Courts at work:
Bankruptcy Statutes, Majority Rule and Private Contracting in England (17th-18th century)

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ABSTRACT

Rather than evolving as a platform for renegotiation and debt discharge, as on the Continent, English bankruptcy emerged as a liquidation-only procedure after majority arrangements among creditors were banned in 1621. Over the course of the 17th and 18th centuries, the courts then developed an alternate, private-law set of rules on the basis of the old English trust and the Composition agreement, which belonged of the medieval Law Merchant. The main advantage of this little-known institution was its perpetual character and the flexibility of its governance, and its main drawback was obviously the requirement of voluntary initial adhesion. Symmetrically, under the Continental model, collective action was easier to obtain but it not extended beyond the doors of the court. The discussion brings forward two further themes: the symmetry between adjudication and voluntary adhesion to a collective contract; and the capacity of judges to invent new legal concepts out of diverse set of existing rules, rather than through the simple, bottom-up approach usually emphasised by the literature on the Common Law tradition.
I. COURTS AT WORK

Bankruptcy law is an institution geared to private markets, especially to the debt markets, while being at the same time about abrupt state interventions into core private rights. Take the mainstream tradition that emerged in Italy during the Middle-Ages, before informing virtually all later, modern bankruptcy regimes: each single rule in this generic model is highly problematic from the perspective of private rights. Then as now, a typical bankruptcy process thus starts by suspending both the debtor’s “natural right” to contract and his control over his assets, i.e. his property rights. His correspondence and private dealings are thrown open and, for centuries, he might have spent time in jail. Creditors meet and coordinate under the judicial supervision, debts are accelerated and a detailed procedure governs the successive steps in the deliberation process. Typically, a weighted, qualified majority vote eventually decides between liquidation and some restructuration plan so that, after confirmation, capital losses and property rights are coercively redistributed.

This benchmark Continental procedure works therefore as a judicial platform for bargaining, in which large transaction costs are traded off against the negative externalities of a disorderly default: adjudication and procedural safeguards aim at controlling the collective action problems that are inherent to any default with multiple creditors (Jackson, 1986). Otherwise, creditors may run on the assets so that the ex post distribution of capital losses would be both unfair and unpredictable; alternately, minority creditors may block any agreement and force liquidation even when the majority agrees that a continuation agreement would better serve its interests. From a jurisprudential perspective, the majority vote should thus be understood as a signal of where the collective interest probably lies, so that the judge may confirm the underlying settlement and impose the redistribution of property rights on the minority. As such, creditors, even a qualified majority of them, may not interfere in the property rights of fellow merchants and bankers.

Early modern England presents the most significant exception to this classic model of bankruptcy law. In 1621, a principled defence of private property rights led the Parliament to forbid any arrangement with the debtor not based on the voluntary adhesion of each single participant creditor. The statutes would just not lend their support to creditors, even a qualified majority of them, as they tried to control holdout investors. As a consequence, the bankruptcy process could only end up in liquidation and the
The creditors’ bargain had to take place outside courts and on a voluntary, hence unanimity basis (Sgard 2013). Confronted to such an adverse legal framework, debtors and creditors could have opted-out *en masse* of the courts and build alternate private rules far away from them, as is often the case in the informal sector of developing countries (Fafchamps, 1996); or criminal rings could have taken over the job of brokering deals and restructuring property rights - that is the job of “transaction costs engineers” (Gilson 1984). To the contrary, merchants kept coming to the courts, so that precedents accumulated and, over time, a new, coherent institution gradually emerged in the shadow of the dysfunctional 1621 statute and eventually gained a high degree of consistency: from about the 1720s onwards, it offered a complex set of decision and coordination rules, assembled into an agency framework with an idiosyncratic firm-like structure. It included procedural and substantive dimensions, it entirely redesigned the structure of property rights, and it interacted at several points with public regulators.

When confronted to financial distress or default, Merchants could thus rely upon a coherent, fully-enforceable, two-track regime. On the one hand there was the statutory option founded on adjudication that inevitably led to liquidation; and on the other one was a voluntary case-law option that mitigated parts at least of the underlying collective action problems so as to make bargaining and restructuring easier. Tellingly, in the later part of the nineteenth century, when this Act was eventually abolished, the voluntary road to settlements not only survived, in parallel with the bankruptcy statutes: it even expanded as the preferred option for restructuring large businesses. Still today its distant heir remains widely practiced and defended under the name of the “London approach” to business failures.

This article analyses how this voluntary road to restructuring emerged from a heterogeneous legal material and gradually acquired its remarkable, self-standing and persistent formal structure. Where did these diverse elements come from and how were they gradually aggregated in a logically coherent set of rules? Which rules coordinated in practice these two tracks at maturity? And how can we account for path-dependent character of this innovation? The coming discussion draws from past legal treatises, commentaries of cases as well as textbooks written by barristers for laymen. Beyond their relatively great number, an interesting feature of these later publications is that they present the most relevant cases in each sub-field as well as collections, or toolboxes, of standardized models of contracts offered to private persons - landowners, merchants, bankers, widows, ship owners, etc. Hence, these books observe legal practices behind the frontier of legal change, rather than just on this line, so that they may lack chronological precision. On the other hand, once described in this type of publications, there is little doubt that these instruments were well accepted, both by the courts and the economic agents.

The next section brings this experience within the broader literature on the evolution of economic institutions and, in particular, the evolution of judge-made law. At this point, and when needed in the rest of the paper, the Continental model of bankruptcy law is used as a default rule and is therefore briefly presented. Sections three and four then analyse the genealogy of the alternate, private-law route
to debt settlements, first by looking at the political and institutional context within which it emerged; then the focus shifts to the formation of this new legal institution, between the mid-seventeenth and the late eighteenth centuries. Section five discusses how it worked at maturity, from a synchronic perspective that emphasises the structure of incentives and constraints to which the parties responded when trading off the respective advantages of adjudication and voluntary adhesion. Section six is a conclusion.

II. THE SHADOW OF STATUTE AND THE EVOLUTION OF CASE-LAW

A large and rich literature, both economic and legal, has discussed for decades how norms, formal and informal, substantive and procedural, can be agreed upon and how they may evolve over time. In particular, the role of dispute resolution in the mutual adjustment of norms and actual behaviours explains why the experience of the English Common law has emerged here as key reference. Its open and experimental orientation would be especially adequate to a competitive and changing economic environment, where the law should be able to adjust smoothly to a new technological and market conditions. Social interests and preferences may thus percolate upwards and inform the decisions of judges, whereas statutes and codes are often seen as potential sources of rigidity and exclusion, as when a dysfunctional (civil law) system causes widespread informality in Latin America (de Soto, 1989), or entrenched criminality in Japan (Milhaupt and West, 2000).

The bottom-up, decentralised view of social ordering and law-making that is associated with the Common Law rest ultimately on the principle that efficiency and legitimacy derive from a process of selection, hence from the closeness of the lawmakers to real-world agents. An argument initiated by Cardozo (1921) and Posner (1973) see this pro-efficiency bias in the anonymous, Darwinian process of repeated litigation, leading over time to the steady erosion of bad precedents and the preservation of good ones (Rubin 1977, Cooter and Kornhauser, 1980). An alternate view has its origin in Hayek (1973) who locate this built-in trend in the mind of the judges, hence in their own preferences and independence (Mahoney 2001, Cross 2007). The divergence between the two views stems from the actual qualities that judges should present: they may be the blind operator of an anonymous selection process or they may possess a broader and more demanding expertise so as to be able to design novel solutions to social or economic problems, which lay people would then adopt or reject.

This discussion also presents an historical dimension, where the Common Law tradition is typically envisaged as the heir, or the modern continuation, of the old medieval Law Merchant: i.e. the body of

2 This argument, that builds on notions of flexibility and pragmatism, should be carefully distinguished from another, in fact very different line of contributions that insists on the quasi-constitutional features that would be build into the English Common law. The main theme here is the superior protection of private property rights, as emphasised e.g. by Beck et al. (2003) or Glaeser and Shleifer (2002). Curiously, the tension if not the contradiction between these two themes has not been much explored.
informal norms that are said to have structured commercial exchanges across Europe at a time when territorial states and their hierarchic jurisdicational orders had not yet emerged. An important figure in this narrative is Lord Mansfield, English Chief Justice between 1756 and 1788, who used to “discover” the law in this matter by consulting expert merchants on accepted commercial customs, before confirming them by way of precedents.\(^3\) He would have thus acted as the benevolent agent of the absorption of the old Law Merchant into the legal language and procedural tradition of the common law.

This genealogy of modern commercial law is then opposed to the early drive to codification, as observed typically in France, where a first and rather light commercial code was adopted as early as 1673.

The present article covers this broad period in modern legal history and explores specifically how English judges responded to the problems raised by the 1621 ban on majority arrangements among creditors. The overall view is more Hayekian than Posnerian, in so far as the creative dimension in law making comes out as far more diverse and sophisticate than what a purely pragmatic, bottom-up perspective may reasonably account for. At some key points, when balancing incentives and constraints, the intention to design a better institution should have motivated decisions. For the same reason, the perspective does not strictly align with the traditional, possibly simplistic, “Mansfield narrative” where enlightened judges recognise and simply confirm pre-existing merchants’ customs, or the Law Merchant.

First, the legal innovation that was eventually produced was closely articulated to the 1621 Act, so that at maturity they were de facto proposed together as a menu. By extension, the case for an efficiency-enhancing evolution is conditional in the present case upon the continuing presence of the anti-entrepreneurial 1621 act: the precedent-based rule made life easier to merchants, considering the collective action problems they were confronted to. Secondly, if anything the Continental approach to bankruptcy was much closer to the medieval legal tradition than the English one, just as the Continental traders’ courts were as close as any to the merchants’ communities.\(^4\) In fact, as English judges struggled with the problems left over by 1621 Act, they did not look just at the merchants’ customs, they drew also “lateral” on a large and rich legal material whose origins were outside the commercial sphere. At that point, professionals had to do the job of identifying possible legal solutions and formally assembling them so as to respond to the demand of commerce. The merchants’ communities could not be reasonably expected to have this expertise.

The next two sections discuss the history and genealogy of this innovation, and the following, fifth section analyses from a synchronic viewpoint how it worked at maturity, i.e. in the late eighteenth and early nineteenth centuries.

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\(^3\) On Mansfield, see Scrutton (1909), Lowry (1973) and Poser (2015); in the larger literature on the Law Merchant and the Common law, see i.a. Holdsworth (1907) and Baker (2007).
III. BANKRUPTCY LAW AS AN ABSOLUTIST INSTITUTION?

Starting in 1543, business failures in England were administrated by so-called Bankruptcy Commissions, created on a case-by-case basis by the Chancery after one or more creditors had petitioned the Lord Chancellor. Each Commission was therefore a short-lived public authority, whose members were chosen from local notables and fellow traders. It received control over a debtor’s assets, and it had the power to put him in prison or free him, audit him, control debt titles, collect and sell his assets, and share the resulting dividend. Contrary to the well-established continental merchants’ courts, however, the judicial character of Bankruptcy Commissions was at best partial and their weaknesses regarding procedural guarantees were well acknowledged. At least until the eighteenth century, guidelines for decision making were not explicit, recruitment was not strong and corruption is often mentioned: we are a world apart from the classic image of a grand English judge.

A consequence of the relative weakness of Bankruptcy Commissions is that they made an unpromising forum for open-ended bargaining among the parties over the future of the failed business, not to mention the possibility of confirming a majority arrangement. Hence, attempts to control the risk of hold-out by minority creditors took the separate route of an appeal to equity judgments: majority creditors, or the debtor, would petition the Privy Council, the Court of Request, or the Chancery and ask that they issue a Bill of Conformity, ie a court injunction imposing a settlement on all creditors. But this separate practice came under increasing attack after 1609 and in 1614 the Common Law courts de facto obtained the authority to annul, or ‘prohibit’ the Bills. The key reason for this resistance is that both the principle and the actual practice of these interventions in private dealing presented a strong discretionary character. This is where the constitutional dimension of the discussion on bankruptcy comes back in. Smith (2010) provides a wealth of examples showing how these courts were all too willing to pressure recalcitrant minority creditors and even to threaten them with imprisonment. Treiman (1938a) also quotes for instance how in 1591 the Privy Council instructed the Bankruptcy Commissions to lead recalcitrant minority creditors “plainlie to understande that yf anye informacion shalbe broughte at anye tyme againste them upon any matter by strictness of law, they are to looke for noe favor but all extreamitie that maie be used, in respecte of the contempte they shewe to her Majestie’s authoritie and harde disposicion to theis poor men oppressed by their rigorous dealing”. Malynes (1622), a well-known

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4 On the general history of bankruptcy laws, see Kohler (1892), Santarelli (1964), Hilaire (1986), Safley (2013). On the economics of bankruptcy law, in a large literature, see i.a. Jackson (1986), Baird (1986).
6 During the seventeenth century, “[p]rocedures were crudely outlined, clerical requirements were ignored, and all the statutes were amorphous on the subject of ultimate administrative and legal responsibility” (Jones 1979). On Commissions, see also Holdsworth (1914), Dawson (1950). Price (1694) for a typical pamphlet against the corruption of commissioners.
commentator of early modern English mercantile law, and a supporter of Continental-style majority arrangements, also shared this grim view with regard to the Chancery’s interventions.7 Against this background, the fight over Bills of Conformity became rapidly embroiled in the much broader conflict between the Common law courts and Parliament on the one hand, and the King and Equity courts on the other. Its core object, as is well known, was the evolution of the monarchy and the resistance to emerging absolutist trends. One major stake in this fight was indeed the protection of private rights against state-enforced monopolies, arbitrary taxation or executive interventions. It is not insignificant that the present episode unfold at the same time and place as the dispute over the Statutes of Monopolies (1624) which remains a better-known landmark of early modern English political history. In 1620, a streamlined version of the Bills of Conformity was introduced by Francis Bacon—then Lord Chancellor, hence an ally of the King, and no minor historical figure.8 His main opponent in this fight was Edward Coke—then the most articulate defender of Common law and Common law courts, as well as a major leader in the House of Commons. His attack on the Bills of Conformity, on 14 March 1621, would be the opening shot in the final scene of Coke’s long political and personal fight against Bacon. Immediately after the Bills had been actually banned, and in front of the same parliamentary committee, charges of corruption were levelled against Bacon, charges to which he would confess to before being impeached by Parliament on 3 May9 - this would mark the end of his long and remarkable public life.10 Even though they were entering at that time a long-term competition for pre-eminence over commercial affairs, the Common law courts did not attempt however to take control of bankruptcies: after Coke had lend his arm to the abolishment of majority arrangements, these procedures remained in the weak and contested hands of the Commissions.11 The overall result was that bankruptcy remained a pure debt-collection instrument with strong anti-market features. On the one hand, the entrepreneur was very much at risk: if any unpaid debt remained after a bankruptcy procedure was closed, then any new resources acquired or earned by him could be seized (including inheritance). He could also be returned to prison by any individual creditor and would stay there as long as the latter was willing to pay for his incarceration. These risks were further compounded by the Common law courts’ resistance to

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7 “the Bills of conformitie were of late yeares used in the Chauncerie, which by the Parlement Anno 1621 are made void, because of divers great abuses committed in the defence of Bankrupts, who to shelter themselves from the rigor of the Common-lawes, did preferre their Bills of complaint in Chauncerie, which was in the statute of protection, and the parties broken, became to be relieved for easie composition with their Creditors, albeit at charges another way extraordinarie”. (Malynes, 1622/1996)
8 See Pocock (1987) and Cromartie (2006) for a discussion of the “constitutional debate” over absolutism between the Monarchy, the Parliament and the Common lawyers. Kishlanski (1996, Chapter 4) for a broad presentation of the political history of Britain during the first decades of the 17th century.
9 On the circumstances and the Parliamentary politics of the day, see Zaller (1971), White (1979), Powell (1996). For the economic environment Supple (1959) and Kindleberger (1991). In 1624 the very attempt to reach an arrangement with adverse effects for creditors would be qualified as a penal “act of bankruptcy”, inevitably leading to liquidation.
10 Note also that Bacon’s private secretary at the time was the young Thomas Hobbes.
partnership’s limited liability of the *commenda* type. On the other hand, the voluntary principle made it hard to address situations of financial distress: solvent businesses that suffered a liquidity shock might not be able to reschedule and creditors may fail to restructure insolvent firms as going concerns even when this option was superior to liquidation. Even a piecemeal, gradual liquidation over a few months or a year (as opposed to fire-sale liquidation) could be difficult to obtain.

Until the end of the seventeenth century, a great number of pamphlets against the debtor and bankruptcy law can actually be found, together with recurring attempts at allowing again the judicial confirmation of majority arrangements, along Continental lines. This proposal experienced a strong revival during the last two decades of the seventeenth century, as attempts to introduce it were made in 1679, in 1693 and in 1696–97, along with *ad hoc* measures of debt relief (in 1649-1654, 1670–72, 1678, 1690, and 1694).

The breakthrough as regard the debtor’s fate occurred in 1705 with the Act of Anne, which brought more balance into the institution: if he transferred all his assets and acted cooperatively, and if four fifths of creditors agreed, then the failed merchant would be discharged of his residual liabilities and his old creditors could no longer throw him in prison or seize his new assets. Hence, fresh start had now become a possibility though the counterpart to this step was that the property rights of the minority could now be intervened. At least since the late eighteenth century and until today, the 1705 Act has been hailed as the true birth date of a unique, pro-market, English bankruptcy tradition: one that uniquely conjoins “principles of humanity and the benefit of trade”—in the usual phraseology. This new sense of legitimacy and efficiency is also underlined by the complete ignorance of the well-established presence of the fresh start in the Italian and Continental tradition since medieval times.

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11 Common law courts had developed a specific debtor law, a very harsh one indeed, that relied extensively on imprisonment for debt, but this was only an instrument for individual creditors, not one that would coordinate action against a common debtor.

12 Rogers (1995), Harris (2000); also Getzler and McNair (2005) for a partially revisionist statement.

13 The digital collection “Early English Books Online” that covers the seventeenth centuries includes (a minimum of) 52 pamphlets, petitions or libels against prison for debt, about half of them dated between 1640 and 1653. Note, however, that prison for unserviced debt concerned bankrupts as well as small debtors who had no access to bankruptcy.

14 See Treiman (1938) and Hoppit (1987). The 1697 act, which abolished the 1696 act on arrangement, mentions primarily the opportunities for fraud and deception. However, Cooper (1801) states that only a single arrangement was actually confirmed during the whole year when the law was in effect.

15 See Kaddens (2011), as well as Tabb (1991) and McCoid (1996)

16 Terms similar to these are used by Cooke (1799), Cullen (1800), and Beawes (1813). In the much-quoted, later commentary of Blackstone: “Thus the bankrupt becomes a clear man again; and [...] may become a useful member of the commonwealth” (1811, p. 488). In 1732 a comprehensive “codifying Act” reiterated the principle of discharge and would remain, more generally, the touchstone of legislation until 1825. Hoppit (1987) discusses how bankruptcy proceedings worked during the eighteenth century (chapter 3), and how they related to the rules applying to small debts and to Insolvency proceedings; see also his quarterly statistical series, and Marriner (1980).

17 Continental lawmakers had long noted that keeping debtors in jail indefinitely and pre-empting all future income flows was not a promising incentive scheme. In *Les coutumes du Beauvaisis* (1283), one of the best-known medieval legal treatises, Philippe de Beaumanoir had already made the point: « It would be against any sense of
The true enigma in this apparent unanimity in favour of the post-1705 settlement is that it addressed only one part of the problem, i.e. the personal fate of the bankrupt debtor. What is missing in this narrative is the symmetric problem of how to deal with continuation and restructuring. There are indeed good reasons to hypothesize that the emerging sense of English exceptionality reflected also progress on that side. Significantly, by the late eighteenth century, all references to the Continental approach to majority-based restructuring had also been shed. The very memory of this old practice seems to have been lost.\textsuperscript{18} Even during the long and tortuous road back to the majoritarian principle, between the 1820s and the 1880s, the recognition of returning to a past or foreign model is seldom evident.

\section*{IV. LEGAL INNOVATION: THE LAW MERCHANT MEETS ENGLISH TRUSTS}

The modern economic and legal historiography on debts often mentions the practice of so-called “composition arrangements” and “composition deeds” among seventeenth and eighteenth century English merchants. But it says very little on how these agreements worked and how they were regulated.\textsuperscript{19} One reason for this neglect is that those agreements being private, thanks to the 1621 Act, they would not find easily their way into public archives. Hence, they tend to be scattered or lost. Another factor is that the main institutional innovation that marked this practice resulted from the gradual convergence of two legal institutions that belonged to very distinct bodies of law.

On the one hand was the traditional composition agreement that had indeed its roots in the old, cross-European Law Merchant.\textsuperscript{20} In short, provided they all agreed, creditors could at their discretion offer to the debtor either more time or a write-off, and a protection from imprisonment for a given period. Failure to agree on a private basis would then be followed on the Continent by court-petitioning, leading to a second round of bargaining, with more judicial safeguards. The parties would then benefit from more guarantees regarding the validity of individual debt contracts, equal access to private information, the protection of assets during the procedure, etc. Qualified majority vote, on a weighted basis, would then be followed by judicial confirmation. Formally, however, such accords were structured by new humanity to keep the debtor indefinitely in prison, since we can see that the creditor cannot be paid by the prison. » (quoted by Troplong 1847, p. 19)

\textsuperscript{18} In his treatise on commercial law, Wyndham Beawes (1813) allocates more than a hundred pages to bankruptcy issues, including a detailed comment on the 1673 French \textit{Ordonnance sur le Commerce}; but he does not mention once the arrangement based on qualified majority vote. In the case of the Netherlands, he suggests that traders “may find some method to settle with the creditors”. Cooper (1801) defines this same practice (now called \textit{Concordat}) as “a mode of composition which not unfrequently takes place” in France.

\textsuperscript{19} Muldrew (1998) presents detailed analysis of the interaction between credit markets and court in the early-modern period, including bankruptcy. Hoppit (1987) comments on compositions during the eighteenth century and mentions trusts. On the nineteenth century experience, Lester (1995) offers statistical indications that compositions were actually far more numerous than bankruptcies. But none of these authors explore in detail how compositions worked and evolved, and how they addressed the underlying collective action problems.

\textsuperscript{20} On the English practice of these accords, see Malynes (1622), Hutton (1652), Billinghurst (1674), and Brown (1701). For Continental versions, see Peri (1672) and Savary (1675).
bilateral contracts between the debtor and each individual creditor: the collective dimension of the proceeding did not extend beyond the judicial process.

Contrary to the old Continental composition, the trust was a typically English institution. It initially belonged to land and inheritance law and was developed as a response to the difficulty, under the Common Law, to transfer assets by way of will. Originally, trusts were thus assignments made by a landowner to (what we today would call) a fiduciary agent; he would then exercise and manage the underlying property rights in favor of a third-party—typically a widow or other inheritor(s). The legal discussion about trust is thus in large part about the extent to which ownership rights were actually transferred, the respective rights of the three parties, the exact mandate and responsibilities of the trustee or the reversibility of the operation. Beside is also a discussion on whether trusts ultimately belong to the law of property or contract.

By the mid-seventeenth century the typical clientele of such accords, i.e. land-owners, remained in a world far apart from commerce—socially, politically, and legally. This distance was further increased due to the fact that bankruptcy statutes applied only to a specific list of professions, directly associated to trade. The issue at stake, in the present discussion, is how these professions would progressively gain access to trust and transform it in a collective instrument, or a vehicle, to renegotiate commercial debts and assets. As said, this evolution was not driven by legislation but by precedents. Here is how, following textbooks and treaties, trusts and composition agreements converged over many decades and eventually offered a practical legal tool for restructuring businesses.

i. In The Young Clerks Guide, Hutton (1652) describes separately a traditional, voluntary Letter of Composition and a trust to which a husband may assign his properties, which in practice meant land, to the benefit of inheritors and creditors. The same legal strategy as regard inheritance is presented in Herne (1656), though he mentions that the trustee would pay off the debts first, perhaps in order of their legal ranking (i.e. in terms of classes of creditors); he would then transfer the balance (or revenue flow) to the landowner’s heirs. Still, there is no mention in these two books that the trust could be used as well by merchants and traders.

ii. Twenty years later, things did not seem to have changed much: in Arcana Clericalia, Billinghamurst (1674) describes in a similar manner how a property holder can convey unmovable assets to a trust. Yet, in the second half of the book, which deals specifically with contracts forms used by traders (e.g., partnership, maritime contracts, bills, etc.), he does not mention trusts as a vehicle to reshuffle commercial debts and assets. Only traditional compositions with creditors are envisaged, i.e. «every of them, for himself and not jointly» (p. 222). Even the somewhat

22 See Langbein (1995) on this count.
intermediate case of a merchant’s widow is envisaged only on the basis of a debt write-of, plus a Letter of Administration that puts her under the supervision of an agent of the creditors; but the later do not have any right on, or direct access to, the assets.

iii. The same year in a treatise of inheritance addressed primarily to land-owners, The Orphans Legacy, Godolphin (1674) proposes however a much more developed treatment of the deceased’s financial affairs, especially in the case of his being insolvent: the judge may then decide to create a trust, to which the debts and remaining assets will be transferred to the joint benefit of all creditors. The rules that are being described then shadow many aspects of a generic bankruptcy procedure: debts are accelerated, a hierarchy of creditors governs the distribution of dividends, the trustee may negotiate a composition with the creditors, and the heirs may received a minimal guaranteed income. Bridgeman (1682) presents similar materials and confirms therefore an evolution of the jurisprudence on trusts towards more market-based contractual activities. This suggests that, in this early phase of evolution, trusts moved towards commercial failure first by taking on the case of the physical decease of the debtor.

iv. The next step was observed on the side of bankruptcy law: in The Law Against the Bankrupts, Goodinge (1695) mentions that Bankruptcy Commissioners may now assign the debtor’s assets and debts in trust to the creditors. From a purely formal perspective, this did not mark a real innovation: a 1603 Act already established this very possibility, although in the previous decades practitioners’ books did not mention this practice. Hence, by all accounts, it only remained an ignored possibility. Beside, in Goodinge’s treaty, the intention beyond the creation of a trust is only to safeguard the assets during the procedure and before liquidation is completed. Hence it is not yet envisaged as a long-lived business institution. Giles, in The Accomplished Conveyancer (1715) describes a similar mechanism under the form of “An Assignment of a Bankrupt’s Estate, made from the Commissioners to one of the chief Creditors of the said Bankrupt, in Trust, to be sold for the Benefit all the Creditors”.

v. The two trends, with regard respectively to trusts and arrangements, finally meet in Bird’s Practicing Scrivener and Modern Conveyancer (1729). On the one hand, he presents a model for the “Absolute assignment of debts to a Person, in Trust, for himself and the rest of the Creditors” (p. 389). The point, here, is that a trust can now be created even outside bankruptcy, though arguably as a response to a situation of financial distress. On the other hand, Bird states (p. 462) that after the opening of a bankruptcy procedure, and if all creditors and the debtor agree, they may ask for the proceedings to be closed or “superseded”, so as to allow them creating a trust. In other words, bankruptcy was not anymore a strict “one entry-one exit” process, as it had been since the 1621 Parliament Act. A strategic link was established between the operation of statutes and private arrangements: bargaining in the shadow of the law had become a much more sophisticated game.
By the 1720’s it seems therefore that the main pieces of a comprehensive bankruptcy regime were in place: liquidation at the hands of a Bankruptcy Commission (as established in 1543), the traditional “Law Merchant” composition, the newly fashioned trust (also known as a composition deed), and debt discharge (the 1706 Act of Anne). Here is the background against which the narrative on the English exceptionality in bankruptcy matter was formed. Innovation then seems to have stalled, a point observed later by Holland (1864). Or perhaps lawyers just kept writing along the usual dividing lines of the legal academy, without exploring further the new connections invented by practitioners.24

What is sure is that by the late eighteenth century compositions-cum-trusts were widely practiced, they enjoyed strong court protection, and they had become increasingly sophisticated. Cases (mostly from Equity Courts) are commented on and comprehensive models of such accords are published, for instance in Barton’s Original Precedents in Conveyancing (1802) and in Montefiore’s Commercial and Notarial Precedents (1803). The dates of these publications suggest that the economic and financial disruptions brought about by the Revolutionary and Napoleonic wars might have accelerated legal innovations in this field as in others. Later on, Crabb’s 1835 Conveyancer’s Assistant offers two remarkable examples of a complex management or agency contract built into a trust deed, established to the benefit of creditors though in the absence of any formal bankruptcy proceeding.25

With hindsight, and from a formal perspective, the outcome of this effort by generations of judges is brilliant. In essence, (continental) adjudication had been replaced by adhesion to a (English) trust, and the eventual confirmation of majority voting substituted by initial unanimity. On the Continent, the authority to redistribute property rights and to rewrite contracts coercively rested ultimately in the judge, whose legitimacy derived from the delegation he received from the sovereign. In England, just as in Jean-Jacques Rousseau’s Social Contract (1762), provided unanimity had been obtained at entry, agency and majority vote would rule inside. Voluntary adhesion thus created a new entity that would be both self-governed and virtually permanent.

As the great legal historian Frederic W. Maitland wrote, from a broader perspective, “the device of building a wall of trustees enabled us to construct bodies, which were not technically corporations, and which yet would be sufficiently protected from the assaults of individualistic theory” (Maitland

24 Lily (1735) and Woods (1762), two practionners’ guides, include materials comparable to those present in Bird (1729); but the connection between bankruptcies on the one hand, and trust and conveyances on the other, is absent from both Green (1776) and Sanders (1792), which are among the main, late eighteenth century treatises on their respective subjects. Similarly, many bankruptcy treatises mention the possibility to “supersede” a bankruptcy proceeding, i.e. to close it by agreements among the parties; but they don’t say why, or under which conditions, the parties would have an interest in taking this decision.

25 The first ever treaty on compositions, Montagu (1824), does not say much on trusts. Afterwards, the main authors are Forsyth (1841), Holland (1864) and Brown (1868). Note also that, from a formal perspective, this trust-based approach should be carefully differentiated from more recent practices of: i) pre-bankruptcy contracting, which typically requires ex post confirmation, via rapid-pace court proceeding (Warren and Westbrook, 2005); and ii) private procedural ordering, as an extended form of alternate dispute resolution (Dodge 2011).
1905/2003). In the present case, the “individualistic theory” is indeed well illustrated by the tradition of the Italian fallimento, followed by the French faillite. Once the agreement is confirmed and the judge has closed the procedure, the parties are returned to their separate, individual market existence and to their bilateral contractual relationships. This was most clearly stated by the Baron Locré, from the French Conseil d’Etat, who drafted the landmark 1807 Code de Commerce: “from the moment all creditors have agreed [and exited the court] (…) all parties are brought back to the situation where they were [before the bankruptcy process]. (…) Such a state of things, where everything is individual, excludes any coordination of creditors, whose interests would be unified in a common interest and exercised in common.”

With hindsight, the key point is that both the Continental and the English roads were structured, though in different ways, by the unique strength that derives from the free, individual commitments of private wealth and property. In this sense, both traditions are liberal and belong to a judicialised, law-based economic environment.

V. BARGAINING IN THE SHADOW OF STATUTE

How did the English private-law, non-statutory arrangements work at maturity? Which rules helped the parties circumventing at least some of the collective action problems caused by the absence of a majority rule? And how did they organise the governance of the trust, once they had joined it?

As we shift from the long term genealogy of this institution to its operation at maturity, i.e. to its synchronic structure, the first evidence that comes out is that the defining constraint was still, at the turn of the nineteenth century, the 1621 prohibition of Bills of Conformity. The new contractual institution had been shaped in the shadow of this statute and it kept operating under its threat: anything looking like a side-agreement, or an attempt to coerce recalcitrant creditors, could warrant the immediate opening of a bankruptcy proceeding, hence liquidation. Thus, on the one hand, the constant reminders not to cross the sometimes indistinct ‘red line’ and, on the other, the recurring account of: “the extreme difficulty of getting all creditors, where the number of them is great, to acquiesce in the arrangement”. That being said, the jurisprudence very clearly aimed at limiting, as far as possible, the room for disruptive or opportunistic behaviours.

Take the case of entry into a trust. Whereas a rigid interpretation of such private accords could have required express written adhesion before a deed (i.e., the final legal instrument) became binding to all creditors, the courts decided that even an oral agreement made at the creditors’ meeting would be sufficient, provided other parties had acted on the basis of that signal: “if a creditor, by his undertaking to accept a composition, induce the debtor to part with his property to his creditors, or induce the other

26 Locré (1829), volume III, page 453
27 Forsyth (1841), p.16
creditors to discharge the debtor, to enter into the composition deed, or deliver up securities to him, such creditors would be bound by such undertaking.”

More generally, the jurisprudence construed compositions deeds as a collective contract that formally substituted its own collective rules to those of the earlier, individual contracts: “all the creditors being assembled for the purpose of arranging the defendant’s affairs, they all undertook and mutually contracted, with each other”. Or, in another formulation: “upon a composition deed all the parties are supposed to stand in the same situation (...) and no engagement can stand which has been held from the whole body of the creditors (...). In bankruptcy there is no concert or understanding between the creditors”.

This echo of the Baron Locré’s comment on bankruptcy underlines again the contrast with the Continental practice, where traders’ courts were the place where the “concert of creditors” met. In England, creditors only convened outside bankruptcy and no one could be pushed into the concert hall against his will. On that basis, a series of supplementary rules supported further the creditors as they tried to address their common interest. Most of them mimic key features of a standard bankruptcy law and tend to make easier for the parties to coordinate.

i. Debts not yet mature at the time of the composition were accelerated; that is, they were considered as if they had become due, so that they were all brought together on the table “as if the same debts had been proved or claimed under a fiat of bankruptcy”. This clause is non-contractual, in so far as merchants could not adopt it on a pure, decentralised basis. Its role was to ease the way for the renegotiation of the whole stock of debt at once, rather than remaining bounded by the respective maturity schedule of each single contract. Hence this rule solved a critical problem of coordination by “synchronising” the time horizon of parties and contracts.

ii. Once all creditors had been convened at the (private) negotiation table, they could ask one of the Masters of the High Court of Chancery to confirm the validity of both the debtor’s accounts and the creditors’ debt titles. This powerful public authority thus contributed decisively to reducing the risks implied by this bargain, whose aim was to move irreversibly to a collective trust. It also shadows one key guarantee typically offered by a judicial procedure, after adjudication of bankruptcy.

iii. Creditors were paid on an equal (pro-rata) basis, a rule that is in many respect the founding stone of a bankruptcy process, as opposed to a DIY approach to defaults, based on individual

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28 Chitty (1824, p. 691). Cases establishing this rule include Ex Parte Sadler (1808), Bradley v. Gregory (1810), Butler v. Rhode (1820).
29 Chitty (1824, p. 740), quoting an unreferenced case.
30 Britten v. Hughes (1829).
31 Crabb (1835, p. 308).
remedies. A principle of inter-creditor equity was thus built into the institution, together with the principle of acceleration. On other hand, the rights of senior creditors remained intact.  

iv. Weighted majority rule applied among the parties once they had joined a composition. Said differently, the ‘sanctity’ of the initial debt contracts warranted a unanimity-based decision rule only once – when entering collective action – but not afterwards. Voluntary adherence, even an oral one, was considered sufficiently strong to first displace the earlier contracts and then enforce a majority rule among the parties that would extend far into the future, well after they had left the negotiating table. The parties were thus considered to have joined a long-lived collective body (the trust), not solely a transitory platform for contractual renegotiation.

v. Any secret side-arrangement between the debtor and some creditors would be void – just as under virtually any European bankruptcy statute. The aim was to offer a strong legal safeguard to absentee creditors or to minority stakeholders with a limited incentive to invest much time in the negotiation. On the other hand minority investors could be bought-out by the majority or by the main players. This was again a most clearly a potent instrument to control the risk of holdout or costly negotiations among participants to the trust.

vi. If for any reason a bankruptcy were declared on the back of a composition (i.e. by a creditor who had remained outside), then participant creditors were remarkably well protected. First, they retained whatever payment they had received in the composition, as some kind of anticipated dividend from the eventual liquidation. Second, their earlier, pre-composition rights against the debtor were re-instated, so that they were allowed to claim payments on the basis of their initial debt titles. This second rule raised serious and obvious critics, due to the legally irreversible character of the trust. However, if the legal argument is indeed contestable, the economic rational is clear: other things equal the obligation to participate in an eventual bankruptcy on the basis of (irreversibly) reduced debts, would have created strong ex-ante disincentives to enter such accord. This would have reduced their chance of success, even though it was in the interest of many creditors to join it.

vii. Yet, once inside a trust, a creditor could not opt out and go back to court: he would keep that option only by staying put. Still, the reverse movement from court to trust remained a distinct

32 Stock vs. Mason (1798).
33 Cork v Saunders (1817), see also the model agreement by Crabb (1835, p. 309).
34 Cockshott v. Benett (1788), Mawson v. Stock (1798/1801); by the same token, if assets were discovered or inherited after a debt write-off had been agreed under a composition, then creditors could not sue on their initial contracts (Lord Castleton v. Lord Fanshaw, 1699).
35 Ex parte Vere (1812).
36 “The effect of these compositions is mischievous. They are in truth private bankruptcies, without the advantage attending a Commission under the general law; and paying the old creditors with the property of the new.” Ex Parte Vere (1812).
possibility: as said, the whole concert of creditors could decide to exit or “supersede” bankruptcy and join collectively a newly-minted trust.

Let’s summarize this complex game. The two first rules deal with the structure of debt contracts, to the effect that transaction costs when re-contracting are reduced; the next two ones are about inter-creditor equity when sharing the dividends and making decisions; then is the clause about buying-out minority investors; and the last two rules are about the interaction between the trust-based arrangement and the bankruptcy procedure per se. A common thread links however these elements together, namely the irreversible character of joining a trust (unless a bankruptcy process is opened by an outsider). Here is a straightforward, court-enforced commitment mechanism which effect is i.a. to extend sharply the time-horizon of the arrangement; but it also works backward, to the ex ante stage, by making more acute the need to control transaction costs and informational risks when the parties calculate their strategies and bargain on the structure of a possible deed. The whole institution thus works on the balance between these two terms: the binding, irreversible character of adhesion to the trust, and the necessity to ease the way for the parties as they converge towards this mutual understanding.

This regime also presented serious drawbacks. First, the solution to the dilemma created by the 1621 vote took a lot of time to come. As already underlined, the unanimity rule long remained a continuing source of frustration: it could cause undue liquidations, like in the paradigmatic case of a viable firm that suffers a liquidity shock but cannot coordinate with its creditors. Secondly, safeguards when bargaining out of court were also a source of concern, whether one thinks of asymmetric access to information, publicity, or to power relationships during the negotiation. Lastly, the trusts long remained an imperfect business vehicle, as already underlined by Harris (2000): they raised problems of unlimited responsibility for the trustees and internal governance problems could be substantial. 37

This broad, largely accepted account provided the background for two series of reforms between the 1840s and 1880s which set the two-track English regime on a new course: the trust-based approach to restructuring was amended by way of statutes, so as to make it safer to the parties; and at about the same time, the majoritarian principle was gradually reinstated in English bankruptcy statutes 38. Remarkably however the end of the ban on majority accords was not followed by a decline of the voluntary road to restructuring, which had developed in its shadow. Market forces did not dismantle the institution that had been slowly built-up since the early seventeenth century on the basis of the trust, the old merchants’ composition, and the supplementary judge-made rules. The resulting, anomalous institution had acquired a life of its own, a raison d’être, that was vindicated by the continuing adhesion of merchants,

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37 In 1840, a Parliamentary report on bankruptcy reform had indeed stated that “the only alteration in the law relating to arrangement with creditors through the medium of such [trust-]deed, which we think it right, at present, to recommend to your Majesty is, that they should be placed under more efficient control”. Report of the Commissioners (1840), p. xii; quoted in Forsyth (1841).

38 The first attempt at reintroducing majority vote, in 1843, came with a high majority threshold of 9/10, and was not a great success; other reforms followed, in 1849 and 1861, without great results on this count. It was only after 1883 that this principle became widely accepted.
manufacturers and bankers. By the end of the century, trust-based settlements had become the standard approach to the restructuring of large capitalist firms, whereas the majority-based road was more often taken in the case of smaller businesses (Bowen 1907).

This second lease of life suggests, first, that path-dependency did not result here from network externalities or even the very principle of *stare decisis*, as argued for instance by Hathaway (2001); in the present case, formal persistence rested on the capacity of the assembled rules to structure options, incentives and constraints in ways that kept being helpful to the parties, even after the economic and legal environment had changed beyond recognition. The key features therefore are the *synchronic structure of this set of rules*, from which their efficiency at solving collective action problems derived; then is the scope of cases that could be addressed on that basis, as conditions evolved.

The late and unexpected success of this institution also sheds lights retrospectively on the key difference with the Continental model. Because the two regimes did not balance in the same way transaction costs at entry and the ulterior capacity to restructure property rights, their implicit target were not the same. If anything, the Continental approach, with its strong roots in medieval commercial law, is more adequate to an economy based on comparatively small businesses, little capital on the ground, a distribution of debt among many peer-merchants, and a lot of liquidity shocks calling for easy adjustments of short term payments constraints. In other words, an economy that is still in the first stages of commercial and industrial expansion. On that count, and at least until the early eighteenth century, the English bankruptcy regime was not much supportive of entrepreneurship. Even a century later, the mature two-tracks regime may not have presented clear comparative advantages vis-à-vis the related chapter of the 1807 *Code de Commerce*. Things changed in the second half of that century. At that time, the policy debate on bankruptcy reform was focussed across Europe on how to make arrangements easier and, critically, more adequate to the restructuring of large incorporated firms, with a complex balance sheet and a substantial going concern value (Sgard 2006). In this context, the trust-based approach, with its long time horizon, its developed agency structure and its recently reformed governance emerged as an (almost) ready-made solution.

**VI. CONCLUSION**

This article has analysed how an original, two-sided bankruptcy regime gradually emerged as a consequence of a largely ignored act, passed in 1621 by the London Parliament. Against the dominant, Continental approach, where statutes support bargaining within the court, this bifurcation left the English procedure with just one exit, liquidation. Arrangement had to be adhered to voluntarily, so that serious problems of collective action had to be confronted. However rather than opting out of both the law and the courts, the merchants kept submitting cases. Over two centuries the judges then developed a
coherent, two-track regime, which eventually presented to debtors and creditors a set of options, constraints and incentives that was proved de facto helpful, even under new economic circumstances.

The paradox is that the 1621 Act, with its utterly anti-entrepreneurial features, is indirectly though strongly linked to a remarkably open, flexible instrument, which real success came only in the late decades of the Industrial revolution. Beyond the paradox however, the real success story is in how the courts worked over decades and delivered this consistent and enduring pro-market institution. They demonstrated at this point a capacity to create new legal concepts and build a consistent, complex regime. Path dependency has its origins in these courts and in the ingenuity of their judges - not in the 1621 Parliament, nor in the spontaneous capacity of merchants to design new rules and customs.
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