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Debts, Disasters, and Delinquencies: A Case for Placing a Mandatory Force Majuere Provision into Consumer Credit Agreements

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DEBTS, DISASTERS, AND DELINQUENCIES:

A CASE FOR PLACING A MANDATORY *FORCE MAJEURE* PROVISION INTO CONSUMER CREDIT AGREEMENTS

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ABSTRACT

This article addresses inequities in the apportionment of losses that arise when traditional rules of consumer finance are applied to enforce payment obligations that accrue during and after catastrophes. Disasters lead inevitably to job losses, property destruction, inhibited access to homes and workplaces, and problems with debt repayment. In the wake of such devastation, fees and interest charges mount, and payment defaults increase. The author argues that hardships and social distress can be mitigated, and losses more equitably allocated, by mandating the inclusion of a force majeure provision in consumer agreements.

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I.
INTRODUCTION: THE IMPACT OF DISASTERS

If San Francisco, or Miami, or Manhattan—or any densely populated area—were rendered uninhabitable by an earthquake, a flood, or some awful weapon, how would the law of consumer finance affect recovery? The prospect that a serious catastrophe might occur is horrifying, but it is within the realm of possibility. For decades, geologists and disaster planners have been seriously concerned about a major earthquake hitting the West Coast.[1] Crippling floods and hurricanes have affected the Atlantic and Gulf Coasts with increasing severity[2] and frequency.[3] Nor can the possibility of an assault on an American city using biological, chemical, or radioactive means be dismissed lightly.[4] When a catastrophic event comes to pass, homes and apartments might not be habitable for months or even years. Businesses would close and many of them would not reopen. The impact on most aspects of everyday life would be traumatic.

An important dimension of such a calamity would be its impact on commercial life, and particularly on the welfare of consumers. A companion article explored the pervasive consumer problems and debt repayment difficulties that occurred along the Gulf Coast, and in New Orleans particularly, after Hurricane Katrina.[5] Katrina caused a state of emergency that formally lasted approximately three months but required a recovery effort that continues up to the present time, delayed by a poor

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1. *See* Fed. Emergency Mgmt. Agency, U.S. Dep't of Homeland Sec., FEMA: Earthquake Risk by State and Territory, http://www.fema.gov/hazard/ earthquake/risk.shtm (last visited Dec. 2, 2010) (listing several West Coast states as having a "very high risk" of earthquakes).

2. Kerry Emanuel, *Increasing Destructiveness of Tropical Cyclones Over the Past 30 Years*, 436 NATURE 686, 686 (2005), *available at* ftp://texmex.mit.edu/pub/emanuel/PAPERS/NATURE03906.pdf.

3. *See* Lisa Gardiner, Are Hurricanes Becoming Stronger and More Frequent? (Sept. 14, 2005), http://www.windows2universe.org/earth/climate/hurricane_ climate.html (noting that frequency of hurricanes varies based on natural twenty- to forty-year cycle and that scientists predict that we will experience more frequent hurricanes than normal through 2015).

4. *See* Elizabeth Eraker, *Cleanup After a Radiological Attack: U.S. Prepares Guidance*, NONPROLIFERATION REV., Nov. 2004, at 167 (outlining national preparations for dirty bombs and other potentially catastrophic terrorist attacks).

5. Norman I. Silber, *Thriving on Adversity: Corporate Treatment and Mistreatment of Consumers in the Wake of Hurricane Katrina*, 22 LOY. CONSUMER L. REV. 139 (2009) [hereinafter Silber, *Thriving on Adversity*].

economy and a disastrous oil spill.[6]

This article explores the contracts and debt obligations of those who would be affected in another disaster of similar or even greater magnitude and duration and suggests a reform that could ameliorate foreseeable consumer finance difficulties in a manner consistent with contemporary approaches to consumer protection. Part II considers ways in which many businesses protect themselves against catastrophic risks. Part III explains the barriers to risk insulation that consumers face because of creditor-drafted financial instruments. Part IV analyzes deficiencies in solutions that are market-based or oriented toward government relief payments. Part V offers a proposal to reapportion the burdens associated with the accumulation of consumer debt during catastrophes through a mandated *force majeure* provision.

II.
PRE-DISASTER MITIGATION OF RISK BY BUSINESS DEBTORS

Both natural and man-made disasters can cause significant economic fallout. The value of commercial real estate and government, residential, and personal property would all diminish in a major catastrophe. Financial losses would result from the destruction of tangible and intangible assets, from lost patronage, and particularly from the destruction of business properties, including repair costs and lost productivity. Insurers, banks, and other financial institutions would watch their secured loans decline in value as the financial position of their business debtors worsened and the collateral that supported their lending dropped in value. They would also watch their unsecured business debts lose value as the revenue streams flowing from borrowers become disrupted, causing borrowers to miss payment deadlines and eventually to default.[7]

In this setting, commercial creditors are motivated to enforce their contractual rights as vigorously as possible against commercial debtors—to recover from them the full value of all payments due plus interest accrued

6. *See, e.g.*, Amy Liu & Nigel Holmes, *The State of New Orleans*, N.Y. TIMES, Aug. 28, 2010, at WK10 ("Two years [after Katrina], the Great Recession arrived, drying up private capital for redevelopment and blunting the job gains that had been expected from rebuilding. Then, in April [2010], the Deepwater Horizon oil rig exploded, wreaking havoc on the region's already battered economy and environment.").

7. Major loans to businesses are generally secured—i.e., they are conditioned on the lender's receipt of collateral, or guarantees worth more than the indebtedness. In the event of a default on the law, the creditor has the right to take ownership of the collateral. To the extent that collateral diminishes in value because of a catastrophe, a secured creditor may no longer be able to recover the value of the loan should the borrower default. Consumer credit debt is generally either unsecured, like most credit card debt, or secured by the very consumer goods that are likely to deteriorate or disappear in a catastrophe. *See generally* BARKLEY CLARK & BARBARA CLARK, THE LAW OF SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE (rev. ed. 1999) (outlining law of financial transactions).

during any delay—plus late fees, attorneys' collection fees, and other charges. They will issue demands for payment to all their potentially accountable commercial debtors who entered into business debt agreements before the disaster. Commercial creditors are also likely to file claims against insolvent commercial parties in bankruptcy proceedings.

Commercial debtors, however, can and do protect themselves against the risk of disasters in a number of ways, including through the purchase of insurance against liability for breaches of their own payment obligations that result from events beyond their control. These policies indemnify them against losses arising from their inability to continue the normal operations and functions of a business and provide sums which allow them to make installment payments on their own debt instruments.[8] One survey found that about a quarter of American businesses carry conventional "business interruption" insurance protection, attached to commercial property insurance policies.[9] At least fifteen major insurance companies offer "Property Terrorism Insurance" coverage designed to protect major corporations against all types of terrorist events.[10]

Commercial debtors and tenants are able to spread the risk that a catastrophe will prevent repayment of a debt through the insertion of mutually protective clauses and waivers of subrogation in loan and lease agreements.[11] For instance, an increasing number of business loan and

8. *See* RICK L. HAMMOND, UNDERLYING PRINCIPLES OF BUSINESS INTERRUPTION INSURANCE (1999), http://library.findlaw.com/1999/Jun/1/127909 .html ("Business interruption insurance is designed to protect the prospective earnings of the insured business. It is also designed to do for the insured, in the event of a loss, what the business would have done for itself if an interruption in the operation of the business had not occurred."). *See also* DANIEL T. TORPEY, DANIEL G. LENTZ & DAVID A. BARRETT, THE BUSINESS INTERRUPTION BOOK: COVERAGE, CLAIMS, AND RECOVERY 21–41 (2004) (discussing common elements of coverage in standard business insurance policies).

9. Steven Lobel, *Business Interruption Insurance Can Protect Prospective Earnings*, ALBANY BUS. REV., Dec. 3, 2001, http://www.amer-tech.com/articles1-90/BusinessInterruptionInsuranceCanProtectProspective Earnings.

10. *See* MARSH, MERCER, KROLL, MARKETWATCH: TERRORISM INSURANCE 2009: THE STANDALONE TERRORISM MARKET (2009), *available at* http://global.marsh.com/documents/Marketwatch_Standalone_Terrorism_Market_Q1_2009 .pdf (indicating that a theoretical maximum of approximately three billion dollars in such insurance is available as of 2009). *See also* Terrorism Risk Insurance Act of 2002 § 103, Pub. L. No. 107-297, 116 Stat. 2322 (codified in scattered sections of 12, 15, 28 U.S.C.) (prohibiting exclusion of terrorism risks in commercial property and casualty policies, and authorizing program under which government shares risk of loss from future terrorist acts). *See generally* AIG, Property Terrorism, http://www.aig.com/Comm-Property-Terrorism-and-Sabotage_262_ 151870.html (last visited Dec. 2, 2010) (marketing property insurance for damages resulting from acts of terrorism).

11. Commercial lessors regularly include mutually protective clauses, mutual waivers of subrogation (by which the parties renounce claims against each other for insured or insurable damage to the property of the party who waives), and clauses requiring landlords to carry insurance against floods, earthquakes, and other catastrophes. *See* Sidney G. Saltz, *Allocation of Insurable Risks in Commercial Leases*, 37 REAL PROP. PROB. & TR. J. 479, 481 (2002) (noting that commercial leases customarily include numerous provisions seeking

lease agreements contain mutual "*force majeure*" clauses, which suspend a commercial debtor's payment obligations when "Acts of God" interfere with performance and reduce or entirely excuse debtors' and creditors' responsibilities during a catastrophic event, and for a period thereafter.[12]

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to allocate, as between the parties, risks of injury to persons or damage to property and require insurance to cover these risks). Recommended standard terms place the burden of insurance against catastrophes on lessors. Thus a sample lease term regarding insurance reads:

> Landlord's Insurance. Landlord shall procure and maintain policies of insurance insuring:
>
> . . . .
>
> (b) The improvements at any time situated upon the Real Estate against loss or damage by fire, lightning, wind storm, hail storm, aircraft, vehicles, smoke, explosion, riot or civil commotion as provided by the Standard Fire and Extended Coverage Policy and all other risks of direct physical loss as insured against under Special Form ("all risk" coverage). The insurance coverage shall be for not less than ninety percent (90%) of the full replacement cost of such improvements with agreed amount endorsement. Landlord shall be named as the insured and all proceeds of insurance shall be payable to Landlord. Said insurance shall contain an endorsement waiving the insurer's right of subrogation against any Tenant Protected Party, provided that such waiver of the right of subrogation shall not be operative in any case where the effect thereof is to invalidate such insurance coverage or increase the cost thereof. Landlord shall promptly give Tenant written notice thereof and Tenant shall have the right, within thirty (30) days following such written notice, to pay any increased cost, thereby keeping such waiver in full force and effect.
>
> (c) Landlord's business income, protecting Landlord from loss of rents and other charges during the period while the Leased Premises are untenantable due to fire or other casualty (for the period reasonably determined by Landlord).
>
> (d) Flood or earthquake insurance whenever, in the reasonable judgment of Landlord, such protection is necessary and it is available at commercially reasonable cost.

Id. at 502. In other areas of commercial debtor-creditor relations common forms also include such terms. *See, e.g.,* Internet Legal Research Group, New York Commercial Lease Agreement, http://www.ilrg.com/forms/lease-comm/us/ny (last visited Dec. 2, 2010) (providing a standard commercial lease form that includes clause relieving tenant from payment of rent and other charges during any portion of term that leased premises cannot be used for tenant's purposes or are unfit for occupancy). Because they presume relatively level bargaining power and at least the availability of representation, commercial leases often provide an option to excuse performance in the event that *either* party experiences an unforeseeable calamity.

12. Characteristic *force majeure* clauses in a commercial agreement contain such language as:

> Neither party shall be liable in damages or have the right to terminate this agreement for any delay or default in performing hereunder if such delay or default is caused by conditions beyond its control including but

And when all else fails, bankruptcy laws permit for-profit corporations the alternative of modifying, extending, and discharging unsecured and under-secured debts through a corporate liquidation or reorganization.[13] Bankruptcy is generally unfortunate for shareholders, managers, and employees, but it is effective for limiting creditor recoveries.

III.
CONSUMER VULNERABILITY TO THE EXTERNALIZATION OF CREDITOR RISK

Consumer debtors are situated quite differently from business debtors. They confront a different insurance market, and they have different incentives to purchase policies. As an initial matter of contractual risk allocation, consumers have scant ability to reshape standard forms of legal agreement. And, as a matter of judicial recourse, they confront a litigation climate in which courts uphold traditional views of contracting by enforcing standard form provisions that reject consumer defenses based on excuse.

While business debtors can readily insure against business operation losses from catastrophic risk, it is difficult for consumers to protect against their own loss of income or necessary delays in debt repayment. Except

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> not limited to acts of God, government restrictions (including the denial or cancellation of any export of other necessary license), wars, insurrections and/or any other cause beyond the reasonable control of the party whose performance is affected (including mechanical, electronic, or communications failure).

Or:

> Neither party shall be liable for any failure or delay in performance under this Agreement ([other than for][including a] delay in the payment of money due and payable hereunder) to the extent said failures or delays are proximately caused (I) by causes beyond that party's reasonable control and occurring without its fault or negligence, including, without limitation, failure of suppliers, subcontractors, and carriers, or party to substantially meet its performance obligations under this Agreement, provided that, as a condition to the claim of no liability, the party experiencing the difficulty shall give the other prompt written notice, with full details following the occurrence of the cause relied upon. Dates by which performance obligations are scheduled to be met will be extended for a period of time equal to the time lost due to any delay so caused.

AllBusiness.com, What is a Force Majeure Clause?, http://www.allbusiness.com/legal/contracts-agreements/541-1.html (last visited Dec. 2, 2010). The *force majeure* clauses in commercial agreements typically apply to natural disasters, riots, and wars, as well as third party performance failures outside the contracting parties' control. *See, e.g.*, Licensing Digital Information, Force Majeure, http://www.library.yale.edu/~llicense/forcecls.shtml (last visited Dec. 2, 2010) (listing sample *force majeure* clauses in commercial contracts).

13. *See* Elizabeth Warren & Jay Lawrence Westbrook, *Financial Characteristics of Businesses in Bankruptcy*, 73 AM. BANKR. L.J. 499, 558 (1999) (noting that some businesses reported that hurricanes pushed them into bankruptcy).

for some umbrella policies or those with special riders, homeowners' insurance policies and automobile insurance policies protect against property destruction but do not provide credit insurance to cover employment interruption.[14] Several other types of disaster risk—such as moving of earth, floods, war and insurrection, and terrorism—are frequently excluded from homeowners' policies.[15]

Consumer credit insurance, debt cancellation agreements, and credit-related insurance products—which could provide some relief to consumers unable to meet their obligations due to illness, unemployment, disability or death—have proven inadequate to these tasks.[16] Insurance to cover a mortgage or credit card debt against loss of life, sickness, or certain types of involuntary unemployment, is always sold for a specific loan, and not always for the full length of the loan or the full loan amount.[17]

14. *See, e.g.*, Texas Department of Insurance, Homeowners Insurance, http://www.tdi.state.tx.us/pubs/consumer/cb025.html (last visited Dec. 2, 2010) (noting that most homeowners' insurance covers "damage or destruction to your house and any unattached structures and buildings, such as fences, detached garages, and storage sheds . . . theft, damage, or destruction of the contents of your house, including furniture, clothing, and appliances . . . financial loss if you are sued and found legally responsible for someone else's injury or property damage . . . medical bills for people hurt on your property . . . [and] additional living expenses (temporary housing, food, and other essential expenses) if you must temporarily move while repairs are made").

15. *See, e.g.*, *id.* (noting that most Texas polices do not cover flooding and earthquakes, among other things).

16. Credit insurance is extremely profitable for creditors because creditors are compensated by the insurers whose credit insurance products they sell, are the primary beneficiaries of the policies they sell, and charge interest on the insurance premiums which are due from their borrowers. ELIZABETH RENUART, KATHLEEN E. KEEST, CAROLYN L. CARTER, ALYS I. COHEN & CHI CHI WU, NAT'L CONSUMER LAW CTR., THE COST OF CREDIT: REGULATION, PREEMPTION, AND INDUSTRY ABUSES § 8.2.2 (3d ed. 2005) [hereinafter THE COST OF CREDIT]. By contrast, credit insurance offers few benefits to consumers. *See id.* at § 8.1 (describing how insufficient regulation and market competition have led to systemic failures in credit insurance market, leading to "annual overcharges of $2.5 billion" and creation of market in which "consumers spend as much as $6 billion per year on credit insurance, often with little understanding of what they have bought."); ELIZABETH RENUART, KATHLEEN KEEST, CAROLYN L. CARTER, CHI CHI WU, ALYS I. COHEN, DIANE THOMPSON & JOHNATHAN SHELDON, NAT'L CONSUMER LAW CTR., TRUTH IN LENDING § 3.9.4.1 (6th ed. 2007) (noting that credit insurance is more expensive than comparable coverage sold outside of credit context and "that the borrower's chance of collecting on a policy may be smaller than one would expect"). *But see* Consumer Credit Insurance Association, Consumer Information: What is Credit Insurance?, http://www.cciaonline.com/consumers.nsf/default.htm (last visited Dec. 2, 2010) (providing favorable description of products from the perspective of credit insurance industry association).

17. *E.g.*, New York State Insurance Department, Life Insurance - Top Ten Questions: Credit Insurance, http://www.ins.state.ny.us/que_top10/que_life_cre.htm (last visited Dec. 2, 2010). To illustrate how credit life insurance works, the Oregon Insurance Division offers the following example:

> A 30-year-old woman in good health is taking out a $5,000, five-year loan. She can buy credit life insurance for the five-year life of the loan, paying a single premium of $112.50, to be added to her total loan amount. If she

Furthermore, credit card insurance policies can include unexpected exclusions and proof requirements.[18] Major actors in the private market for consumer credit insurance have historically engaged in predatory and unscrupulous practices and have charged excessive rates,[19] leading many financial advisers to discourage its use.[20]

Even if the credit insurance market operated with greater transparency and fairness, credit insurance probably would appear worth purchasing only for a subset of persons with means, good credit, and a high fear of future misfortune. For poorer consumers, the cost of insuring against a distant, low probability risk may appear to be an indulgence compared to present need for consumption.[21]

> dies, the insurance will cover only the outstanding balance of the loan. Life insurance, however, pays the entire amount of the policy value. If she already has an individual term life insurance policy for $50,000 and increases it by $5,000, the additional cost would total less than $15 for the five-year loan period. If she buys a new term life insurance policy, the cost will be about $500 for five years of coverage.

Oregon Insurance Division, Wise Choices - Oregon Credit Insurance, http://insurance.oregon.gov/consumer/credit-insurance/wccred.html (last visited Dec. 2, 2010).

18. *See, e.g.*, Marshall v. Citicorp Mortgage, 601 So. 2d 669, 671–72 (La. Ct. App. 1992) (holding that ten-year decreasing term credit life insurance policy on fifteen-year loan, in which contract failed to disclose that "insurance proceeds . . . would drop to 'zero' in 10 years" regardless of the balance of the debt at that time, was unconscionable and violated Unfair Trade Practices law); Tomaszewski v. McKeon Ford, Inc., 573 A.2d 501 (N.J. Super. Ct. App. Div. 1990) (describing instance in which car dealer selling credit life insurance neglected to tell buyer that credit life insurance plan excluded her spouse); Kermit Card v. Chase Manhattan Bank, 669 N.Y.S.2d 117 (N.Y. Civ. Ct. 1996) (holding that defendants' deceptive solicitation of credit card did not disclose standards for unemployment claim or third party status of solicitor).

19. THE COST OF CREDIT, *supra* note 16, at § 8.5.1 (noting that credit insurance sales can be a pretext for usury and that "overpricing [and] a variety of abusive marketing practices . . . are all too common in connection with credit and ancillary non-credit insurance sales"). *See also* Julia Patterson Forrester, *Still Mortgaging the American Dream*, 74 U. CIN. L. REV. 1303, 1303–5 (2006) (describing nine hundred million dollar credit insurance fraud perpetrated by Citigroup and others); Christopher Peterson, *Federalism and Predatory Lending, Unmasking the Deregulatory Agenda*, 78 TEMP. L. REV. 1, 22 (2005) (noting that "predatory lenders tend to use the product as an opportunity to gouge unsuspecting consumers by packing unreasonable amounts of insurance in their loans").

20. *E.g.* THE COST OF CREDIT, *supra* note 16, at § 8.1 (noting that "for many years advisors outside the credit industry have recommended that most consumers do not purchase" credit insurance). *See also, e.g.*, Gene Marsh, *A Practitioner's Guide to the New Alabama Mini-Code*, 48 ALA. L. REV. 957, 989 (1997) (stating that consumer credit insurance "is generally a bad bargain by any measure"); Peterson, *supra* note 19, at 22 (noting that "consumer investments in credit insurance tend to have poor value). *But see* Maurice L. Shevin, *Pro Consumer Finance*, 58 ALA. LAW. 230, 233 (1997) (arguing that "credit insurance is a valuable product to assist those who borrow with the intent to repay their debts, but are set back by disability, unemployment and even death. . . . The premium on such insurances is not pure profit. There is a real risk which is insured, and insurance claims are paid each and every day on behalf of customers who have covered losses.").

21. The extent to which debtors try to protect themselves in the present by putting away savings against disruptive "shocks" that might occur in the future, and their

Furthermore, in distinction from business debtors, it is exceptional for consumers to negotiate out of catastrophic risk by contracting in advance through express agreement. The standard language contained in consumer debt agreements does not include any provision to relieve consumers of their payment obligations in the wake of a disaster.[22] Consumers are almost always incapable of inserting nonstandard provisions or exculpatory, self-protective language into standard installment sales and lease agreements.[23] They have little ability to insist upon sharing, reducing, or shedding their payment obligations when acts beyond their control make debt repayment impossible.

Upon default, courts will enforce payment terms in standard agreements because American contract law leaves little ground for consumers to challenge such charges. Notwithstanding a lack of mutuality in the risk allocation, contract terms defining strict default rules are presumptively enforceable.[24] The presumption is justified based on the

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motivations, is a contested matter in the law and economics literature. *See, e.g.*, M. Keith Chen & Alan Schwartz, *Intertemporal Choice and Legal Constraints*, 53 J.L. & ECON. (forthcoming 2010) (on file with author) (using game theory to demonstrate that consumer borrowing regulations and current savings instruments are inadequate to optimize protection against income shocks). Whether non-savers (non-insurers) have adequate information and cognitive ability to calculate the risk of misfortunes such as their own unemployment or ill health, or even communal catastrophes, is doubtful. Oren Bar-Gill, *The Behavioral Economics of Consumer Contracts*, 92 MINN. L. REV. 749, 754–65 (2008) [hereinafter Bar-Gill, *Behavioral Economics*] (presenting evidence of persistence of consumer mistakes). *See also infra* Part IV. *But see* Richard Epstein, *Symposium: Homo Economicus, Homo Myopicus, and the Law and Economics of Consumer Choice: Human Errors and Market Corrections*, 73 U. CHI. L. REV. 111, 111–13 (2006) (acknowledging existence of cognitive biases but arguing that these do not impair rational decisionmaking if rational decisionmaking is defined as consciously seeking to make oneself better off).

22. *See, e.g., infra* notes 36, 44, and 45 for examples of standard form provisions for payment contained in VISA card and other agreements.

23. Silber, *Thriving on Adversity*, *supra* note 5, at 140 (describing inequities in consumer-creditor bargaining power).

24. *See* Michael I. Meyerson, *The Efficient Consumer Form Contract: Law and Economics Meets the Real World*, 24 GA. L. REV 583, 594–96 (1990) (defining consumer form contracts and discussing their presumptive enforceability). *See also, e.g.*, McFarland v. Citibank (S.D.), N.A., 293 S.W.3d 759, 763 (Tex. App. 2009) (holding that, based on consumer's usage of credit card and language in agreement, reasonable inference may be drawn that consumer impliedly agreed to pay fixed amount equal to purchases and cash advances he made, plus interest); Winchek v. Amer. Express Travel Related Servs. Co., 232 S.W.3d 197, 204 (Tex. App. 2007) (holding that user of a credit card agrees to be responsible for interest and late fees).

When debts are purchased by aggregators, furthermore, courts will often convert accumulated late fees and charges into a new principal amount in the hands of the debt purchasers. *See* Lorraine Nordland, Presentation at the Protecting Consumers in Debt Collection Litigation and Arbitration: A Roundtable Discussion (Sept. 29–30, 2009), http://www.ftc.gov/os/comments/ debtcollectroundtable2/091119outline.pdf ("[P]urchased-debt default matters have run into very few impediments in the district courts, and the debt purchasers have come to see it as a matter of right that they be allowed to prevail in a default situation, even though they have no supporting evidence of any contractual

formal consent given by debtors and by the economic value standard forms are said to provide to consumers in the form of cost savings from transactional efficiency and lower prices.[25]

Governing Restatement and Uniform Commercial Code (U.C.C.) provisions reflect this classical economic perspective about form contracts. The Restatement (Second) of Contracts contains a test for the enforceability of a term in a standard agreement which directs that a term is not an enforceable part of the contract "where the other party has reason to believe that the party manifesting such assent would not do so if he knew that the writing contained a particular term."[26] The U.C.C. does not have a provision that directly addresses the enforceability of adhesive and unbargained-for terms that are not unconscionable. While the unconditional nature of payment terms might appear to be pernicious from a subsequently affected consumer's point of view, it is considered an effective, legitimate method for risk allocation in our competitive, efficiency-driven market economy.[27]

The judicial response to the enforcement of debtor obligations after

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agreement. Moreover, there seems to be a universal misunderstanding by the assignee debt-purchasers that the charge-off amount is THEIR balance, and therefore all they have to do is prove that this was the balance at the time they bought the debt.").

25. The supposition is that these prices are lower than consumers might have to pay if they did *not* assume responsibility for interest and installment payments that accrue during events beyond their control, or if they had to negotiate these terms individually. *See* Meyerson, *supra* note 24, at 587–88 (noting that "'[s]o-called default terms' or 'gap fillers' reduce the complexity and cost of contract negotiation" and that these terms are presumed to be economically efficient).

26. RESTATEMENT (SECOND) OF CONTRACTS § 211(3) (1981) ("Where the other party has reason to believe that the party manifesting such assent would not do so if he knew that the writing contained a particular term, the term is not part of the agreement.").

27. Commentators agree that standard form contracts have social utility. They facilitate mass marketing of goods and services by creating one-size-fits-all contracts, the cost of which can be amortized over numerous transactions. They also permit sellers to monitor a substantial sales force more readily by avoiding variations in contract terms. Additionally, standard form contracts standardize terms in ways that facilitate interpretation both by parties to the contract and by third-party interpreters. This minimizes transactions costs, resulting in net benefits to consumers, reflected in the lower price of mass-marketed goods. Robert A. Hillman, *Rolling Contracts,* 71 FORDHAM L. REV. 743, 747 (2002) (arguing that standard form contracts are generally enforceable and efficient because sellers "pass along savings [from lower bargaining costs, reduced contract litigation, and standardized risks] to consumers in the form of lower prices. Moreover, sellers can best determine the particular set of terms that 'fits' the practical problems and needs that arise . . . in carrying out the transactions, and therefore, produce the most efficient allocation of risks for both parties." (internal citations and quotations omitted)); Clayton P. Gillette, *Rolling Contracts as an Agency Problem,* 2004 WIS. L. REV. 679, 680–81 (2004). This economic perspective is shared by contracts scholars and courts. *See, e.g.,* David Horton, *Unconscionability in the Law of Trusts,* 84 NOTRE DAME L. REV. 1675, 1690 (2009) (using law and economics framework to argue that sellers in all circumstances will offer terms in standard form contracts that increase buyers' welfare and, as such, that such contracts are efficient and should be enforced by courts "as written, no matter how 'unfair' [they] seem[. . .]").

Hurricane Katrina was grounded in traditional approaches.[28] Some creditors warned storm victims immediately after the hurricane that, although they might defer payments during the emergency, interest charges attributable to the postponements would certainly be collected.[29] Nothing in the reported case law suggests that the catastrophe led courts to reduce the interest amount creditors could claim when obtaining a judgment. Classical assumptions about the enforcement of standard form consumer contracts held firm, despite growing doubts about the validity of classical assumptions underpinning the enforcement of terms in, *inter alia*, consumer contracts.[30]

Put another way, the occasion of a catastrophic event will increase the number of injured persons and the size of each debt, but it does not generally lead courts to doubt the ex ante reasonableness—and therefore the enforceability—of the terms of the payment obligation. Whether it is a hurricane, whose incidence might be factored by a debtor at the time of contracting and might lead the debtor to wish for a change in the boilerplate term if it were possible, or the proverbial meteor from Outer Space, whose potential incidence would never enter a debtor's calculation of default risk, the problem for the unfortunate consumer is similar. In both cases, multitudes have taken upon themselves responsibility for failure to pay for any reason, presumably for a better price than they otherwise would pay. This reinforces the position that the terms are enforceable under the Restatement standard. Absent unusual facts (did the meteor also destroy all records of the transaction, perhaps?), it disqualifies any particular debtor for an adjustment of terms under a classical treatment of the standards for excusing performance.[31]

28. *See, e.g., In re* Katrina Canal Breaches Litig., 495 F.3d 191, 208–21 (5th Cir. 2007) (reversing lower court decision finding that contract term "flood" is ambiguous and holding that flood exclusion in insurance contract barred recovery for damages caused by flooding from breached levees during Hurricane Katrina); Tuepker v. State Farm Fire & Cas. Co., 507 F.3d 346, 352–53 (5th Cir. 2007) (holding that exclusion in insurance contract that prevented recover for water damage, "include[ing] damages caused by, among other things, flood, waves, tidal water, and overflow of a body of water, 'all whether driven by wind or not,'" prevented recovery for damage by storm surge during Hurricane Katrina); A. Brooke Overby, *Mortgage Foreclosure In Post-Katrina New Orleans*, 48 B.C. L. REV. 851, 867 (2008) (noting that, while Mississippi instituted moratorium on foreclosures following Hurricane Katrina, "in Louisiana creditors retained all rights that they had before the storm and . . . in the case of default could easily and quickly seek foreclosure on the debtor's property either through ordinary or executory proceedings").

29. *See* Silber, *Thriving on Adversity*, *supra* note 5, at 147, 170 (noting that creditors did not forgive outstanding interest on debts and that "[i]n most of the cases studied . . . even if late charges were waived and payment obligations were suspended . . . interest charges on pre-existing balances nevertheless continued to accrue").

30. *See, e.g.,* discussion *infra* Part IV(A).

31. Section 2-302, the U.C.C.'s unconscionability provision, allows a court to provide relief if the court finds the term to have been "unconscionable at the time it was made." U.C.C. § 2-302(1) (2001). Courts will not hold credit card agreements unconscionable

In the absence of greater protection, consumers will remain uniquely vulnerable to the economic impacts of disasters. In future catastrophes, creditors will argue that their contractual rights permit them to continue to demand adherence to the strict legal terms of their obligations.[32] They will invoke payment terms permitting them to continue to collect base service fees, even though the actual use of those services is impossible.[33] They will invoke the payment schedules and calculation rules contained in credit cardholder and sales agreements that permit them to charge compound interest on pre-catastrophe balances and to continue to charge interest during extended periods of the catastrophe itself.[34] Consumers and their advocates will find that penalty and late fee provisions, detailed security

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because of unequal bargaining power. *See, e.g.*, Albank, FSB v. Foland, 676 N.Y.S.2d 461, 462–63 (N.Y. City. Ct. 1998). Numerous courts have held that contracts remain enforceable even when unforeseen weather-related events prevent one party from benefiting from the original contract. *See* Louis Dreyfus Corp. v. Brown, 709 F.2d 898, 899 n.2 (5th Cir. 1983) (noting that defendant conceded that bad weather did not excuse failure of commercial party to perform contract, citing *Ralston Purina Co. v. Rooker*, 346 So. 2d 901 (Miss. 1977)); Meek v. Cunha, 96 P. 107, 107 (Cal. Ct. App. 1908) (holding that lessee unable to grow crops due to massive flooding was not entitled to apportionment of rent).

Impracticability may also offer consumers a defense to performance. Section 261 of the Restatement (Second) of Contracts permits the discharge of the obligation to perform where, "after a contract is made, a party's performance is made impracticable without his fault by the occurrence of an event the nonoccurrence of which was a basic assumption on which the contract was made . . . unless the language or circumstances indicate the contrary." RESTATEMENT (SECOND) OF CONTRACTS § 261 (1981). However, it is harder to demonstrate the impracticality of performance by money payments (which are fungible and easy to transfer), as compared to performance by delivery of goods (which are often perishable, fragile, and subject to the vicissitudes of transportation). *See* RESTATEMENT (SECOND) OF CONTRACTS § 263 (stating that "[i]f the existence of a specific thing is necessary for the performance of a duty, its . . . destruction . . . as makes performance impracticable is an event the non-occurrence of which was a basic assumption on which the contract was made," thus discharging the debtor's responsibility). *See generally* Sheldon W. Halpern, *Application of the Doctrine of Commercial Impracticability: Searching for "The Wisdom of Solomon,"* 135 U. PA. L. REV. 1123, 1131–1154 (1987) (tracing the doctrine's emphasis on physical difficulty of performance). Consumers thus may have difficulty resorting to this provision. At the same time, the parties "may, by appropriate language, agree to perform in spite of impracticability that would otherwise justify . . . nonperformance" and "factors such as the practical difficulty of reaching agreement on the myriad of conceivable terms of a complex agreement may excuse a failure to deal with improbable contingencies." RESTATEMENT (SECOND) OF CONTRACTS § 261, cmt. c. U.C.C. Section 2-615(a) similarly excuses the seller for the failure to deliver goods when the delivery is made "impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made," U.C.C. § 2-615(a) (2001), but does not excuse non-performance "when the contingency in question is sufficiently foreshadowed at the time of contracting," *id.* at cmt. 8.

32. *See generally* Silber, *Thriving on Adversity*, *supra* note 5 (explaining imbalance in creditor-consumer relations in aftermath of Hurricane Katrina).

33. *See id.* at 140 (explaining with documentation that consumers were bound to their payment obligations for goods, services, and property even when inaccessible or unusable in the aftermath of Katrina disaster).

34. *Id.*

provisions, comprehensive definitions of "default," and specific terms for payment are fairly impregnable.[35] Such agreements rarely allow debtors to postpone payments, much less forgive interest or principal.[36] In their defense, consumers will try to argue that standard form consumer contracts, either by implication or via the invocation of equitable doctrines, should compel creditors either to excuse performance or to reform contracts in light of unforeseen circumstances. Such arguments will require costly litigation—and, if precedent is observed, will generally be unsuccessful.[37]

Victims of future disasters will find, as did the majority of victims of Katrina, that lenders are permitted to invoke default clauses and payment obligations contained in open-end[38] and closed-end[39] credit agreements and can insist on timely payments of principal and interest—regardless of

35. *Id.*

36. A representative credit agreement with VISA reads:

> Default. You will be in default if you fail to make any Minimum Payment when due. You will also be in default if (a) your ability to repay us is materially reduced by a change in your employment, an increase in your obligations, bankruptcy or insolvency proceedings involving you, your death or your failure to abide by this Agreement, (b) you break any promise you have made to us under this Agreement or any other agreement you have with us, (c) any statement you have made in this agreement, in connection with this Agreement, or in connection with any other agreement you have with us is not true, or (d) we should otherwise feel insecure in receiving payment of the Account balance for whatever reason. If you are in default, we have the right to demand immediate payment of your full Account Balance at once without notice to you. In the event of a default, you agree to pay all costs of collecting the amount you owe under this agreement including, if the unpaid balance under this plan is greater than Three Hundred Dollars ($300.00) at the time of collection, reasonable attorney's fees if the debt is referred for collection to any attorney who is not our employee and if suit be filed, court costs.

Visa, Credit Card Application and Line of Credit Agreement, http://www.usouthal.edu/usafedcu/creditcardapplication.pdf (last visited Dec. 2, 2010).

37. *See supra* note 24 and accompanying text. My research has not revealed any case discussion of a debtor's challenge to the application of interest charges during the period following a natural disaster.

38. The Federal Reserve's Truth in Lending Regulations define open-end credit as:

> consumer credit extended by a creditor under a plan in which: (i) The creditor reasonably contemplates repeated transactions; (ii) The creditor may impose a finance charge from time to time on an outstanding unpaid balance; and (iii) The amount of credit that may be extended to the consumer during the term of the plan (up to any limit set by the creditor) is generally made available to the extent that any outstanding balance is repaid.

12 C.F.R. § 226.2(a)(20) (2009). Credit cards, among other revolving lines of credit, are open-end. *See* 12 C.F.R. § 226.5 (2009).

39. Promissory notes, among other fixed term obligations, are closed end. *See* 12 C.F.R. § 226.2(a)(10) (2009) (defining closed-end credit as "consumer credit other than open-end credit").

the existence of an emergency or the uninhabitability of residences and places of employment.[40] Lenders will, if necessary, invoke merger and parol evidence doctrines to exclude any evidence supporting their willingness to share responsibility for interest or principal payments that come due while a state of emergency persists. Acceleration clauses[41] will be invoked to demand payment in full of entire loan obligations in the event a single condition of default is established.[42]

Mortgagees (banks and other financial institutions) can insist on the right to collect principal and interest on their home mortgage payments in accordance with mortgage agreements. Banks and secured credit card lenders will likely invoke the right to take possession of collateral or insurance proceeds offered in support of home equity loan agreements.[43] Finance companies can foreclose on valuable collateral, including bank

40. *See* Silber, *Thriving on Adversity*, *supra* note 5, at 182 (describing how, post-Katrina, "[companies] took advantage of the standard form contractual provisions in their customer agreements which consumers did not actually bargain for in the first place . . . to shift losses from their shareholders and management onto their customer base").

41. *See* U.C.C. § 1-309 (2001) (describing contract terms which provide that "one party or that party's successor in interest may accelerate payment or performance or require collateral or additional collateral 'at will' or when the party 'deems itself insecure'").

42. A characteristic acceleration clause reads: "In the event of default in the payment of any of the said installments or said interest when due as herein provided, time being of the essence hereof, the holder of this note may, without notice or demand, declare the entire principal sum then unpaid immediately due and payable." Quazell.com, Promissory Note - Installment - With Acceleration Clause, http://www.quazell.com/BusinessLetters/ltrpromnot3.html (last visited Dec. 2, 2010). *See, e.g,.* Supreme Realty, Inc. v. Wurzel, 636 P.2d 1327, 1329 (Colo. Ct. App. 1981) (finding promissory note acceleration clause premised upon default in payment valid and enforceable); Smith v. Certified Realty Corp., 585 P.2d 293, 294 (Colo. Ct. App. 1978) (finding promissory note acceleration clause premised upon default in payment valid and enforceable); Dumas v. Helm, 166 N.W.2d 306, 308 (Mich. Ct. App. 1968) (finding acceleration clause of land contract valid and enforceable since "acceleration clauses, even when harsh, are enforceable").

43. The security language in a representative home equity loan agreement and promissory note provides:

> To secure payment of all amounts owed on your home equity loan, you must give us security interest in the real property described in the Multiple Indebtedness Mortgage that you sign at the time of the loan settlement. You also must assign us (a) any rents or profits form the property, (b) any proceeds of the insurance you must obtain . . . . and (c) any proceeds of any condemnation award, or sale in lieu of condemnation, for such property. You also pledge and grant to us a security interest in, and a right of set-off against, all monies and other property of yours that is on deposit with us or under our control. We have the right, but are not required to take such action as is necessary to protect the security interest described in this paragraph. Any amounts we may pay in exercising our right to protect our security interests must be paid by you on demand, and will bear interest at the Annual Percentage Rate than applicable to your account until paid.

Home Equity Line of Credit Loan Agreement and Promissory Note, http://ig.libertyonline.net/ImageGallery/Custom/cu0439/PDFs/heloc_loanagreement.pdf (last visited Dec. 2, 2010).

deposit accounts and realizable and accessible personal property.[44]

Landlords likewise enjoy protections included in rental apartment lease agreements. If tenants assert the putative obligations of landlords to adjust debt obligations during a state of emergency due to the impossibility or impracticality of living in a dwelling,[45] landlords can usually insist on their right to collect principal and interest on both rents due and back rent, notwithstanding the nonhabitability of their rental properties. They generally will be successful.[46]

Automobile finance lenders can assert their right to collect loan payments, together with all interest payments, notwithstanding the inability of consumers to access their cars, or to use them, if they have become unusable or dangerous to human health. Where cars remain

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44. An example of characteristic language in a security interest contract reads:

> In the event of a default in failure to pay by the DEBTOR to the CREDITOR the amounts due and owing to the CREDITOR pursuant to an agreement evidencing any obligations to the CREDITOR, the CREDITOR shall declare the obligations immediately due and payable. The CREDITOR shall have all remedies according to a secured party under the Uniform Commercial Code of Illinois.

LawChek, Sample Contract Legal Forms: Security Agreement, http://www.lawchek.net/Library1/books/contract/sample/security.htm (last visited Dec. 2, 2010).

45. A representative eviction clause from an apartment lease agreement reads:

> Any failures by the Tenant to pay rent or other charges promptly when due shall constitute a default herein under and permit Landlord at its option to terminate this tenancy upon 14 days' written notice to Tenant. Failure to comply with any other material term or condition herein shall also constitute a default and permit Landlord at its option to terminate this tenancy upon 30 days' written notice to Tenant. Upon such termination(s), all leasehold rights of Tenant under this agreement shall be forfeited and Tenant shall surrender possession.

Champlain Valley Office of Economic Opportunity, Sample Lease Agreement—Vermont Tennants, http://www.cvoeo.org/htm/Housing/tenants/Lease_agreement.html (last visited Dec. 2, 2010).

46. *See* Schwegmann Family Trust No. 2 v. KFC Nat'l Mgmt. Co., Nos. 06-2447, 06-2530, 2007 WL 60971, at *6 (E.D. La. Jan. 5, 2007) (requiring lessee to continue rent payments as per contractual agreement despite uninhabitability of land in the aftermath of Hurricane Katrina); John A. Lovett, *Property and Radically Changed Circumstances*, 74 TENN. L. REV. 463, 501–507 (2007) (describing default rules governing relationship between landlords and tenants in Mississippi in event of drastic change of circumstances and observing that, although tenants may withhold payments of rent in event their building disappears, tenants do not have right to stay in possession of landlord's property and withhold rent in order to force landlord to make necessary repairs to the property). Nonpayment of rent is grounds for a money judgment against a tenant and, in the absence of equitable relief, forfeiture of the lease. *See* Colleen K. Sanson, *Cause of Action by Residential Landlord to Evict Tenants or Other Occupants*, 44 CAUSES OF ACTION 2d 447 § 5 (2010) (stating that failure to pay rent is a common ground for eviction under most state statutes). *But see* William K. Jones, *Private Revision of Public Standards: Exculpatory Agreements in Leases*, 63 N.Y.U. L. REV. 717, 738–49 (1988) (describing trend toward prohibiting broad exculpatory clauses in leases which strip residential tenants of rights or absolve landlords of their own negligence, and presenting economic analysis opposing enforceability).

usable and accessible, self-help language in automobile security agreements will be invoked to permit repossession.[47]

Utility and telecommunications companies will likely charge for, and demand, the minimum monthly charges for utility service, regardless of whether premises are unoccupied or actual utilization of services is possible.[48] Electricity, gas, water, telephone, cable, and wireless vendors can continue to assess interest on outstanding balances as of the date of the catastrophe, and such interest charges will mount quickly.[49] Interest charges, too, will be due and payable despite the impossibility of access to the services or consumers' inability to make effective use of the time-value of the money borrowed.[50]

Where consumers are in danger of becoming delinquent on their debts, creditors will exploit their power to diminish their customers' reputations, so as to discourage default. Credit scores are statistical evaluations of a person's creditworthiness, based primarily upon credit reports compiled through credit bureaus.[51] Lenders rely on credit scores to determine whether a potential applicant qualifies for a loan, what interest rate she will receive, the level of income and asset verification necessary for approval, and what credit limit shall be imposed.[52] Given the

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47. A characteristic auto security agreement default clause may read:

> If Borrower defaults in the payment of this Note or in the performance of any obligation, and the default continues after Payee gives Borrower notice of the default and the time within which it must be cured, as may be required by law or written agreement, then Payee may declare the unpaid principal balance and earned interest on this Note immediately due. Borrower and each surety, endorser, and guarantor waive all demands for payment, presentation for payment, notices of intentions to accelerate maturity, notices of acceleration of maturity, protests, and notices of protest, to the extent permitted by law.

Robins Air Force Base, Promissory Installment Note, http://www.robins.af.mil/shared/media/document/AFD-090317-043.pdf (last visited Dec. 2, 2010).

48. *See* Silber, *Thriving on Adversity*, *supra* note 5, at 161 (noting that, in months following Hurricane Katrina, local electricity companies "began reading meters again and sought to return to its normal billing schedules. . . . [W]hen the company was not able to read a meter (for example, when a house had been totally destroyed) it nonetheless endeavored to 'estimate a customer's usage in order to determine the bills' for September and October.").

49. *See id.* at 164 (describing how cable companies, like other consumer creditors, "charged interest [to victims of Hurricane Katrina] on balances that were outstanding at the time of the storm for the continuous period thereafter; and, as the balances grew, interest charges were compounded").

50. *See id.* at 147 (explaining that principal and interest charges were assessed against inaccessible and uninhabitable properties in aftermath of Katrina).

51. *See* myFICO, Understanding Credit Scores: Credit Bureaus & FICO Score Calculation, http://www.myfico.com/crediteducation/creditscores.aspx (last visited Dec. 2, 2010) (explaining the process of calculating credit scores). For more detail on how credit scores are calculated, see *infra* note 59.

52. *See id.* ("When you apply for credit—whether for a credit card, a car loan, or a mortgage—lenders want to know what risk they'd take by loaning money to you. FICO®

considerable incentive consumers have to maintain a favorable credit rating, creditors will likely threaten to report defaults and delays to credit reporting agencies, insurance companies, and similar entities.[53] If these threats are acted upon, the reports can be expected to detrimentally affect credit and FICO scores, eventually forcing consumers into less desirable types of lending, at higher rates with inferior terms.[54] Creditors will likely gain leverage by this sort of threat, even where consumers must make payments for services for which they receive zero use value.

There is another side to this story. Some creditors will try to help debtors out of empathy, self-interest, or a combination of motivations.[55] Some creditors will defer, and even forgive, consumer indebtedness in solidarity with their communities. In other cases, creditors will have little choice except to write-off or discharge consumer debts because the debtors are missing, insolvent, or destitute. But all creditors who modify or forgive claims will interpret their actions as discretionary, since they will not have been mandated to do so according to the terms of their agreements.

Under the existing contract law, acts of debt forgiveness are normally acts of generosity rather than obligation. Opting for generosity may not even be a viable legal decision, since a management executive or board of directors of a public corporation that forgives debt could violate the fiduciary duties that executives owe to shareholders or corporate parents.[56]

In sum, the terms establishing payment obligations in standard form consumer finance agreements offer little protection to consumers. To the contrary, traditional contract law sanctions the imposition of liability and confines excuse doctrines even where catastrophe intervenes, leaving creditors with formidable tools to force repayment and facilitate collection.

A highly oversimplified calculation based on just three sorts of consumer finance assessments—credit cards, utility bills, and auto loan

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scores are the credit scores most lenders use to determine your credit risk.").

53. *See, e.g.*, Illinois Pro Bono, Fair Credit Reporting: Creditor Threats to Ruin Credit Rating, http://www.illinoisprobono.org/index.cfm?fuseaction=home.dsp_Content&contentID=302#THREATS (last visited Dec. 2, 2010) ("A common creditor and collection agency threat is to ruin the consumer's credit record if s/he does not pay up on the debt.").

54. Silber, *Thriving on Adversity*, *supra* note 5, at 176 ("[A]s consumers were further scarred by bad credit ratings connected to late payments and defaults, it was inevitable that many more consumers would turn to alternative financial markets, markets where the contract terms were even harsher and rates more expensive.").

55. For example, in the wake of Hurricane Katrina, "the Army and Air Force Exchange Service, an organization that provides goods and services of necessity and convenience to members of the armed forces, . . . announced its intention to waive interest *and* suspend monthly payment requirements" for displaced cardholders. *Id.* at 170–71.

56. *See, e.g.*, Vikas Bajaj, *Fund Investors Sue Countrywide Over Loan Modifications*, N.Y. TIMES, Dec. 1, 2008, at B8 (discussing lawsuit filed by investors against Bank of America for its proposed plan to modify mortgage loans where mortgagors alleged they were victims of predatory lending).

payments—offers some indication of the magnitude of losses automatically transferred to consumers through standard payment terms. Consider a case in which five hundred thousand households are driven from their homes for six months due directly to a catastrophe. Suppose (1) the average monthly utility charges plus the interest accumulated on previous balances is $100 per month over those six months.[57] Suppose (2) that the average interest charges attributable to postponed payments of consumer credit card balances outstanding at the time of the catastrophe is seventy dollars per month over those six months. And suppose (3) that the average interest charges on postponed payments of principal for automobile loans averages thirty dollars per month above the usual interest charges.

For a conservative estimate of costs, do not count credit card late fees, over-the-limit fees, and rental property arrears charges,[58] or higher rates due to FICO delinquency downgrades,[59] or any of scores of other typical consumer charges. Exclude, too, any continuing assessment of fees beyond

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57. This example sets aside, for the purpose of illustration, the compounding interest charges that would accrue on the balances of these bills until they are paid.

58. During normal periods, the number of late fee assessments and the dollar cost to consumers of each assessment has steadily increased on a per-capita basis. *See* TAMARA DRAUT & JAVIER SILVA, DEMOS, BORROWING TO MAKE ENDS MEET: THE GROWTH OF CREDIT CARD DEBT IN THE '90S 35 (2003) (explaining proliferation of credit card penalty fees and increasing amounts of revenue generated by those fees); U.S. GOV'T ACCOUNTABILITY OFFICE, CREDIT CARDS: INCREASED COMPLEXITY IN RATES AND FEES HEIGHTENS NEED FOR MORE EFFECTIVE DISCLOSURES TO CONSUMERS 5 (2006) (indicating that the average late fee per assessment has almost tripled from thirteen to thirty-four dollars in between 1995 and 2005). *See generally* Norman I. Silber, *Late Charges, Regular Billing, and Reasonable Consumers: A Rationale for A Late Payment Act*, 83 CHI.-KENT L. REV. 855, 855–60 (2008) [hereinafter Silber, *Late Charges, Regular Billing, and Reasonable Consumers*] (outlining "late fee problem" consumers confront). While it is safe to assume that credit card late fees, over-the-limit fees, and rent arrears penalties would only increase during emergency periods, there is no data available on this point.

59. Numerous credit scoring methodologies exist, but the FICO score is widely used for many purposes, including residential mortgage lending. As described previously:

> While the exact formula is a closely guarded secret, it has been disclosed that the score is approximately determined through a weighted contribution of 35% past payment punctuality, 30% debt to credit ratio, 15% length of credit history, 10% type of credit that has been utilized in the past, and 10% recent searches for credit and recent credit obtained.

Silber, *Thriving on Adversity*, *supra* note 5, at 176–77 n.128. Late payments, including "minor late payments . . . such as 30-day delinquencies," can negatively affect consumers' FICO scores. myFICO, Why Scores Go Down, http://myfico.custhelp.com/cgi-bin/myfico.cfg/php/enduser/std_adp.php?p_faqid=3 (last visited Dec. 2, 2010). *See also* myFICO, What are the Different Categories of Late Payments and How Does Your FICO Score Consider Late Payments?, http://www.myfico.com/crediteducation/questions/Late-Credit-Payments.aspx (last visited Aug. 13, 2010) ("Your FICO® score considers late payment using these general criteria; how recent the late payments are, how severe the late payments are, and how frequently the late payments occur. So this means that a recent late payment, could be more damaging to your FICO score than a number of late payments that happened a long time ago.").

the six-month period.

Even with the exclusion of these additional costs, more than $600 million ($200 x six months x 500,000 persons) would be charged to the consumers in question, assessed against them for unusable services and for interest charges attributable to payment delays and unanticipated circumstances that the catastrophe brought about.

In the absence of a new model for addressing the problem, consumer debtors are likely to continue to suffer financial damage of great magnitude from payment terms that are enforced in the aftermath of disasters.[60]

IV.
LOOKING FORWARD: ANTICIPATING FUTURE CATASTROPHES

How should we adjust the laws related to consumer credit agreements to improve the treatment of consumers in times of catastrophe? One response might be that they should not be changed at all. Rather, courts and legislatures should resist the impulse to create exceptions for catastrophic events and instead should continue to treat them as extensions of normal occurrences. Such a response assumes that it is appropriate to rely on market forces to adapt to newly-perceived catastrophic risks. A second approach might be to adopt government relief programs that ameliorate injuries after they have occurred. Both of these approaches are considered below.

A. Market Solutions

Libertarian theorists and classical economists might argue that market responses are sufficient to help consumers cope with the financial fallout of disasters. They would argue that, in light of greater publicity being given to the vulnerability of the public to future disasters, consumers are gradually becoming attuned to the financial dangers they would face as individuals in

60. Some may argue that consumers in financial distress can resort to bankruptcy to mitigate their losses. Filing a bankruptcy petition to liquidate or reorganize is an option—or an unavoidable consequence—for consumers facing acute financial distress. In a consumer bankruptcy liquidation that occurs as a result of a catastrophe, the unsecured claims of creditors, including interest charges and fees, are paid *pro rata* from out of the debtor's estate. 11 U.S.C. § 726 (2006) (describing how assets are distributed following liquidation of debtor's estate). The amount of the claims that remain unsatisfied after available funds are exhausted is discharged so far as possible. 11 U.S.C. § 727 (2006). To the extent of the discharge, the law permits the debtor to "reallocate" the loss occasioned by the bankruptcy. Since bankruptcies happen in only a fraction of debt collection cases, and the remedy is costly and exceptionally traumatic, the "reallocational" result of bankruptcy cannot be considered a substitute for a general policy of catastrophic loss redistribution. *See generally* Elizabeth Warren & Amelia Warren Tyagi, THE TWO INCOME TRAP: WHY MIDDLE CLASS PARENTS ARE GOING BROKE (2004) (documenting hardships of financial distress and bankruptcy).

the wake of a disaster. In time, awareness of the problem could lead to widespread consumer interest in entering only into debt instruments that limit exposure to catastrophic risk.[61] Progressive landlords, utility companies, and credit card issuers might find ways to gain market share by offering premium-priced but reasonable credit insurance options that cover interest accumulations during periods of catastrophe. These sorts of market-based solutions, however expensive, could theoretically diminish the need for any sort of regulatory response.

Creditors will have considerable practical difficulty in mitigating their financial vulnerability to future disasters. At the outset, in order to mitigate their risk exposure and to spread their losses, they will need to protect themselves through specialty insurance or reinsurance.[62] Unfortunately, this sort of all-risk catastrophe protection is either unavailable or prohibitively expensive. According to the International Credit Insurance & Surety Association (ICISA), the leading global association representing trade credit insurers and sureties, only debts arising from undisputed transactions having a direct link with the underlying trade transaction—i.e. the delivery of goods and services—are currently insurable.[63] This means that unless a reinsurance market develops more fully, creditors attempting to innovate by offering a credit insurance product covering every catastrophe would be forced to self-insure, which would limit the scale of an offering.[64]

While losses arising from a natural disaster are in some cases insurable

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61. As indicated earlier, some credit card vendors and mortgage instruments offer protection to households against the death or unemployment of the primary breadwinner. *See supra* note 16 and accompanying text.

62. Insurance and reinsurance companies protect themselves by taking out insurance policies of their own. *See, e.g.*, Guy Carpenter & Company, LLC, About Guy Carpenter: A Full-Service Reinsurance Intermediary, http://www.guycarp.com/portal/extranet/about/aboutgc.html?vid=1 (last visited Dec. 2, 2010).

63. International Credit Insurance & Surety Association, Credit Insurance FAQ, http://www.icisa.org/templates/mercury.asp?page_id=1514 (last visited Dec. 2, 2010).

64. *See* Jonathan S. Masur & Jonathan Remy Nash, *The Institutional Dynamics Of Transition Relief*, 85 N.Y.U. L. REV. 391, 417–8 (2010) (attributing absence of catastrophic coverage to problem of correlated risks in disasters; whereas insurance company can safely insure against house fires in Iowa and New York, as no single event causes both, "[a] single hurricane can destroy an enormous swath of housing along the Florida coast or (nearly) the entire city of New Orleans, and only an extremely large and well-diversified insurer could bear the risk of insuring a substantial number of houses in a potential hurricane path"). Self-insurance is only a viable option when the creditor can establish a fund that is large enough to cover either one hundred percent of losses, or less than one hundred percent of losses with the remainder covered by a third-party insurer. In the absence of a private market for insurance, self-insurance of this type would necessarily involve huge sums of capital. For an analysis of the effectiveness of self-insurance in the context of state-owned property, which might be relevant to large commercial parties considering what actions to take to mitigate risk of losses, see generally Mark R. Greene & Michael L. Murray, *Self-Insurance of State Owned Property*, 45 J. RISK & INS. 109 (1978).

under the category of political risk,[65] because there is wide variability among consumers in terms of the ability to pay interest on fluid credit card balances in the aftermath of a disaster, the cost of insurance is inordinately expensive. Devising a comprehensive credit insurance scheme for the national consumer market would more than likely require large deductibles and exclude coverage for cardholders located in high-risk areas.[66]

Even if a market-driven expansion of credit insurance came to pass, however, there would be limits to its saturation and demographic reach. If creditors independently innovate along these lines, they will rationally discriminate between geographical areas of lesser and greater risk and raise the price of credit in high-risk areas accordingly. Such policies would encourage people to move away from areas most likely to experience catastrophes—a problematic social and economic incentive.[67] While incentives to relocate might make sense with respect to areas highly prone to particular natural disasters, such as flood zones in barrier islands, they would be futile and counterproductive in the context of terrorism.

At the same time, a market-oriented approach also countenances economic discrimination. While the inclusion of interest payment protection, tenant occupancy protection, and other similar consumer protections within insurance policies could ameliorate some of the negative financial consequences of disasters, many of the persons in greatest need of such protection will be unable to pay the premium demanded for that protection.[68] Given the price increases necessary to expand consumer insurance markets to meet demand, it is unlikely that a

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65. *See* International Credit Insurance & Surety Association, *supra* note 63 (stating that credit insurance covers political risk—i.e., "the risk of non-payment following an event outside the control of the buyer or the seller . . . for example the risk that money cannot be transferred from one country to another").

66. *See generally* Michael C. Dennis, The Advantages and Disadvantages of Purchasing Commercial Credit Insurance, http://www.coveringcredit.com/business_credit_articles/Credit_Concepts/art507.shtml (last visited Dec. 2, 2010) (detailing the difficulties associated with purchasing commercial risk insurance).

67. Although there is little debate in the abstract about consumers having no "responsibility" for an "Act of God," consumer responsibility for losses in the wake of such Acts is often contested. For example, the citizens of New Orleans are sometimes criticized for choosing to live below sea level, while the citizens of San Francisco face blame in some quarters for choosing to live along a fault line. *See, e.g.*, Anna John, *Watching 'Treme', Remembering Katrina*, THE ATLANTIC, Apr. 13, 2010, http://www.theatlantic.com/culture/archive/2010/04/watching-treme-remembering-katrina/38841/ ("Among the awful reactions [to Hurricane Katrina] I've heard or read over the years: 'That's what they get for choosing to live below sea level.'"). This article assumes that businesses and consumers *both* choose to operate in an affected community, and that, for this reason, moral claims for assigning responsibility to debtors as a class is unwarranted.

68. *See supra* note 21 and accompanying text.

sufficient level of coverage would pervade the community.[69] In addition, in comparison to other ways of providing financial protection to consumers, the transaction costs attached to issuing and claiming against millions of individual policies would increase the expense of insurance.[70]

In broader perspective, reliance on a market-oriented approach inappropriately ignores new theories of human behavior in the context of contracting. Traditional rational choice theory presumes that the impersonal market facilitates bargaining toward an efficient norm embodied in fair, standard terms, which courts, legislators, and regulators should be loath to amend or displace.[71] From a behavioral point of view, however, intrinsic cognitive mistakes and processing limitations can lead to inadequate levels of insurance and a poor contracting norm if market-based solutions are uncorrected by regulatory action.[72] As Christine Jolls and Cass Sunstein point out, "a central impetus for the large body of existing law regulating consumer safety is the belief that consumers do not adequately understand the potential risks of the products they use . . . because they lack factual information, because they suffer from bounded rationality . . . or both."[73]

Socio-legal theories build on empirical studies to suggest that contracting is inherently imperfect and that it is reasonable for individual

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69. *See generally* MICHAEL M. GREENFIELD, CONSUMER LAW: A GUIDE FOR THOSE WHO REPRESENT SELLERS, LENDERS, AND CONSUMERS § 10.2.1 (1995) (presenting overview of factors contributing to exorbitant cost of credit insurance).

70. Adopting the approach suggested in Part V would lead the much smaller number of commercial creditors to insure, rather than the much larger number of consumers. *See infra* Part V.

71. *See* Clayton P. Gillette, *Rolling Contracts as an Agency Problem*, 2004 WIS. L. REV. 679, 683–84 (arguing that nonreading, nonparticipating buyers should be bound to contract terms, provided that they are "virtually represented in a manner that satisfies the same objectives as personal assent").

72. For a description of rational choice theory as applied to contractual decision making, and an exploration of its deficiencies with respect to subprime mortgage contracting, see Oren Bar-Gill, *The Law, Economics and Psychology of Subprime Mortgage Contracts*, 94 CORNELL L. REV. 1073, 1107–1118 (2009). As long ago as 1943, Friedrich Kessler posed the question of enforcement of an adhesive term as "whether the adherent makes a sufficient claim based on public policy or simple fairness to override the drafting party's claim based on the value of free [rational] choice to enter the contract as a whole." Todd Rakoff, *Contracts of Adhesion, An Essay in Reconstruction*, 96 HARV. L. REV. 1174, 1238 (1983) (citing Friedrich Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629, 636 (1943)). Forty years later, in 1983, E. Allen Farnsworth could report that nevertheless, most courts would enforce contracts of adhesion based on an objective determination that a rational decision to enter a contract had been made "since the objective theory of contracts imposes no requirement that a party intend or even understand the legal consequences of his actions, a party is not entitled to relief merely because he neither read the standard form nor considered the legal consequence of adhering to it." E. ALLEN FARNSWORTH, CONTRACTS § 4.26 (1982).

73. Christine Jolls & Cass R. Sunstein, *Debiasing Through Law*, 35 J. LEGAL STUD. 199, 207 (2006).

consumers to disregard or to severely discount catastrophic eventualities when they consider moving ahead with a bargain.[74] Where contracting involves essentially compulsory acquiescence to standardized legal terms, consumers rarely make accurate predictions of the costs of contingent outcomes—even when those outcomes are possible or even likely to occur.[75] Unless large-scale disasters occur with sufficient periodicity to

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74. *See* Subha Narasimhan, *Of Expectations, Incomplete Contracting, and the Bargain Principle*, 74 CAL. L. REV. 1123, 1129 (1986) ("The premise underlying current contract enforcement doctrines—that parties should and do foresee and allocate all possible risks—is false."). Professor Subha Narasimhan develops a compelling alternative theory of incomplete contracting that seeks to distinguish between the risks and prices that are consented to at the time of contract formation and outside risks that should be treated as subject to allocation under principles of fairness and efficiency. *Id.* at 1127 ("[C]urrent theory starts from a model of the contracting process in which parties have allocated all events by the terms of the contract. Doctrines of excuse and modification seek to develop principled ways of determining which risk-events will serve as grounds for excuse, and which risk-events may be reallocated by mutual consent. For any risk-event to qualify for relief it must be unforeseeable, and hence unallocated. As a result, current contract doctrine is inconsistent in its approach to incomplete contracting, and incompatible with the goals of the bargain principle.").

The conventional rule does not allow courts to intervene unless one party makes the exceptional claim that a contract term is unconscionable. However, on rare occasions courts have accepted the position that contract rights change over the course of a long-term relationship in response to unanticipated events, and have adjusted terms when one party faces a substantial unforeseen loss that is not its fault. *See, e.g.*, Aluminum Co. of Am. v. Essex Group, Inc., 499 F. Supp. 53, 60–70, 78–79 (W.D. Pa. 1980) (holding that, under Indiana's doctrines of impracticability and frustration of purpose, seller was entitled to equitable restitution where, following execution of the contract, seller's non-labor production costs rose greatly beyond foreseeable limits of risk). *See also* Wallace Lightsey, *A Critique of the Promise Model of Contract*, 26 WM. & MARY L. REV. 45, 66–69 (1984) (arguing for a model of contract obligations that includes "continual adjustment of the relationship to unanticipated circumstances that occur as the future unfolds"). Some scholars have argued against such adjustment of terms, even where bargaining is concededly incomplete and estimating risks is difficult, *if* both parties are relatively equal in bargaining power and operate under comparable circumstances of bounded rationality. *See* Clayton P. Gillette, *Commercial Rationality and the Duty to Adjust Long-Term Contracts*, 69 MINN. L. REV. 521, 523–24 (1985) ("If a commercial actor is able to bargain with uncertainty in mind, I suggest the law ought to consider a such bargain the product of a cognitive and analytical process for which the actor can be held accountable, notwithstanding the intervention of specific events that the actor did not predict. The failure of the law to respect decisions made under these circumstances is unjustifiably paternalistic towards individual actors and frustrates individual effort that would otherwise generate greater personal and social welfare."). Under such circumstances, "[i]nability to foretell the future may induce the actors to adopt a mutually beneficial process for resolution of any event that disrupts their initial expectations. The model does not, however, compel the imposition of any duty to adjust once that event has intervened." *Id.* at 575.

75. *See* Bar-Gill, *Behavioral Economics*, *supra* note 21, at 754–765 (providing examples of systematic misperception persisting in some consumer markets); Silber, *Late Charges, Regular Billing, and Reasonable Consumers*, *supra* note 58, at 867 (providing examples of scholarship suggesting that "inherent information processing limits that affect all of us, as a notable example, affect our ability to estimate probabilities accurately. Consumers are further limited in their ability to calculate and maximize their expected

alert consumers to their likelihood, their potential impact is unlikely to be salient enough to factor into the bargain, even if a standard form agreement were to draw out the implications of the demand for unconditional payment when due in large-point type. According to Alan White, "individuals' predictions are clearly biased and inaccurate" in this area.[76]

Such socio-legal approaches ultimately argue in favor of limiting the unfairness caused by imperfect information and incomplete contracting.[77] While classical assumptions about rational choice are often used to support enforcement of adhesive terms, they are inapposite where at the time of contracting the risks are insufficiently salient or highly improbable. In these circumstances, an approach based on behavioral law and economics and socio-legal jurisprudence offers a fuller understanding of consumer behavior.[78]

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utilities; the deficiency exists because consumer choices are affected by external manipulative factors, including 'framing effects' and 'induced disinclinations to maximize utility under particular conditions.'"); Norman I. Silber, *Observing Reasonable Consumers: Cognitive Psychology, Consumer Behavior and Consumer Law*, 2 LOY. CONSUMER L REV. 69, 72 (1990) (arguing that, despite the assumption that "consumers are able to anticipate the consequences and calculate the potential value of their contracts," "[r]esearch has shown . . . that individuals frequently err even in simple calculations, and sometimes avoid complicated calculations entirely"). Compare, for example, the visibility to a consumer of the impact of a flood on their ability to pay a debt with the likely impact of rain on a beach vacation. *See* Andrew A. Schwartz, *A "Standard Clause Analysis" of the Frustration Doctrine and the Material Adverse Change Clause*, 57 UCLA L. REV. 789, 816 n.148 (2010) (describing press release in which the Barbados Tourism Authority promised that "visitors to Barbados will receive $100 for every day the weather falls below an average of 78 degrees Fahrenheit and accumulates more than a quarter-inch of rain").

76. Alan White, *Behavior and Contract*, 27 LAW & INEQ. J. 135, 154 (2009) [hereinafter White, *Behavior and Contract*]. *See also* Roger G. Noll & James E. Krier, *Some Implications of Cognitive Psychology for Risk Regulation*, *in* BEHAVIORAL LAW AND ECONOMICS 331 (Cass Sunstein ed., 2000) ("[P]eople will tend to overestimate the probability of an outcome if an example of the event has recently been called to their attention or otherwise comes readily to mind . . . . Probabilities will tend to be underestimated if the opposite . . . is the case.").

77. *See* Narasimhan, *supra* note 74, at 1129–1132 (arguing that imperfect information and incomplete contracting are endemic to contracting process and that contract law must be reformulated to make incomplete contracting the fundamental premise of the contract process); Edith Warkentine, *Beyond Unconscionability: The Case for Using "Knowing Assent" as the Basis for Analyzing Unbargained-for Terms in Standard Form Contracts*, 31 SEATTLE U. L. REV. 469, 469–473 (2008) (acknowledging that most consumers neither read standard-form contracts, nor recognize that they have legal challenge to enforcement of contract terms, nor have means to litigate such claims, and arguing that courts should abandon unconscionability doctrine in favor of assent-based analysis of unbargained-for terms); White, *Behavior and Contract*, *supra* note 76, at 154 (arguing that consumer contract law should incorporate the findings of behavioral economists and "prevent seller exploitation, exploitation which often consists of sellers understanding and using knowledge about consumer behavior and bounded rationality.").

78. *See generally* Melvin Eisenberg, *The Limits of Cognition and the Limits of Contract*, 47 STAN. L. REV. 211 (1995) (canvassing empirical research on human cognition and arguing that "an understanding of the psychological constraints on decisionmaking

Behavioral economics and socio-legal theories thus undermine our faith in using formal understandings of consent and efficiency to justify enforcement of boilerplate terms that allocate distant risks. They encourage us to consider common law and regulatory approaches that would impose alternate terms.[79]

B. Government Relief Programs

Another possibility for addressing consumer debt would be to rely on an approach that has worked to alleviate some of the worst suffering in the past: direct subsidies in the form of government disaster relief checks. Consumers are likely to use a significant part of such relief payments to pay their consumer installment debts. Proponents of government disaster relief programs argue that, if properly administered, direct government assistance to affected populations during times of emergency can adequately address consumer financial distress.[80]

Unfortunately, history does not support this claim. To the contrary, studies of the post-Katrina relief effort reveal that the delivery of monetary payments to victims in the wake of Katrina, principally by the Federal Emergency Management Agency (FEMA), was a monumental failure—a "second" disaster, in the opinion of many citizens.[81] Financial

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should play a central role in the development of contract doctrine"); Martha C. Nussbaum, *The Future Of Law And Economics: Looking Forward: Flawed Foundations: The Philosophical Critique of (a Particular Type of) Economics*, 64 U. CHI. L. REV. 1197 (1997) (critiquing theoretical underpinnings of "law and economics" movement, and disaggregating normative and descriptive uses of term "rational"); Cass R. Sunstein, *Empirical Legal Realism: A New Social Scientific Assessment of Law and Human Behavior: What's Available? Social Influences and Behavioral Economics*, 97 NW. U. L. REV. 1295 (2003) (arguing that understanding of relationship between behavior and law requires in-depth examination of social influences that shape and determine behavior).

79. *Cf.* Margaret Jane Radin, *Boilerplate Today: The Rise of Modularity and the Waning of Consent*, 104 MICH. L. REV. 1223, 1232 (2006) (suggesting that aggregate preferences indicate consumers' willingness to buy product at particular price, but do not represent voluntary interaction or expression of free will); Rakoff, *supra* note 72, at 1176 (using behavioral economics as frame, proposing that contracts of adhesion be considered presumptively unenforceable). *But see* Joshua Fairfield, *The Cost of Consent: Optimal Standardization in the Law of Contract*, 58 EMORY L.J. 1401, 1404 (2009) (arguing standard form contracts should be enforced because contract term standardization reduces information costs of consent, and that courts should minimize cost sum of contractual consent).

80. The federal government has made efforts to study this proposition at least in connection with the cost of insuring housing and replacing damaged property. *See, e.g.*, U.S. GOV'T ACCOUNTABILITY OFFICE, NATURAL DISASTERS: PUBLIC POLICY OPTIONS FOR CHANGING THE FEDERAL ROLE IN NATURAL CATASTROPHE INSURANCE (2007) (examining seven public policy options for changing federal government's role in provision of catastrophe related insurance). From a theoretical standpoint, such government assistance is arguably one of the core functions of government. *See* JOHN LOCKE, SECOND TREATISE OF GOVERNMENT 8 (C.B. Macpherson ed., Hackett Publishing Co. 1980) (1690) (stating civil society was created for purpose of protecting property).

81. Silber, *Thriving on Adversity*, *supra* note 5, at 172–76 (arguing that FEMA's

relief was neither effectively calibrated to the magnitude of individual consumer debt, nor to the time over which consumers struggled to normalize their financial condition.[82] These pitfalls inhere in the government assistance model, since relief payments are not self-executing, immediate, or comprehensive.

A government relief system, furthermore, allows creditors to continue piling charges onto consumers for their pre-disaster debts during a disaster. It also allows creditors to make themselves whole for their additional charges at the expense of consumers, who of necessity use their relief checks and other resources to pay them off. When a hurricane victim uses a taxpayer-funded relief check to pay a credit card interest charge that covers the cost of prior borrowing during an emergency, the government essentially has used public funds to fully compensate the creditor for a previous extension of credit over a period of time that has subsequently proven to include a disaster.

Justice arguably warrants a burden-sharing regime instead. The possibility for victims to renegotiate or refinance credit terms during a disaster is irregular or nonexistent. The result is to leave taxpayers and/or debtors to carry the unanticipated burden of the cost of credit over the disaster period.[83] Taxpayers as a class are not better equipped to bear the costs of the additional interest charges occasioned by disasters than debtors or creditors, and creditors are in the best position to adjust the price of their lending to the risk of nonpayment so that the cost is shared between themselves and borrowers. There is thus a case for redistributing the responsibility for the time value of money[84] among debtors and

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consumer relief efforts in response to Hurricane Katrina were woefully inadequate). *See also* Spencer S. Hsu, *Housing Aid Called Too Much, Too Little: FEMA Critics Cite Waste as Evacuees Strain to Pay Rent*, WASH. POST, Oct. 12, 2005, at A6 (detailing FEMA's inability to adequately provide for housing expenses of resettled Hurricane Katrina victims); Spencer S. Hsu, *Order Shows FEMA Aid Shortcomings: Fraction of Households to Reach Cap—Bureaucracy Is Faulted*, WASH. POST, Dec. 3, 2006, at A16 (stating that thousands of families who were denied FEMA aid).

82. *See, e.g.*, Eric Lipton, *Leaders in Congress Agree on Aid for Gulf Recovery*, N.Y. TIMES, Dec. 19, 2005, at A29 ("Because there is a $26,200 cap on federal disaster aid to families, many people faced the possibility of taking out a second mortgage to rebuild their homes or perhaps even filing for bankruptcy.").

83. The same cannot be said of direct payments of principal, which are intended to ameliorate the suffering of the debtor. *See* David W. Sar, *Helping Hands: Aid for Natural Disaster Homeless vs. Aid for "Ordinary Homeless,"* 7 STAN. L. & POL'Y REV. 129, 131 (1995) (observing that stated purpose for government relief in times of natural disaster is to place victims "back in a position close to that which they were in before the disaster" by providing essential needs assistance such as housing repair, personal property loss, transportation, medical expenses, and funeral costs).

84. References to the "time value of money" embody the observation that money increases or decreases in value over time based on its ability to earn interest. Money today is thus "worth" more than the same amount of money tomorrow. Credit agreements account for the time value of money by providing borrowers with the use of money in

creditors.

Ultimately, neither market forces nor government relief can solve the problem of consumer debt following a disaster. New solutions must be developed to protect consumers against the financial consequences of catastrophe.

V.
PROTECTING CONSUMERS THROUGH SUBSTANTIVE REGULATION: A MANDATORY *FORCE MAJEURE* PROVISION

Recognizing the inadequacy of market-oriented solutions and the inappropriateness of government relief programs for our purposes suggests a third path—one that builds upon historical efforts to forestall widespread consumer loss through substantive consumer protection. This path invokes classic consumer protection approaches, including regulation of standard form contracts to remedy relational imbalances—of bargaining power, experience, and sophistication—between lenders and consumers at the contract formation stage. An administrative or legislative mandate to include *force majeure* provisions in consumer debt agreements could serve a constructive purpose.

The Federal Trade Commission's (FTC) Holder-In-Due-Course Rule[85] provides a model for that agency or the new Bureau of Consumer Financial Protection (BCFP)[86] to address the relational imbalance between borrowers and lenders with respect to the loss allocation when catastrophes occur.[87] The holder-in-due-course doctrine, which is embodied in the Uniform Commercial Code, protects assignees of consumer debt agreements from, *inter alia,* ordinary contract defenses.[88] It was entrenched in standard form consumer contracts, to the detriment of many consumers, until the FTC enacted its own Holder Rule.[89] The Rule, formally enacted as a rule designed for the "Preservation of Consumers' Claims and Defenses," requires sellers or related entities who lend to

exchange for the payment of interest. The time value of money borrowed by credit card holders who pay their bills in full and on time is very small. Adam Levitin, *The Antitrust Super Bowl: America's Payment Systems, No-Surcharge Rules, and the Hidden Costs of Credit,* 3 BERKELEY BUS. L.J. 265, 301 (2005). By contrast, disasters disrupt debtors' ability to repay and create additional interest charges for the use of funds during disruptions, which neither taxpayers, creditors, nor debtors should desire to absorb.

85. 16 C.F.R. §§ 433.1–433.3 (2009).

86. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, §§ 1001–1109, 124 Stat 1376, 1954–2129 (2010) (to be codified in scattered sections of the U.S.C.) (creating the Bureau of Consumer Financial Protection and defining its powers), *available at* http://www.financialreformwatch.com/uploads/file/Dodd-Frank-Final-Enrolled(1).pdf.

87. *See supra* Parts II & III.

88. U.C.C. §§ 3-305–3-306 (2001).

89. 16 C.F.R. § 433.2 (2009).

consumers to finance their purchases to include a special provision in their sales contracts and loan agreements.[90] This provision preserves the consumers' defenses to payment under the contract if the seller assigns (or sells) the financing contract to another creditor, such as a bank or a finance company.[91]

The Holder Rule does not, by itself, create a right for the consumer to withhold payment from the entity that purchased the contract. Instead, it guarantees private rights under state law by preserving any rights given the consumer under the law, no matter who holds the contract.[92] As applied to consumer agreements, the holder-in-due-course doctrine has now been effectively supplanted by the FTC Rule, without major disruptive effect.[93] It is widely accepted, respected, and influential in shaping related areas of commercial law.[94]

In similar fashion, the BCFP or FTC could insist upon the insertion of a *force majeure* provision in all consumer contract agreements—including consumer installment contracts, consumer credit agreements, and property leasing and sale agreements—through administrative action. As Jennifer Bund has explained, *force majeure* clauses define "the nature and degree of extraordinary circumstances that are both necessary and sufficient for debt forgiveness."[95] The doctrine of *force majeure* is thus one aspect of the

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90. *See id.* (defining failure to include language describing holder-in-due-course rule as "an unfair or deceptive act or practice").

91. *Id.* ("ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED PURSUANT HERETO OR WITH THE PROCEEDS HEREOF").

92. *Id.*

93. *See* U.C.C. § 3-305(e) (2001) (subordinating the holder-in-due-course doctrine to consumer protection rules).

94. *See* Kurt Eggert, *Held Up in Due Course: Codification and the Victory of Form over Intent in Negotiable Instrument Law*, 35 CREIGHTON L. REV. 363, 429–30 (2002) ("Instead of the predicted dire consequences, it appears that the suppliers of consumer goods and credit, at least the honest ones, have accommodated themselves easily. . . . [T]he FTC's rule 'has caused some adjustments in the market, largely unseen, but it surely has not had the catastrophic impact upon consumer market that some predicted.' . . . '[T]he financial community has not been particularly perturbed by the FTC Rule. . . .'"); Martin B. White, *Coping with Violations of the Federal Trade Commission's Holder in Due Course Rule*, 66 TEMP. L..REV. 661, 661 (1993) ("The substantial abolition of holder in due course ("HDC") status and similar legal devices in consumer transactions has been one of the major accomplishments of consumer law reformers since World War II.")

95. Jennifer M. Bund, Force Majeure *Clauses: Drafting Advice for the CISG Practitioner*, 17 J.L. & COM. 381, 383 (1998). Courts apply Article 79 of the United Nations Convention for the International Sale of Goods, which embodies the *force majeure* concept, to determine whether a party's obligation to perform should be excused when extraordinary circumstances arise. *Id.* at 386. Article 79 requires the non-performing party to establish: (1) an impediment; (2) beyond the party's control; (3) that could not reasonably have been taken into account, avoided or overcome. *Id.* In addition, to qualify for Article 79 exemption, the non-performing party must also (4) notify the other party of "the impediment and its effect on his ability to perform" within a reasonable time. *Id.*

doctrine of excuse; conventional contract law considers the employment of a *force majeure* provision an appropriate method to define extraordinary circumstances that will excuse performance.[96] The language of a *force majeure* provision would extinguish any obligation of a consumer-debtor to pay interest charges and unearned service fees, and permit the postponement of debt payment obligations during one of the circumstances stated in the provision.[97]

If the FTC were to mandate such a rule, then a creditor's failure to include a *force majeure* provision in a standard form agreement would constitute a punishable "unfair or deceptive act or practice" under the terms of Section 5 of the Federal Trade Commission Act.[98] The BCFP can invoke similar sanctions.[99] It would defeat the purposes of the provision to

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Once invoked, the Article 79 excuse remains in effect throughout "the period during which the impediment exists." *Id.* at 387. Under more general UNIDROIT Principles of International Commercial contracts, a demonstration of "hardship" can establish an obligation to renegotiate if it can be shown that a change in circumstances is fundamental and will cause the party to suffer hardship in the absence of renegotiation. *Id.* at 390–91.

96. The law of excuse generally assumes that certain events, such as acts of God or governmental prohibition of performance, are unforeseen at the time of contracting. *See* Saul Litvinoff, *Force Majeure, Failure of Cause and Theorie De L'imprevision: Louisiana Law And Beyond*, 46 LA. L. REV. 1, 1 (1985) ("After a contract is made, a party bound under that contract run into obstacles that make his performance impossible. When such is the case, that party is not liable for any damages that may result from his failure to perform. That is the doctrine of *force majeure* . . . ."). Therefore, the occurrence of such events will sometimes be grounds for excusing performance of a contractual obligation. Shirley R. Brener, *Outgrowing Impossibility: Examining the Impossibility Doctrine in the Wake of Hurricane Katrina*, 56 EMORY L.J. 461, 467 (2006) (noting that, under modern impossibility doctrine, "courts focus on whether the difficulty of performance was contemplated by the parties during the negotiation of the contract. When the promissee appears to be the bearer of the risk, courts read the contract to include an implied condition the occurrence of which excuses the promisor's performance. In contrast, when the promisor appears to have borne the risk of the unexpected event, his performance is not excused.").

97. For example, the FTC might mandate the inclusion of this provision:

> Consumer obligors and guarantors on this instrument shall not be liable for failure or delay in payment or performance under this Agreement to the extent the failures or delays are proximately caused by war, riot, civil disorder, terrorist events or other hostilities; or are proximately caused by catastrophic weather conditions or other catastrophic circumstances beyond the control of the obligors and guarantors.
>
> Dates by which payment and performance obligations are scheduled to be met will be extended for a period of time equal to the time lost due to any delay so caused or for a longer time by mutual agreement. The consumer obligors and guarantors reserve all claims and defenses to payment and performance and to payment of penalties, recurring fees, interest and other charges and assessments and all claims based on excuse, impossibility, or the failure of consideration.

Alternatively, Congress could amend the Consumer Credit Protection Act, 15 U.S.C. § 1601 (2006), to require a similar *force majeure* term to be included in all consumer credit agreements.

98. Federal Trade Commission Act, 15 U.S.C. §§ 45–58 (2006).

99. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L.

allow a creditor to offer a lower price of credit to a consumer who allowed the creditor to omit a *force majeure* provision.[100]

The regulatory requirement to include a *force majeure* provision would not create new federal law or impair any contract right. Like the FTC's Holder Rule, it would create private rights under state law and prevent creditors from inserting oppressive language in adhesive boilerplate.

As indicated earlier, creditors already insulate themselves against uncertainty through business interruption insurance and other devices when commercial losses are at stake, but they have generally relied on contractual loss allocation to deal with the consumer market.[101] To the extent that it shifts the risk of lost charges and fees to creditors, a mandated clause would reverse incentives to obtain insurance and/or to self-insure.

Disasters impose unavoidable costs on communities, and law has a role to play in minimizing and equitably distributing the risk of these costs in the face of market imperfections. Unlike consumers, creditors—particularly sophisticated financial institutions—are in a strong position to lay off their risks. With large capital assets and substantial buying power, creditors are better situated to negotiate and develop a competitive market for credit insurance. Of course, creditors are also positioned to distribute the costs of their insurance down to consumers themselves: They can be

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111-203, § 1031, 124 Stat 1376, 2005–06 (2010) (authorizing the BCFP to "prescribe rules applicable to a covered person or service provider identifying as unlawful, unfair, deceptive, or abusive acts or practices in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service").

100. A different approach might establish that the waiver of a standard *force majeure* clause is "presumptively" unfair, in order to allow consumers who want to assume catastrophic risks to do so depending upon whether the assumption is individually negotiated and sufficiently compensated. For example, the European Parliament has proposed a directive that would create such a list of presumptively unfair terms. Proposal for a Directive of the European Parliament and of the Council on Consumer Rights, PARL. EUR. DOC. (SEC 2544, 2545, 2547) 34 (2008), *available at* http://ec.europa.eu/consumers/rights/docs/Directive_final_EN.pdf. The list of presumptively unfair terms would include terms "obliging the consumer to fulfil all his obligations where the trader has failed to fulfil all his obligations." *Id.* at 41. As these terms are only *presumed* to be unfair, the trader may still prove that the particular term is fair in the context of a particular contract. *See id.* at 33 (stating that whether contract term is, in fact, unfair shall be assessed by examining "the nature of the products for which the contract was concluded," "all the circumstances attending the conclusion" of contract, "all the other terms of the contract or of another contract on which the former is dependent," and "the manner in which the contract was drafted and communicated to the consumer"). In the case of economic harms resulting from catastrophes, however, the insufficient salience of the risk of disaster and imperfections in the consumer credit insurance market argue against permitting consumers to negotiate away the *force majeure* clause. *See supra* Part III and Part IV.

101. *See supra* Part III.

expected to recover the cost of their own premiums by spreading them to consumers, to the extent that the competitive conditions of the market allow, and to shareholders, if they cannot.[102]

If a *force majeure* clause were mandated, virtually all creditors who lend to consumers would either need to hedge against a possible disaster through insurance or to self-insure. A major advantage of imposing the clause would be that a much larger—nearly universal—base of consumer debtors therefore would be protected, indirectly, through commercial policyholders. Not only would the market in which commercial creditors purchase coverage be more robust, economically efficient, and competitive than the consumer credit insurance market, but insurers would be less likely to experience catastrophes affecting a major portion of their claims base at the same time. This would diminish problems of "risk correlation" which are said to have deterred insurers from issuing policies in the past.[103]

Critics may argue that the imposition of a compulsory risk-sharing regime could produce undesirable consequences, particularly if the provision is widely abused by consumers or interpreted too broadly by courts. If consumers could anticipate having a payment "holiday" every once in a while, for example, they would be motivated to borrow more than they could reasonably repay. Conversely, if creditors could anticipate that consumers would not invoke the *force majeure* rule even in legitimate circumstances, the rule would have little impact.

A more forceful objection might be that a mandatory *force majeure* provision would introduce into the credit system unmanageable uncertainty as to whether any particular debt is actually enforceable. By depriving creditors of predictability, this uncertainty could, in turn, chill efficient and beneficial contracting activity.

Should any of these problems arise, however, they would not be difficult to ameliorate. As in other cases of rule-based interpretation,[104]

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102. *See* Andrew C.W. Lund, *Opting Out of Good Faith*, 37 FLA. ST. U. L. REV. 393, 419 (2010) (noting that corporations pass on cost of increased premiums for insurance against liability and litigation costs associated with "due care" violations by their directors to shareholders).

103. *See* Masur & Nash, *supra* note 64, at 418 (noting that lack of sufficient base of policyholders is one reason "that insurance companies have been reluctant to write policies insuring against terrorism, natural disasters, or other large-scale calamities"). In general, "[i]nsurance companies exist (and succeed) because they are able to diversify across a large portfolio of unconnected contracts that offer unrelated risks." *Id.* at 417. However, in catastrophe-prone areas, risks are correlated, and "one isolated event will force the firm to pay benefits to millions of homeowners simultaneously." *Id.*

104. Countless terms used in commercial statutes are later repeated in standard consumer contracts and judicially confined within reasonable limits, including open-ended phrases such as when a creditor "deems itself insecure," U.C.C. § 1-309 (2001); what is "a reasonable time," U.C.C. § 2-309; what is a "definite time," U.C.C. § 3-104; what constitutes "ordinary care," U.C.C. § 4-202; the meaning of "strict compliance," U.C.C. § 5-108; and when repossession is "without breach of the peace," U.C.C § 9-609. *See* Shael

common law courts should be capable of interpreting these provisions reasonably. If they do not, Congress could authorize the FTC, BCFP, or another regulatory body to use its rulemaking authority to establish guidelines for the invocation of the provision. It would also be possible to modify the *force majeure* provision to restrict its application to officially declared states of emergency; to require the state of emergency declaration to expressly invoke *force majeure*; or to rest responsibility for establishing these periods with the President and with state governors, who may petition the President to declare them, as the present FEMA statute provides.[105] It may be desirable to include state officials in this decision-making process, since they are located among the affected population and therefore might be less susceptible than federal agents to creditor pressure groups. Alternatively, executive offices or independent regulatory agencies could be authorized to establish guidelines for the application of *force majeure* circumstances, subject to judicial review.

Similarly, it is unlikely that such a mandatory *force majeure* provision would actually chill contracting activity. It is worth recalling that there were dire warnings from creditors that the FTC's abrogation of the holder-in-due-course doctrine might cause disruption and increased prices, yet few negative consequences were documented after years of exploration.[106] By the same token, hypothetical creditor objections to this proposal merit skepticism.

Herman, *Llewellyn the Civilian: Speculations on the Contribution of Continental Experience to the Uniform Commercial Code*, 56 TUL. L. REV. 1125, 1168–69 (1982) (noting that one of the U.C.C.'s drafters anticipated that courts would define meaning of terms reasonably using purpose of the Code as a guide).

105. 42 U.S.C. § 5191 (2006). Robert M. Lawless addressed some of the problems discussed here by proposing temporary moratoria on the imposition of late fees, penalty fees, and interest, on adverse credit actions, and on adverse credit reporting for a period of 90–120 days after a hurricane. See Robert M. Lawless, *Bankruptcy Filing Rates after a Major Hurricane,* 6 NEV. L.J. 7, 19 (2005).

106. *See, e.g.*, William H. Lawrence & John H. Minan, *The Effect of Abrogating the Holder-In-Due-Course Doctrine on the Commercialization of Innovative Consumer Products,* 64 B.U. L. REV. 325, 338–40 (1984) (noting that abrogation of holder-in-due-course rule can have minimal impact on availability or cost of credit); Ronald J. Mann, *Searching for Negotiability in Payment and Credit Systems,* 44 UCLA L. REV. 951, 967–68 (1997) (observing that FTC Rule reflects a rejection of benefits of holder-in-due-course status, a former "cornerstone of negotiability," but that the Rule's other provisions ensure promissory notes remain negotiable instruments); Siddhartha Venkatesan, *Abrogating the Holder in Due Course Doctrine in Subprime Mortgage Transactions to More Effectively Police Predatory Lending,* 7 N.Y.U. J. LEGIS. & PUB. POL'Y 177, 214–15 (2003) (reporting that the FTC concluded that "the abrogation of the [holder-in-due-course] doctrine in favor of an affirmative rule of recovery was an efficient marketplace solution in the best interests of the consumer").

VI.
CONCLUSION

The proposal above emerges from observing how consumer debtors are treated, and mistreated, in the aftermath of disasters. Creditors rely on adhesive contract terms incorporated in standard form credit agreements to exact interest payments and fees even after catastrophe strikes.[107] While creditors ought to be allowed to continue to require consumers who sign standard form agreements to continue paying interest on their credit card balance in the period after their *house* burns down, for example, they should not to be able to do so if the *entire city* burns down.

Without a reform like the one proposed in this article, courts will continue to force consumers to live up to terms of credit products that inappropriately hold them accountable for weighing immediate benefits against the prospect of uncertain, unknowable, unpredictable, and probably uninsurable future events.[108] Requiring a *force majeure* provision to be integrated into standard form agreements would produce a more reasonable bargain.

107. Silber, *Thriving on Adversity, supra* note 5, at 139–142.

108. *See supra* text accompanying note 31.