the preservation of mutuality of obligations in contracts of loan."[14]

This strikingly orthodox view of the law's approach to lending transactions contrasts with the judge's *obiter* comments on the role of irresponsible lending in contributing to the Irish financial crisis and recession, however. Charleton J commented that the case produced extensive evidence "of the kind of heedless lending behaviour that has caused fathomless damage to the Irish economy".[15] The judge noted that activities of banks "intent on lending money without proper analysis… have caused ruination to not only those involved in imprudent transactions but also to the wider community that has been required to assume responsibility for debt on a gigantic scale". The court continued to suggest economic policy, prudential regulation and consumer credit regulation reforms that might curb reckless lending practices and the social costs they produce. Charleton J concluded in the following terms:

> **"**Finally, any attitude that a bank on considering a loan does not have to take the requirement of the borrower to repay into account is redolent of exploitation as opposed to sound commerce. It is an incorrect viewpoint. In this case, as in many others, both sides are equally to be faulted for the improvidence of their arrangements."[16]

This opinion did not influence the judge's ultimate decision, however, which followed orthodox contract law principles in holding that the creditor was entitled to a court order for the repayment of the monies it had advanced, however recklessly. This case illustrates the striking position under which courts feel obliged to apply principles of contract law that they consider openly to contribute to exploitation, "ruination… to the wider community" and "fathomless" economic damage. Professor Reifner warned of the risk that if legal rules "are not adjusted to the principles of justice, the gap between state and society will widen."[17] In these statements of Irish judges it is difficult not to see how this gap has already opened widely indeed.

As Professor Reifner notes, the judges in these cases had their hands bound by contract law doctrine and the framing of debt contracts under a "sales ideology", that "has led to the total exclusion of all legal remedies for credit and debt relationships."[18] Under normal rules of contract law, creditors are under no duty to consider whether a loan offered is in the best interests of the debtor, in the context of the debtor's social environment. The principles of

---

[13] *Irish Bank Resolution Corporation Ltd -v- Cambourne Investments Inc & Ors* [2012] IEHC 262, [44].
[14] *ibid 54.*
[15] *ibid 63.*
[16] *ibid 70.*
[17] Reifner (n 1) 563.
[18] ibid 552.

sanctity of contract and *caveat emptor* mean that creditors bear no responsibility when the loan proves unsuitable, and need not acknowledge that the true value of the loan falls below its original nominal level. This gives an absolute quality to debt claims, and enshrines an understanding of a debt as an uncompromised and "safe" asset.[19] This approach not only fails to recognise the special nature of debt contracts as long-term cooperative relationships; but gives a special status to debt claims above other legal claims. Monetary damages in other categories of claim are usually awarded based on actual losses, considering the claimant's efforts to mitigate harm suffered. Debt claims allow creditors to uphold the nominal value of the original loan, "or even to increase it through interest charges", while ignoring the fact that lending is a risky activity for both lender and borrower – a prediction by two parties as to future events.[20]

"Bankruptcy of Bankruptcy"

To a scholar of bankruptcy law, Professor Reifner's paper sometimes makes for difficult reading – a hallmark of his scholarship, which never allows us to rest on our laurels or enjoy for too long the comfort of unchallenged familiar ideas. I maintain optimistically that bankruptcy holds great potential to address problems caused by excessive debt in our contemporary era of financialised capitalism, whether these relate to economic stagnation, inequality or even political unrest. Nonetheless Professor Reifner's critique of current models of bankruptcy law is compelling, and issues a pressing reminder of the evolution needed for the law to fulfil its potential in producing positive (and progressive) public policy outcomes.

At a practical level, bankruptcy (at least in the more well developed and progressive systems) offers a more accessible and reliable source of relief to an over-indebted consumer than the alternative of litigating individual contract claims against all her creditors.[21] Professor Reifner highlights how this practical benefit comes at a price, however. To obtain discharge – and so have declared unenforceable otherwise valid contractual claims - debtors must of course access bankruptcy procedures, and the costs involved mean that some debtors will be "too poor for bankruptcy".[22] This has proven to be the case in countries such as the US[23] and UK,[24] where bankruptcy costs exclude many debtors from the relief legislation seems to make available. Contract law's primacy over bankruptcy law also means that secured debts may be untouched by bankruptcy's discharge. This position limited the ability of bankruptcy to offer relief to victims of the mortgage debt crisis, who instead were largely directed into consensual renegotiation plans of limited efficacy.[25] In a context of tightened UK household

---

[19] A point made by Mian and Sufi (n 4).

[20] This position also fails to acknowledge that the recovery of the full nominal value of a loan may not fit easily with the fact that lenders may already have protected their interests through risk-based pricing, securitisation, and the sale of loan books to debt buyers.

[21] William C Whitford, 'Ideal of Individualized Justice: Consumer Bankruptcy as Consumer Protection, and Consumer Protection in Consumer Bankruptcy, The' (1994) 68 American Bankruptcy Law Journal 397.

[22] Reifner (n 1) 557.

[23] *See e.g.* Pamela Foohey and others, 'No Money down Bankruptcy' (2016) 90 Southern California Law Review [i].

[24] *See e.g.* Iain Ramsay and Joseph Spooner, 'Submission to Insolvency Service Call for Evidence: "Insolvency Proceedings: Debt Relief Orders and the Bankruptcy Petition Limit"' (2014) <https://www.academia.edu/8703184/Joint_Submission_with_Prof_Iain_Ramsay_to_Insolvency_Service_Call_for_Evidence_Debt_Relief_Order_access_conditions_and_creditor_bankruptcy_petitions>; Joseph Spooner, 'Recalling the Public Interest in Personal Insolvency Law: A Note on Professor Fletcher's Foresight' (2015) 3 Nottingham Insolvency Business Law eJournal 537.

[25] *See e.g.* Iain Ramsay, 'Two Cheers for Europe: Austerity, Mortgage Foreclosures and Personal Insolvency Policy in the EU' in Hans W Micklitz and Irina Domurath (eds), *Consumer Debt and Social Exclusion* (2015); Patricia A McCoy, 'Barriers to Foreclosure Prevention during the Financial Crisis' (2013) 55 Arizona Law

budgets, recently borrowers have relied increasingly on secured lending even to fund purchases of essential items,[26] rendering obsolete bankruptcy's protection from seizure of such necessary assets.[27]

Professor Reifner shows how these problems stem from a hierarchical positioning of contract law above bankruptcy. While contract law governs a "normal" credit transaction and credit relationship, for Professor Reifner, bankruptcy is cast as exceptional. It is situated "outside of the normal credit relationship after it has been terminated unilaterally by the creditor", "a point of no return, at which a person is already branded by her insolvency". This makes clear that the price a debtor must pay for the benefits of bankruptcy is to affirm and accept as valid the creditor's full claim for the nominal value of the debt. Bankruptcy makes judgment neither about the validity of debts nor the appropriateness of the lender's conduct. Indeed, it treats all creditor claims as valid and merely offers exceptional relief to the debtor. While contemporary bankruptcy laws have softened their punitive aspects, entry into insolvency still generally requires a debtor's admission that she has defaulted, manifested in her acceptance of scrutiny and supervision, and her compliance with a range of substantive and procedural duties (most notably to earn income for creditors during a repayment plan). Professor Reifner argues that in this way the law places the creditor beyond reproach and "virtually canonises the creditor as the true representation of a sane economy."[28] For him, "creditors are therefore given the role of gods while debtors remain the sinners."[29]

Without challenge to the premise that creditors' claims for full repayment are legitimate, policymakers may remain reluctant to allow bankruptcy law to encroach too extensively on creditors' "rights". A logical conclusion of the reasoning is the contractualisation of bankruptcy law. In England and Wales, policymakers have been happy to stand back and observe a dramatic decline in compulsory bankruptcy cases, as debtors are diverted in large numbers into the contractual Individual Voluntary Arrangement renegotiation procedure.[30] In Ireland, the Personal Insolvency Act 2012 enacted under Troika supervision adopted primarily a model of consensual renegotiation or "market-based debt resolution".[31] This is given effect by requirements that debtors at least attempt to reach a solution via consensual restructuring arrangement procedures before becoming eligible for the statutorily-mandated automatic debt discharge of bankruptcy. [32] Again, in this case the debtor must reaffirm her indebtedness and the validity of her creditors' claims, before asking her creditors for debt forgiveness. Creditors are not obliged to accede to this request and can "veto" a debtor proposal, as confirmed by the Irish courts. When debtors challenged as unreasonable creditors' refusal to accept proposed restructurings, the Irish courts rejected these claims,

Review 723; International Monetary Fund, 'Dealing with Household Debt', *World Economic Outlook 2012* (IMF 2012) <http://www.imf.org/external/pubs/ft/weo/2012/01/pdf/c3.pdf>; Alan M White, 'Deleveraging the American Homeowner: The Failure of 2008 Voluntary Mortgage Contract Modifications' (2008) 41 Connecticut Law Review 1107.

[26] Financial Conduct Authority, 'High-Cost Credit: Including Review of the High-Cost Short-Term Credit Price Cap' (FCA Feedback Statement FS17/2, 2017); Joe Lane and Hamse Yusuf, 'Hire Purchase: Higher Prices' (Citizens Advice Bureaux 2016).

[27] *See e.g. Mikki v Duncan* [2017] EWCA Civ 57.

[28] Reifner (n 1) 555.

[29] ibid 559. Note how some commentators expressly explain consumer bankruptcy as being justified by a societal virtue of forgiveness: Heidi M Hurd, 'The Virtue of Consumer Bankruptcy' in Ralph Brubaker, Robert M Lawless and Charles J Tabb (eds), *A Debtor World: Interdisciplinary Perspectives on Debt* (OUP USA 2012); Karen Gross, *Failure and Forgiveness: Rebalancing the Bankruptcy System* (Yale University Press 1997).

[30] *See e.g.* Ramsay and Spooner (n 24).

[31] International Monetary Fund (n 25) 14.

[32] Personal Insolvency Act 2012, secs. 145–47.

using reasoning that is recognisably similar to that of the contract cases discussed above. The Irish High Court confirmed that

> "creditors of a debtor are entitled to vote to accept or to reject a proposed [restructuring arrangement]. An essential element of the scheme is that they are free to vote in favour or against as they interpret is in their best interests…. The question of the reasonableness or unreasonableness of a creditor in refusing to vote for [a proposal] is not a matter for consideration by the Court… it is expressly a matter for the creditors..."[33]

To emphasise the point, the court reiterated that a bank "is entitled to have regard to its own legitimate commercial interests in its dealings with debtors." A failure to challenge the logic of an adversarial and self-interested contract law, which allows creditors to treat as concrete the abstract value of a debt, therefore resulted in this contractual orthodoxy permeating and dominating even the exceptional institution of bankruptcy law.

Conclusions

Professor Reifner's argument can be understood from many perspectives, including a concern for an internal coherence of the legal system as well as a coherence of legal and economic thinking. It also makes a compelling case from a social justice perspective, highlighting inequality in the credit relationship and the asymmetric legal treatment of debtor and creditor. Private law and regulatory policy have generally tolerated this inequality and concealed it behind contract law's veneer of formal equality,[34] under faith that the equity-efficiency trade-off would ensure this approach guaranteed economic gains for all (with frequent emphasis on how this regulatory model might maximise access to assumedly efficient and welfare-enhancing credit markets).[35] As Professor Reifner notes, however, the legal protection of creditor rights in the expectation of welfare gains "is still a heuristic. Its application has to be justified by its economic utility. The financial crisis has called this into question."[36] Even authors and international organisations using mainstream economic ideas now highlight the harmful macroeconomic effects of debt contracts' unequal allocation of the risks of a debt-based society.[37] As debt contracts, and contract law, shift the losses of a debt crisis onto debtors and away from creditors (whose claims to the full nominal value of the debt plus interest – and often security – remain intact), a "debt overhang" problem arises as households' spending capacity declines and economic demand plummets. The necessary response to this problem is to expand debt relief through bankruptcy, but also to induce equity sharing (and so lender responsibility) into mortgage contracts. This developing view regarding the role of debt contracts in contributing to pressing economic problems shows the prescience of Professor Reifner's call for the recognition of debt contracts as a "productive cooperation over time", and a "system in which the true value of a claim emerges in the course of a credit relationship." It now falls on both contract law and bankruptcy to respond to this challenge.

Joseph Spooner

---

[33] *O'Callaghan (A Bankrupt)* [2015] IEHC 185.

[34] "The job of insolvency law is to compensate for the shortcomings of general contract law, so that the latter can maintain the fundamental fiction that every participant in the market can be prosecuted because he has unlimited access to money at any time.": Reifner (n 1) 553.

[35] *See e.g.* Iain Ramsay, 'Consumer Credit Law, Distributive Justice and the Welfare State' (1995) 15 Oxford Journal of Legal Studies 177.

[36] Reifner (n 1) 563.

[37] Mian and Sufi (n 4); Mian and Sufi (n 6).