Bankruptcy Law, Majority Rule, and Private Ordering in England and France (Seventeenth–Nineteenth Century)

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ABSTRACT

Rather than evolving as a platform for renegotiation and debt discharge, as in France, English bankruptcy law emerged as a liquidation-only institution after majority arrangements among creditors were prohibited, in 1621. However, after 1705, good faith debtors could be offered a discharge, i.e. a form of limited liability. Later, private practices also developed into a little-known body of consistent, court-enforced, "quasi-bankruptcy rules" based however on voluntary adhesion. A key element was the convergence between the old, Law Merchant "composition agreement" and the English trust, to which creditors could jointly convey assets. By the 1780s, therefore, merchants were offered rigidity under the statutes or large, though voluntary negotiability in their shadow. Conversely, the French traders' courts consistently helped the merchants overcome undue defaults, i.e. market failures. But majority vote limited the capacity to restructure rights and to design arrangements that may have better preserved their collective interest over time.

Keywords: bankruptcy law, commercial courts, debt renegotiation, Common Law vs. Civil Law.

JEL numbers: N43, K12, K 40

1. INTRODUCTION

Bankruptcy is the ultimate market sanction. When markets have failed to impose a change of course and when implicit insolvency results in open illiquidity, market exit becomes a systemic necessity. And where markets have failed, a public institution should exercise sanction. Ever since the Italian Middle-ages, lawmakers have designed the intricate mechanism whereby contractual exchanges are suspended, losses shared and assets returned to the market. Hence, not all bankruptcy laws are identical. A law that performs reasonably well in one environment can not be expected to deliver the same performance elsewhere.

Still, there is a set of core problems that should be addressed by all bankruptcy laws. They often derive from the principle of intercreditor equity, hence from a principle of formal coordination that should be substituted to free-wheeling, individual trade-offs. The principle of a pro-rata distribution of losses among creditors is the first logical step in this direction, but the most striking feature is arguably a decision rule allowing a qualified majority of junior creditors to restructure the property rights of the minority. Historically, this has been the main rationale for granting judges a major role in bankruptcy proceedings - mere arbiters for instance might not enforce such a rule.

Once the parties are in court, however, the key question becomes the extent of their bargaining capacity. In principle, they are in the best position to balance the respective benefits of either liquidation, or restructuring and continuation. If this is true indeed, then it seems that debtors and creditors should be supported by the law and the courts, as they try to identify their best way out of default. One problem is that a majority rule may not legitimately support any restructuring of property rights, especially the most comprehensive ones. A further issue is the risk of adverse externalities, or moral hazard: if debtors know ex ante that they may find their way out of a default with reduced cost, then failure may become more common and the credit market may shrink. Therefore, lawmakers may decide after all that the courts should rather leave the parties to bargain privately and voluntarily—that is, out of court though probably not out of law.

This article compares how, from the 1620s until the 1880s, bankruptcy laws in England and France stabilized on opposite equilibria, on two counts. First they did not reach the same balance between market discipline and the freedom to recontract, that is between ex ante and ex post concerns. Second the division of labour between court proceedings and private voluntary approaches did not work the same way. Specifically, bankruptcy law in France has always accepted the judicial confirmation of qualified majority votes among creditors, so that courts became the main forum for bargaining on debts and assets, with little official interference. Private negotiations by notaries were also widespread, but as far as debt renegotiations are concerned, this forum did not emerge as a noticeable source of legal evolution. In England, on the other hand, judicial confirmation of votes was forbidden for two and half centuries, hence bankruptcy worked exclusively as a debt collection instrument, and a lot of business and innovation happened on a private-law basis. Remarkably, by the late eighteenth century, a set of parallel though voluntary "quasi-bankruptcy rules" had emerged, that has so far attracted very little scholarly attention.

It is intriguing that the two leading emerging economies of the day made such contrasting and enduring choices about a core market institution. In a standard "law and economics" framework, market forces would probably have identified much more rapidly a superior solution and induced convergence. Alternatively, if the analytical emphasis is placed less on the malleability of institutions than on path-dependent patterns, such as "legal origins" for instance, then the challenge becomes to account for both the initial divergence and the ultimate convergence of approaches. Since 1843, and more clearly since 1883, English law has indeed allowed for the confirmation of qualified majority vote.

Hence, as it explores these parallel histories, this article contributes to the large body of comparative literature that surveys how England and France slowly negotiated their way from the medieval or Law Merchant traditions into a modern, pro-market legal order. But this contribution also addresses the more theoretical question of how different institutional arrangements might emerge and solve the same, well-delineated economic problem. How did the governments commit themselves not to confiscate assets and rob creditors? Which alternate fora were made available to the merchants? And how did the lawmakers the balance pre-bankruptcy rights and the capacity to design far-reaching, post-bankruptcy arrangements? Still today, these questions remain at the core of what a contract-based, market economy is about and what may be the role for the state and the courts.

From a methodological viewpoint, this discussion is primarily about the "law in the books", which is surely different from actual practice, although their differences make both approaches important and legitimate. However, the sources I draw from go beyond learned treatises and well-known commentaries: they include cases and the many practitioners' law books that have been published since the mid-seventeenth century. Specifically these books present many models of agreements, deeds, and contracts that offer a remarkable entry into actual commercial practices, as they became more formalized and standardized. In other words, I take stock of how the statutes and the legal academy framed the issue and I then look at how businessmen and their attorneys addressed urgent problems of debt and defaults, collective action and market sanction.

It should be noted also that issues of economic efficiency are not addressed here: the possibility that the legal solutions adopted in England and France respectively may have had a differential economic or financial impact is not considered. A second caveat is that the comparison is skewed toward the English experience, which is explicitly envisaged as an exception vis-à-vis the French or Continental benchmark. Lastly, the reference case here is that of independent businessmen or partners – not corporations.

Section 2 summarizes the relevant economic literature. Section 3 describes how bankruptcy law first emerged in Italy and then developed in early-modern France. Section 4 then compares this benchmark experience with that of England, from the late sixteenth century till the nineteenth century. Sections 5 discuss possible explanations for these divergent choices and for their leading to two distinct, institutional equilibria. Section 6 concludes.

2. MARKET DISCIPLINE AND DEBT RENEGOTIATION

The expectation that ex post renegotiation may have adverse ex ante effects on implementing contracts is widely held in the economic literature. Probably the most general or systematic argument along this line derives from the economics of socialist and transition economies and, more specifically, from the works of János Kornai (1980). His core concept of soft versus hard budget constraints is based on widespread accounts of central planners' inability to commit themselves *not* to complete (or refinance) investment projects that appear to be bad ones.[1] Whereas a credible threat of liquidation might have induced management to better screen projects and to increase implementation efforts, the lack of ex post sanctions led instead to a loose pattern of resource mobilization. By implication, the more general lesson of this argument is that any contingent clause that affects the binding power of rules and contracts is presumed to have adverse consequences.

This paradigm thus converges with the "legal origins" literature as initiated by La Porta et al. (1998) and Glaeser and Shleifer (2002). In arguing that legal traditions protect contracts differently over time and across countries, these authors suggest that the enforcement of budget constraints is indeed the causal "transmission channel" from law to development. In particular, the more strongly pro-market

[1] See Kornai (1980). The more recent, standard model was formulated by Dewatripont and Maskin (1995).

character of English Common law—as compared with Civil or French law—would be reflected (other things being equal) by the superior binding power of contractual commitments in the former case.

Both the "budget constraints" and "legal origins" approaches have a direct effect on how the historical account of bankruptcy law is interpreted.[2] In their review of the literature on soft budget constraints, for instance, Kornai, Maskin and Roland (2003) claim, without any supportive evidence, that the long-term trend of market economies has historically been from harder to softer constraints. Although there are arguments for the superiority of a relatively tough, pro-creditor approach to bankruptcies in weak legal environments (Ayotte and Yun 2008), an alternate hypothesis may also be defended: in a monetary systems with no central bank and no lender of last resort, and where secondary markets for physical assets are illiquid, a tough bankruptcy law may disproportionately increase the number and the cost of undue failures, that in fact reflect market failures.[3] A narrow entry into the institution and low expected return may then lead to widespread creditor passivity and moral hazard (Mitchell 1993, Roland 2000).

Many seventeenth- and eighteenth-century traders' books actually make the point that an arrangement with an insolvent merchant is a viable option if it allows the debtor to liquidate progressively and on better terms. But they also note the underlying risks: in the introduction to *Le Parfait Négociant* (1675), Jacques Savary mentions for example that he witnessed failures occurring more than twenty years after the decisive losses had been incurred.

If this risk is assumed and if renegotiation is warranted, the question arises of where and under which rules it would take place. A well-established pattern is that settling disputes in court is ex ante the least preferable option for merchants – English, French or else. Courts take time and are costly, reputation costs are typically high, and all private dealings are revealed to the public eye. Hence, in a typical Coasean way, the parties should try to anticipate the outcome of a formal procedure and settle out of court, "in the shadow of the law" (Shapiro 1981, Galanter 1981). In the case of bankruptcy, they would agree on a distribution of losses that is equivalent to the one they would obtain in court (Schwartz 1993, White 1994). Still, the adverse incentives specific to end-game scenarios are distinctly pervasive in the case of defaults with multiple creditors. The later may run on the assets, so that distributive outcomes would be both unfair and unpredictable; or they may leverage asymmetries of information during renegotiation, so that problems of inter-creditor equity may arise. Alternatively, the debtor may just run away: in the 1820s English and French debtors were said to pack hotels, in Boulogne (France) and Dover (England) respectively.

These are the main reasons why bankruptcy laws have always been predicated on the notion that, unless the freedom of the parties to arbitrate is curtailed, defaults may lead to (largely) sub-optimal outcomes (Jackson 1986). Hence, some results that are possible under a bankruptcy statute may be out of reach in its absence: bankruptcy is doomed to be altogether a matter of process and substance. The problem however is that, at least in the short run, the very fact that the parties may be discretely shifted from a market rule of interaction to a constraining, non-market one, may rather add disruption or "volatility" in microeconomic interactions.[4] In other words, although this institution aims at smoothening the consequences of defaults and at extending the capacity of the parties to cooperate, in the short-term its non-linear mode of operation may further incite the agents to adopt disruptive strategic behaviours.[5]

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[2] La Porta et al. (1998), the first article by these authors on the economic effects of "legal origins", draw on (and misinterpret) bankruptcy laws as a source of indices regarding the protection of creditors' rights.

[3] Critics of reorganizations who point to their excessive reliance on dubious nonmarket valuations often assume, if only implicitly, that agents are not bound by liquidity constraints, as arising from markets; see, for instance, Roe (1983) and Baird (1986).

[4] See for instance the now classic confrontation between, on the one hand, Baird (1987) and Jackson (1982) who argue that bankruptcy outcomes should shadow as closely as possible pre-bankruptcy rights, and, on the other hand, Warren (1987) who defends that the logic of the process allows for far more discretion.

[5] By convention, the term *bankruptcy* refers here to the statutes in the narrow sense, whereas *bankruptcy regime* extends to the broader set of rules, jurisdictions, and established social practices that contribute to the settlement of debt defaults in general.

The mere fact that for centuries both the statutory and the private routes have always been available simultaneously in Europe strongly suggests that their relationship is one of both substitutability and complementarity. The consequence is that in the agents' perspective, the interaction between the statutory and the private "work-out" strategies is quite complex. Clearly, for instance, the private route should not be analysed in the same terms as the "informal" mechanisms of debt collection that are observed in countries with a dysfunctional judiciary.[6] Nor do they parallel the essentially private or professional orders of the type documented by a long line of researchers such as Macaulay (1963), Bernstein (1992) or Greif (1993). Even the notion of "arbitration in the shadow of the law", as applied in the case of tort litigation or conflicts over the interpretation of contracts, is inappropriate. The reason for this is that bankruptcy settlements are not primarily about legal uncertainty, of the sort that may be settled with "small talks" or informal guidance (Ginsburg and McAdams, 2004). Again, they are about collective action problems, often of the hard, end-game variety. The following discussion analyzes how these alternate options were framed and how they interplayed, in two countries with distinct legal traditions.

3. THE EARLY HISTORY OF BANKRUPTCY LAWS: THE ITALIAN-FRENCH BENCHMARK

3.1. Italian Origins

Modern bankruptcy laws emerged in the trading cities of northern Italy (Florence, Pisa, Genoa, Venice) during the thirteenth and fourteenth centuries (Kohler 1892, Santarelli 1964). At that time, the opening of a bankruptcy procedure already imposed on agents a clearly defined brake on normal contractual interactions: the individual remedies of creditors were suspended, and the debtor's status was severely reduced; he could no longer trade; his assets, accounting books, and correspondence were seized; he was usually imprisoned and torture was sometimes countenanced. A primary aim of these laws was to control the usual endgame problems in strategic interaction: creditors may run on the assets and the debtor may fly away, or adopt high-risk strategies of "gambling for resurrection".

Creditors could then either liquidate and share the proceeds on a pro-rata basis or negotiate a *concordato*: that is, a collective agreement with the debtor that allowed the latter to recover his assets and to resume trading with reduced or rescheduled debts-though without an intact reputation. The critical point is that a majority of creditors (generally a qualified majority) could bind dissenters when deciding between continuation and liquidation. If needed, a court would confirm the *concordato* and impose enforcement on any holdout investors. The contractual rights of minority creditors were thereby intervened, and their remaining wealth invested against their will in new contracts with the debtor. The critical character of such decisions was certainly not lost on lawmakers and the involved parties, which is no doubt a key reason why these procedures adopted a strong judicial character early on.

These core Italian principles were apparently exported to the rest of Europe, possibly via the great fairs, and absorbed into the statutes of the larger trading cities (e.g., Barcelona, Lyons, Antwerp, Bruges, Lübeck). As in Italy, procedures were generally conducted by mostly self-regulated, elected commercial courts. During the sixteenth century, kings and princes added repressive penal statutes against failed debtors.[7] More comprehensively, starting with the seventeenth century commercial customs were progressively confirmed, absorbed, and thoroughly restructured by the legal and judicial institutions of the new, large, territorial states (like England and France to start with). Regulations that had worked at particular times and places became the founding stones of emerging national economies.

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[6] In a vast literature, see for instance McMillan and Woodruff (2000) on former Soviet economies, Gambetta (1996) on the Italian Mafia

[7] The first such statutes were enacted in 1543 and 1571 (England) and in 1536 and 1560 (France).

This is the moment when the English and French experiences with bankruptcy law diverged. Whereas French Commercial law evolved as the legitimate heir to the Italian legacy, English law took a distinct trajectory: beginning in 1621, the judicial confirmation of majority arrangements was forbidden and so bankruptcy became a single-exit institution that allowed only for liquidation; accords between the parties could only be voluntary and private. This apparently minor deviation eventually led to sharply contrasting rules of the game, which by the eighteenth century resulted in well-differentiated, rather stable bankruptcy regimes. Moreover, this lengthy English exception is not an exclusively bilateral pattern: as far as I know, all Continental statutes and codes enshrined the confirmation of majority arrangements during the period under review.[8] This separate English route also had an end: since the later part of the nineteenth century, all countries that belong to the Common law tradition have allowed for qualified majority votes.

<<< Table 1 >>>

3.2. French Outcomes: The Law and the Procedures

An elementary account of the transition in France to an integrated, national legal order starts in the seventeenth century with the Kings (i.e. their courts) confirming and enforcing commercial customs.[9] Then Colbert, Louis XIV's reformist Minister of Finance (1661-1683), used these customs as the main basis for the 1673 *Ordonnance du Commerce*. This first modern commercial code, a light text indeed, would be compounded until the Revolution by a series of piecemeal royal decisions and by a large body of learned comments.[10] It then left a strong mark on the 1807 *Code de Commerce*, which would also have a large influence across Continental Europe and its colonies.

In this long-run history, bankruptcy—which was addressed comprehensively in the 1673 statute—is probably the item whose evolution since the Italian, medieval experiences presents the clearest elements of continuity.[11] The standard procedure, or *faillite*, was the direct heir to the Italian *fallimento* and it offered the two usual options.[12] If the parties decided to liquidate, however, the debtor would not be offered a debt discharge and a fresh start: unless he later fully reimbursed his creditors, he would not regain his full civic and professional rights. Alternatively, a continuation arrangement was the normal and least dishonorable road to debt restructuring and hence to the discharge of debt. The doctrine also made clear that any arrangement would bind only junior creditors - senior creditors were fully protected.[13]

The jurisdictions in charge of bankruptcies were, first, the *Cours Consulaires*, which the French King established in increasing numbers from 1549 onward. Just before the 1673 *Ordonnance* was adopted,

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[8] The *Conseillers d'Etat* who drafted the 1807 *Code de Commerce* considered the *Concordat* to be the "crowning" of the procedure (Locré 1829, book 4, p. 150); in his landmark historical treatise, Kohler (1892) defined it as "the soul of bankruptcy law" - "*die Seele des Konkurswesens*" (Kohler 1892, p. 451); .

[9] See for instance Bounyn (1586), Mareschal (1625) and *Le Stile de la Juridiction royale* (1657); also Guillon (1904).

[10] Savary's *Parfait Négociant* (1675) is by far the most famous commentary; it was re-edited and translated until the end of the eighteenth century. Among many others, see also Toubeau (1682), Bornier (1749), and Rogue (1773). Laurens (1806) for a last account of bankruptcy law before the 1807 Code.

[11] The main classical treaties on French bankruptcy law are Renouard (1857), Thaller (1887), Guillon (1904) and Percerou (1935); the more recent legal historiography includes Dupouy (1960) and Hilaire (1986).

[12] Under the Ancien Régime, debtors could also benefit from *lettre de répit,* which were granted on a discretionary basis by the Chancery and gave temporary relief to the debtor. Then was the *cession,* a Roman institution that re-emerged within the Civil (not Commercial) law. Finally, *la banqueroute* was the penal procedure associated with commercial failure in case of fraud. All legal commentators discussed in detail these alternative roads.

[13] Under the *Ordonnance,* a three-quarters majority (in sums) was needed in order to receive confirmation. The term *Concordat* was rarely used during the Ancien regime and entered the law only in 1807. Before that, terms like *accord*, *contrat* or *composition* are often used, as well as *attermoiement* when only time was offered, without debt write-off.

they were reformed and streamlined (1668–71) though they did not loose their fairly autonomous, self-managed character. Traders elected the judges among themselves for two-year terms that ensured a continuous turnover among the local commercial elite. Justice was also free of charge, rules of discovery and proof were light, attorneys were called in only for larger cases, and an appeal did not usually suspend execution.

Yet, the *Juges Consulaires* have been constantly in conflict with the standard civil jurisdictions, which despised their lack of legal education and their light approach to the rules (and the price) of justice. Bankruptcies became a major stake in this competition so that they went to one or the other jurisdiction, depending upon time and place. Still, both types of judges applied the *Ordonnance*, which in turn made very clear that the substance of cases should remain squarely in private hands. Judges would not weigh on the parties' decision and cash would *never* pass through the hands of bailiffs, notaries, police officers and "*autres personnes publiques*" (title 11, article 9). This game continued until the Revolution: in 1790, the *Cours Consulaires* were transformed overnight into the *Tribunaux de Commerce* and, in 1807 the *Code de Commerce* gave them overall authority over the *faillites*. Only in the smaller towns, where there was no *Tribunal de commerce*, would the civil courts do the job.[14]

4. THE ENGLISH EXCEPTION

When comparing the Italian-French tradition and the English one, an early significant element is that in the latter case the medieval traders' courts (*Pie powders* and *Stapple* courts) were contested early on and then sidelined by the Common law courts.[15] By the sixteenth century, the traders' courts were clearly on their way out at a time when their counterparts were blossoming on the Continent.[16] Hence, absorption of the Law Merchant into the broader legal order would be advanced primarily though very progressively by the Common law courts, then by the Equity courts, and finally by a number of statutes. But there would be nothing like an *Ordonnance*, a comprehensive edict, or Code, adopted and enforced by the monarch.

However, in their fight for pre-eminence over commercial affairs, the Common law courts never attempted to take control of bankruptcy procedures. They also clearly resisted any intervention in private contracts, of which majority votes among creditors is a most striking example. Starting in 1543, cases were then 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 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. The point however is that, contrary to the case of the *Cours Consulaires*, the judicial character of Bankruptcy Commissions was at best partial and their weaknesses regarding procedural guarantees were quite clear. At least until the eighteenth century, guidelines for decision making were not

[14] See Kessler (2007) on the 18th century Parisian Cours Consulaire; Hirsch (1991) for a fine monography on Lille that extends into 19th century; also a number of contribution published in *Les Tribunaux de Commerce* (2007).

[15] The literature is far from unanimous in assessing the medieval Law Merchant in England: Holdsworth (1907, 1925), Gross (1908), Burdick (1909), Hall (1932), and Treiman (1938a) tend to hail it as a self-standing legal order, with a specific and enduring influence, whereas the recent literature is far more circumspect; see for instance Baker (1979), Rogers (1995), Basile et al. (1998), and Donahue (2004). Note also that in general the comparative dimension in this debate is weak. Continental scholars often consider England an economic side-show until the late 16th century, while their English-language colleagues are very much focussed on the relationship between the Law Merchant and the early Common law; by contrast, their referencing the Italian and fair court traditions sometimes verge on the impressionistic. See however Galgano's *Lex Mercatoria* (constantly republished since 1976) or Padoa Schioppa's many writings on the early history of commercial law. The French-language literature on the other hand is more limited, although Hilaire (1986) is a fine introduction.

[16] See among others Holdsworth (1914), Sutherland (1934), Holden (1955), Baker (1979): these authors agree that traders' courts were marginalized early, but they also admit not having a satisfactory explanation of this fact.

explicit, Commission member recruitment was not strong, corruption occasioned frequent mention, and pressure from the executive bureaucracy was clearly a problem. [17]

4.1. The Road Towards the Abolishment of Judicial Arrangements

The consequence of this weak constitution is that Commissions arguably made an unpromising forum for a rule-based, judicial approach to the confirmation of majority arrangements. Hence, attempts to develop this practice along Continental lines were observed exclusively outside Commissions.[18] David Smith (2010) accounts for this long trial-and-error process, which extended from the 1590s until the 1620s, whereby Equity courts—in the name of human charity—tried to mitigate the harshness of the Common law and impose accommodation on creditors. Under Elizabeth I, petitions by debtors were addressed to the Privy Council which typically transferred them to the Court of Request. But this practice came under increasing attacks after 1609 and in 1614 the Common Law courts de facto obtained the authority to annul, or "prohibit" their Bills of Conformity (as their instruments were known). The Chancery then took over but its attempted rescue became also embroiled in the broad conflict between the Common law courts and the Parliament on the one hand, and King and Equity courts on the other.[19]

A reformed and streamlined version of the Bills of Conformity was actually introduced in 1620 by Francis Bacon—then Lord Chancellor (and hence an ally of the King) and no minor historical figure. But this effort was apparently too late: within a year, and in a context of economic crisis,[20] Bills were abolished by the Parliament.[21] The main figure in this fight was Edward Cooke—then the most articulate defender of Common law and Common law courts as well as a major leader in the House of Commons. His ultimate attack, on 14 March 1621, was just an opening shot in the final scene of Cooke's long political and personal fight against Bacon. Immediately afterward and in front of the same parliamentary committee, charges of corruption were levelled against Bacon, charges to which he would confess before being impeached by Parliament on 3 May.[22] The long-term history of economic institutions had just intersected with *l'histoire événementielle* of great men waging great battles. And by the way, note also that Bacon's private secretary at the time was young Thomas Hobbes.

4.2. Bankruptcy as an Absolutist Institution?

In today's political vocabulary therefore the confirmation of majority votes in bankruptcy proceedings had come to exemplify the much broader attempt to establish an absolutist monarchy endowed with new and threatening powers over both the Common law courts and private rights. The "legal origins" argument then immediately comes out as the natural contender in providing a broader, consistent interpretation of the 1621 bifurcation: the fight against majority vote, at this early hour of economic development, may have initiated or crystallized a long-run pattern that gave priority to ex ante market discipline and the integrity of contracts over accommodation and judicial interference. Against Gleaser

[17] During the seventeenth century, "Procedures 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 powerful pamphlet against the corruption of commissioners; Welbourne (1932) for a colorful description of bankruptcy proceedings in early nineteenth-century London.

[18] It is not clear to what extent the Italian *concordato* was practiced in England before the late sixteenth-century. The main authority supporting this proposition is Malynes, but few other authors concur.

[19] See Pocock (1987) and Cromartie (2006) for a discussion of the "constitutional debate" over absolutism between the Monarchy, the Parliament and the Common lawyers.

[20] Supple (1959), Kindleberger (1991).

[21] 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

[22] On the circumstances and the Parliamentary politics of the day, see Zaller (1971), White (1979), Powell (1996).

and Shleifer (2002), who see the bifurcation between the Common law and Civil law traditions in the twelfth and thirteenth centuries, should one rather point to the early seventeenth century?

The problem with such thesis is not to identify the many occasions when Common law principles and Common law courts did bear heavily. Of course, there are a lot of them. The problem is to identify permanent formal patterns that would account altogether, and in some pre-ordained way, for the initial divergence with the Continental tradition, for the ulterior resilience of the English variant and for its specific, pro-market, microeconomic implications. Let's start with the first issue – divergence.

What is clear when considering the pre-1621 experience is that the Privy Council, the Court of Request, and the Chancery were all willing to pressure recalcitrant minority creditors and even to threaten them with imprisonment. Smith (2010) provides a wealth of examples and Treiman (1938a) mentions, 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 stricktness 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".

Some thirty years later, Malynes (1622), who supported Continental-style arrangements, shared retrospectively this "despotic" view with regard to the Chancery: "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 releeved for easie composition with their Creditors, albeit at charges another way extraordinarie".

What such quotations say, is that there were apparently good and practical reasons to limit the Equity courts' discretion on this issue. Hence, attacks by the Common law courts and the Parliament on the Bills of Conformity may not be interpreted as reflecting exclusively, or even mainly, an inherent legal or ideological bias against majority rule, or as a side argument within an ongoing fight for political supremacy. What might have caused the collapse of the Bills is as well the absence of a jurisdiction with the legitimacy needed in order to confirm majority votes. In this case, the original factor in the English divergence would be primarily located in the marginalization of medieval traders' courts, in the early-modern period: when the demand emerged for a safe procedure of confirmation, no jurisdiction could offer the service. Of course, this pragmatic perspective does not exclude that ideological factors may have also weighted. But as far as the "legal origin" argument is used in a deterministic, a-historical perspective, the burden of the proof is clearly on its side.

4.2. After 1621: The Road To a New Institutional Equilibrium

The second leg of the legal origins argument would state that after equity principles had been defeated, in 1621-24, a super-strong definition of creditors rights would have shaped the long-term evolution of the institution in ways permanently favourable to market discipline.

The initial problem raised by this reading is that during the seventeenth century, the fate of bankrupt debtors in England proved quite dire, more so even than under classical debtor Roman law.[23] If any unpaid debt remained after the procedure was closed, then any new resources (e.g., an inheritance) acquired or earned by the debtor could be seized. He could also be returned to prison by any creditor and would stay there as long as the latter was willing to pay for his incarceration. Business risks were further compounded by the Common law's resistance to partnership's limited liability of the *commenda* type.[24] Hence a great number of pamphlets against the "strictness" of debtor law can be

[23] Bankruptcy "has something in it of Barbarity; […] It contrives all the ways possible to drive the Debtor to despair, and encourages no new Industry, for it makes him perfectly incapable of anything but starving. This Law, especially as it is now frequently executed, tend[s] wholly to the Destruction of the Debtor, and yet very little to the Advantage of the Creditor" (Defoe 1697).

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

found.[25] The proposal to once again allow judicial confirmation of majority arrangements actually experienced a revival during the last two decades of the seventeenth century. Attempts to reintroduce 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).[26]

The breakthrough occurred in 1705 with the Act of Anne, that brought more balance into the institution: if the debtor transferred all his assets and acted cooperatively, and if four fifths in sum of creditors agreed, then he would be discharged of his residual liabilities and his old debtors could no longer throw him in prison or seize his (new) assets. Ironically, the overall intention of lawmakers at the time was repressive: as showed by Kaddens (2010), they first introduced death penalty, as a threat raised against uncooperative debtors, and they added discharge at a late hour, as a balance. Still, in hindsight, the Act of Anne introduced a form of limited liability which main beneficiary was the proverbial "honest but unlucky trader" – whether he traded on his own or within a partnership. In later decades, and along the usual complaints about costs and corruption, the notion then gained prominence that this "fresh start" approach had major social benefits. In the much-quoted commentary of Blackstone: "Thus the bankrupt becomes a clear man again; and […] may become a useful member of the commonwealth" (1811, p. 488). [27] More generally, and at least since the late eighteenth century, the Act of Anne has been consistently hailed as the true birth date of an original, pro-market, liberal bankruptcy tradition that uniquely conjoins "principles of humanity and the benefit of trade"—in the usual phraseology.[28] Hence, it seems it was not just by chance that debt discharge survived the abolishment in 1818 of its initial counterparty – the threat of death penalty for un-cooperative bankrupts, which in practice was very rarely applied.

Moreover, praising a modern, liberal bankruptcy law came with a remarkable case of amnesia: not only was the old conflict over the Bills of Conformity soon forgotten, but the very principle of confirmation rarely surfaced again until the 1820s.[29] Even during later decades, on the long and winding road back to the *concordat* approach, a recognition of employing past or foreign models is seldom evident. A first step was an 1825 act that introduced a highly restrictive confirmation mechanism that remained virtually unused.[30] Other failed reforms followed in 1849, 1861, and 1869. Lastly, an 1883 act offered a two-way approach: agents could choose either a Continental-style renegotiation or a voluntary private composition with more limited rules of publicity and registration. Interestingly small firms opted rather for the continental option, while the traditional, English one remained favoured by the largest businesses.[31] Still today, its heir-apparent remains widely practiced

[25] 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 debt concerned bankrupts as well as small debtors who had no access to it.

[26] See Treiman (1938a) 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.

[27] 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).

[28] Terms similar to these are used by Cooke (1799), Cullen (1800), and Beawes (1813). See also in the modern literature Tabb (1991) and McCoid (1996).

[29] In his treatise on Commercial law, Wyndham Beawes (1813) allocates more than a hundred pages to bankruptcy issues—including a rather detailed comment on the 1673 French *Ordonnance*—without once mentioning the *concordat*. In the case of the Netherlands, Beawes suggests that traders "may find some method to settle with the creditors". Cooper (1801) defines the French *concordat* as "a mode of composition which not unfrequently takes place".

[30] On the 1825 law, see Holt (1827). More generally, on bankruptcy law and practice during the nineteenth century, Duffy (1985) and Lester (1995).

[31] "[T]he great commercial world, alienated and scared by the divergence of the English bankruptcy law from their own habits and notions of right and wrong, avoided the court of bankruptcy as they would the plague. The important insolvencies which had been brought about by pure mercantile misfortune were administered to a large extent under private deeds and voluntary compositions, which, since they might be disturbed by the caprice or

and actively defended as the "London approach" to business failures (Brierley and Vlieghe 1999, Armour and Deakin 2000, Willman 2008).

For one thing, therefore, what the overall, long-term history tells is the difficulty of restating it as the development of some permanent, core principles that would have guided in a predictable manner successive generations of lawmakers. First, after Bills of Conformity were abolished, neither the Common law courts nor the Parliament proposed an alternate framework that could be considered anything like pro-market or pro-enterprise. Then, when discharge was eventually adopted in 1705, the Parliament actually introduced majority vote and so the contractual rights of minority creditors could now be intervened. Over the course of the nineteenth century, lawmakers would fight to further extend this rule and ease the way for the confirmation of arrangements. In 1849 they would even allow the judges to discharge debt against the will of creditors.

More generally, successive generations of English lawmakers would first trumpet the virtue of hard budget constraints and then hail the modernity of offering a fresh start. They would classify any attempt to negotiate an arrangement as a quasi-penal Act of Bankruptcy but later would develop a remarkably open, free-wheeling bankruptcy regime. Many would also hail the integrity of contracts as the ultimate foundation of civil society and public order,[32] while others argued for generations against the huge arbitrary costs imposed by society on so many;[33] the latter may also have underlined that the never-ending English debate on prison for debt and the recurring royal amnesties attest to a rather weak "transmission channel" from threat to discipline.

Of course there is nothing wrong or unique about this. Policy debates are made of dilemma like this, whether arguments are exchanged in courts, in Parliament or in the broader public. Coming to terms with an open, competitive market economy is a never-ending experience and, surely, there is no reason why this would be different for bankruptcy. Economic cycles, a changing institutional and political environment, evolving cultural perceptions may push the balance very differently, though within a given inherited legal vocabulary.

5. ACCOUNTING FOR CONTINUING DIVERGENCE: A STRUCTURAL THESIS

The previous section argued that the specific judicial and legal history of England, during the early-modern ages, bore heavily on the exceptional course taken by its bankruptcy law after the 1620s. The point however is that holding on to this original mark is just not enough when trying to account for the ulterior development of this institution, as for the long-term stability of the Anglo-French contrast. In other, more epistemological words: there is no apriori reason why permanence over time of a given pattern, or institutional equilibrium, should respond to the same causes as the original bifurcation. Whereas origination may result from an idiosyncratic addition of elementary factors, resilience calls for a structural or synchronic perspective: one that emphasizes how a series of successive, mutually reinforcing adjustments came to shape expectations and behaviours, and then deliver reasonably functional economics outcomes that would warrant policy support and incremental reforms, rather than abolition.

In the bankruptcy literature, some of these structural traits have been studied as self-standing issues, but bringing them together allows for a more consistent understanding of how they interrelated (see table 1).

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malice of a single outstanding creditor, were always liable to be made the instruments of extortion" (Bowen 1907).

32 "[F]idelity in performance of Covenants and Promises is one main foundation of a well ordered Commonwealth. […] If Bankrupts the Arch-builders of fraud, utterly subvert and take this away, as indeed they do, who doubteth but that the Commonwealth, unlesse prevention be in time used, will shortly be ruinated? […] If the Bankrupts weaken and violate performance of fidelity […] the Commonwealth cannot florish, but become a body without a Soule" (Sauterius 1640, p. 22).

33 On prison for debt, see in a vast literature Innes (1980), Lester (1995), and Finn (2003).

6.1. Rules of the Judicial Game

Since the 16th century, initiation of a bankruptcy was associated in England with the observation of a so-called Act of Bankruptcy, originally a reprehensible one that allowed one or more creditors to petition for a Commission (Treiman, 1938b). As a consequence, entry into bankruptcy was only "involuntary"—that is, initiated by creditors. Before 1705, the threat of lifelong prison rendered moot the alternate, "voluntary" road (initiated by the debtor); later, the possibility of discharge added new reasons for leaving control over entry firmly in the hands of creditors. If the procedure were instead framed as a platform for negotiation, as in France, then there would be no reason to restrict entry into bankruptcy: mutual control would take place inside, provided the institution's internal architecture was adequate and the incentives to initiate the procedure were also adequate (Baird 1991). Indeed, there is just no debate in France on the voluntary versus involuntary issue, which is much discussed in the Anglo-American historical literature.[34] By the same token, the opposition between pro-debtor and pro-creditor statutes is also very much an Anglo-American concern. Open-ended negotiation tends to place the focus on intercreditor relationships and hence on the balance between pro-liquidation and pro-continuation interests, or between senior and junior interests.

Instead of an observable Act of Bankruptcy, French law envisaged the opening of a procedure as a response to a firm's underlying economic "state" and where it might fall. « *Un commerçant est en faillite, ou tombe en faillite* », as the contemporary language still has it. Of course, insolvency was the underlying issue at stake, whatever its definition at the time, and major difficulties were encountered when attempting to recognize this unenviable state. Judges were certainly looking for directly observable (though often elusive) signs or even for acts.

However, the notion of an *état de faillite* also invites an inquiry into the reason for the failure and the prospects for recovery. Its sheer ambiguity makes explicit the need to address an in-built informational problem. And if private transactions should be supported, then all available information should indeed be collected, centralized, and shared among all parties. Accounting books and correspondence should be open, the debtor interrogated, the cause of his failure queried, and experts possibly consulted; all this was made clear either by commercial customs or the 1673 *Ordonnance*, the first statute to allow the opening of a merchant's accounting books against his will. In the English framework, there was certainly a need to identify all assets and to check, for instance, that false creditors did not join in the distribution of dividends; successive statutes included increasing regulation on this score. But because the fate of the business was sealed once a Commission had been created, exploring the reasons for failure and the prospects for recovery was an issue of only secondary importance. An institution that was based entirely on ex ante market incentives faced far fewer requirements in terms of ex post discovery and internal governance, and for the simple reason that there was so little room for deliberation and choice.

A corollary is that disentangling the penal and civil dimensions built into the procedure proved to be much more difficult in England. Initially, defining the bankrupt as a criminal was the only way to take control of his assets so as to distribute the proceeds.[35] But because there was no way for the debtor to negotiate an arrangement and regain the management of his assets, no internal logic urged a distinction between those who could trade again and those who should not; an ex post decision, as the one allowed after 1705, would do as well. In the French case, the very possibility of continuation made it necessary to differentiate between the intrinsic (commercial and financial) state of the firm and the personal behavior of the businessman, who might have acted in a reprehensible manner. Well before the 1673 *Ordonnance*, *la faillite* was explicitly designed as a civil or commercial framework for renegotiation with no intrinsic penal dimension, whereas *la banqueroute* involved crime and

[34] "One of the most fascinating tales in the development of bankruptcy jurisprudence concerns the monumental transformation by which the inthinkable—voluntary bankruptcy—became commonplace" (Baird 1991, p. 142). See also McCoid (1987, 1988).

[35] Treiman (1938b). This problem is linked to the large role given under Common law to personal arrest, which was an alternative (not a complement) to seizure of assets. See Levy (1968) and Cohen (1982).

prosecution.[36] This affected the overall logic of proceedings but also the way bankruptcy law was articulated to the main bodies of law – civil and commercial, penal, constitutional, procedural.

This account contradicts the common narrative by which the introduction of debt discharge in 1705 would have given English (and American) bankruptcy law an early and uniquely modern pro-market pattern.[37] Continental lawmakers had actually noted for centuries that keeping debtors in jail indefinitely and pre-empting all future income flows was not a promising incentive scheme.[38] The point is that, under Italian and French statutes, discharge would be decided solely by the creditors and generally as part of a broader settlement; the notion that judges may discharge debt unilaterally, as in England after 1849, is completely alien to the Civil law tradition.

<< TABLE 2 >>

6.2. Private Ordering: the Law Merchant meets English Trusts

If we now take a step back and look at how the overall bankruptcy regimes operated, a final element to take into account is the manner in which debtors and creditors settled out of court when they wanted to avoid the costs and constraints of a formal process. Remarkably, economic and legal historians have had little to say on this topic beyond casual references to "private arrangements" and "compositions".[39] This dearth is especially striking in the case of England, where these accords became widely used and were consistently enforced by the courts. And rather than deriving from statutes, these rules emerged from the practice of businessmen and were progressively confirmed.

A first period of innovation extends from the later decades of the seventeenth century up to the 1720s. It witnessed the slow convergence of two institutions of very different origins. On the one hand were the traditional *composition agreements* resembling those used on the Continent and whose roots were in the old Law Merchant.[40] In short, provided they all agreed, creditors could at their discretion offer to the debtor either more time or a write-off in addition to a safe conduct, that would suspend the threat

[36] This differentiation was already accepted by the late medieval Italian jurisconsults, like Straccha. It was then written into the French *Code Michaud* (1629): although this code was never enacted, the jurisprudence was comforted. From Mareschal (1625), to Savary (1675), Toubeau (1682), Denisart (1771) and down to Laurens (1806) all treatises and commentaries essentially start by re-stating the difference between *faillite* and *banqueroute*, almost as a matter of terminology. How the dividing line was drawn in practice is however a much more confused matter. Rules of coordination between jurisdictions are anything but clear, at least under the Ancien Regime; and the commentators fluctuate widely between an interpretation of *la faillite* as being caused exclusively by exogenous forces or possibly also by the intentional acts of the debtor. In his quasi-official commentary of the 1807 Code, Locré, from the Conseil d'Etat, first speaks of "*pures faillites*" that are caused by "*une force majeure et invincible*", but he then proceeds by defending that a well-designed statute may incite traders not to take excessive risks. Further reading suggests that, at least discursively, the gap between the unwise and the illegal was filled by that remarkable matter: dishonour. (Locré, 1829, Book 3, page 461).

[37] "The idea that bankruptcy should be utilized to overcome the results of some financial misfortune, and that it should be possible for an individual (…) to obtain a discharge, is English in origin and essentially English in its main characteristics." (Burgin 1923)

[38] In *Les Coutumes du Beauvaisis* (1283), one of the best-known medieval legal treatises, Philippe de Beaumanoir had already made the point: « *Ce serait contraire cose à l'humanité qu'on laissât toujours corps d'homme en prison pour dette, puisqu'on voit que le créancier ne peut être payé par la prison* » (quoted in Troplong 1847, p. 19). Or : « it would be contrary to humanity to leave a man lying in prison for his debts, since we see that the creditor will not be paid by the prison".

[39] 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.

[40] See Malynes (1622), Hutton (1652), Billinghurst (1674), and Brown (1701). For Continental versions, see Savary (1675), or Peri (1672).

of imprisonment for a given period. Such an offer was often balanced by a number of conditions in terms of accountability and surveillance; as a variant, a Letter of Inspectorship or Letter of Administration involved only supervision and no financial concession. Until the mid-nineteenth century, a great number of law treatises and traders' textbooks offered highly standardized models of such letters, which in fact changed little over time.

Contrary to the composition, the second institution at stake, the *trust*, is typically English. Because it initially belonged to land and inheritance law, it existed in a world far apart—socially, politically, and legally—from commerce.[41] The issue at stake therefore is how trusts would progressively be made available to traders as an instrument to renegotiate debts and manage commercial assets on a collective basis. By the 1670s it was common for a landowner to assign his properties to the benefit of inheritors *and* creditors, possibly with the addition of a debt write-off (Godolphin 1674, Bridgeman 1682). After the landowner's death, the trustee would pay off the debts first, perhaps in order of their legal ranking, and then transfer the balance (or revenue flow) to the landowner's heirs. In *Arcana Clericalia* George Billinghurst (1674) confirms the point as regard the case of unmovable assets, which in practice means land. But remarkably he does not mention it in the second half of his book, which deals exclusively with traders' interests (e.g., partnership, maritime contracts, bills, etc.). Only traditional or Continental compositions are envisaged, structured by bond contracts between the debtor and each individual creditor.

Twenty years later, however, in *The law against the bankrupts* (1695) Goodinge mentions that Commissioners might assign the debtor's estate in trust to the creditors. In other words, and under the specific conditions of a bankruptcy, trusts could now become a vehicle for the collective interests of commercial creditors, thereby allowing for instance for a gradual liquidation. Finally, Bird in *The Practicing Scrivener and Modern Conveyancer* (1729) presents a model for the "Absolute assignment of debts to a Person, in Trust, for himself and the rest of the Creditors" (p. 389); thus a trust could now be created for the sake of the parties' collective interest even outside bankruptcy, though apparently with the view to manage only debt titles. The fact that Bird's was a practitioner's book that includes many models of other agreements or contracts, on a wealth of different subjects, clearly indicates that this practice was accepted and could have become somewhat standardized. Separately, Bird also states that *after* the opening of a bankruptcy procedure, if all creditors and the debtor agreed privately on a composition, then they might ask for the proceedings to be closed or "superseded". In other words, bankruptcy was not anymore a strict "one entry-one exit" process. If the parties solved their collective action problems, they could close the judicial proceeding. Bargaining in the shadow of the law had become a more sophisticated game: it could continue in parallel with a bankruptcy proceeding.

By the 1720s it then seems that the main pieces of the puzzle were in place: bankruptcy, composition, trust—and discharge (the Act of Anne). Innovation then seems to have stalled, a point noticed 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.[42] What is sure, however, is that by the late eighteenth century compositions-cum-trusts were widely practiced and enjoyed strong court protection. Cases are commented and comprehensive models of such accords are published i.a. 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 England. Then, Crabb's 1835 *Conveyancer's Assistant* offers two remarkable examples of a complex management contract built into a trust deed, established to the

[41] Trusts were initially assignments made by a landowner to (what we today would call) a fiduciary agent who would exercise the property rights in favor of a third-party—typically, in the early centuries, a widow or other inheritor(s). See Langbein (1995), Macnair (1998), Baker (2007, chapters 15–17). Also the classical 1904 essays reproduced in Maitland (2003).

[42] John (1735) includes materials comparable to those present in Bird (1729); but for instance 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 treatises on the respective subjects.

benefit of creditors though in the absence of any formal bankruptcy proceeding.[43] Trusts in other words had now become a vehicle for extended industrial and financial renegotiations.

This evolutionary process based on private law is indeed similar to the one analysed by Getzler and McNair (2005) in the case of limited liability or, more closely, by Harris (2000) in the case of un-incorporated joint-stock companies. There are good reasons indeed to believe that in practice there were linkages between this later experience and the one being discussed here.

6.3. Private Ordering, early 19° century: a quasi-bankruptcy rule

How did these private-law, non-statutory arrangements work? Which rules allowed the parties to circumvent part at least some of the collective action problems caused by the absence of a majority rule ?

According to the various cases and commentaries published from the 1780s onwards, the first evidence is that the defining constraint around which the entire legal construction revolved was still the 1621 prohibition of *Bills of Conformity*. Indeed, anything looking like a side-agreement, or an attempt to arm-twist recalcitrant creditors, could warrant the immediate opening of a bankruptcy proceeding. 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 aquiesce in the arrangement*".[44]

That being said, the jurisprudence clearly aimed at limiting as far as possible the room for disruptive or opportunistic behaviours. For instance, whereas a rigid interpretation of compositions would have required express written adhesion before a deed (i.e., the final legal instrument) became binding, it was decided that even an oral agreement made at the creditors' meeting would be sufficient, provided other parties had acted in reliance 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 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*".[45] In fact the jurisprudence construed compositions as a collective contract that created a legal irreversibility and substituted its own collective rules to the default, i.e. contractual rules – just like bankruptcy. This was very neatly stated: "*all the creditors being assembled for the purpose of arranging the defendant's affairs, they all undertook and mutually contracted, with each other*".[46] 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*".[47]

On that basis, a series of specific rules were added, which indeed shadow a fair part of how a generic bankruptcy rule is structured:

- Once creditors had joined a composition agreement, they could no longer rely on individual remedies, so that the risk of a run on either the assets or the courts was de facto stayed;
- Debts not yet mature were accelerated; that is, they were considered as if they had come 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*".[48] At this point, the parties could also rely upon one of the Masters of the High

[43] The first ever treaty on compositions is Montagu (1824), but he does not say much on trusts; afterwards, the main authors are Forsyth (1841), Holland (1864) and Brown (1868).
[44] Forsyth (1841), p.16
[45] Crabb (1835, p. 308). Cases establishing this rule include Ex Parte Sadler (1808), Bradley v. Gregory (1810), Butler v. Rhode (1820).
[46] Chitty (1824), quoting an unreferenced case.
[47] Britten v. Hughes (1829)
[48] Crabb (1835, p. 308).

Court of Chancery in order to establish the validity of both the debtor's accounts and the creditors' debt titles. Thus a public authority would directly support private coordination.

- Creditors would be paid on an equal (pro-rata) basis and any secret side-arrangement between the debtor and some creditors would be void.[49] In other words a principle of intercreditor equity was built into the institution, along the lines followed since the Middle-Ages by Continental bankruptcy laws.

- Collectively agreed side-arrangements, however, were possible so that small or minority creditors could be bought-out by the majority, or by the main players. This reduced the risk of holdout.

- If a bankruptcy were declared on the back of a composition, then creditors would retain whatever payment they had received in the composition while participating in the eventual liquidation on the basis of the initial debt.[50] The imposition of an obligation to reimburse the first payments, or to participate in the bankruptcy only on the basis of reduced debts, would have created strong ex ante disincentives to participate in private compositions.

- Lastly, and even most significantly, majority rule apparently applied among the parties once they had joined a composition; in other words, the "sanctity" of the initial debt contracts warranted a unanimity-based decision rule only once – when entering collective action – but not afterwards.[51] From a jurisprudential point of view, the commitment entered into with the other creditors was sufficiently strong to first displace these earlier contracts and then enforce a majority rule among the parties that would extend in the future, well after they had left the negotiating table. The parties were considered to have joined a perpetual collective body (the trust), not solely a platform for contractual renegotiation (the court). On the other hand, the rights of senior creditors remained intact[52].

The legal and economic consistency of this progressive build-up of precedents is impressive, but there were also problems that limited public support. The old unanimity rule caused continuing frustration and judicial safeguards were obviously a source of concern, whether one thinks to asymmetric access to information, publicity, or to power relationships during the negotiation. Harris (2000) also underlines that before the 1870s trusts were not perfect business vehicles: they raised problems of unlimited responsibility for the trustees, internal governance problems could be substantial, etc. Indeed a Parliamentary report on bankruptcy reform already stated in 1840 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*". [53]

So what happened in France with regard to the private side of debt restructurings? Were comparable developments observed in an environment where collective action within bankruptcy was strongly supported by the law and the courts? The answer is simple though not straightforward. On the one hand, by all accounts there were many private arrangements made and kept by notaries. On the other hand, the structure of these voluntary accords show remarkably little change over the entire period: the parties freely negotiated about delays, write-offs or a variety of profit-sharing schemes; yet each collective agreement would then be executed via an exchange of new bilateral debt contracts between the debtor and each individual creditor. In other words, French bankruptcy law probably offered a

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[49] Cockshott v. Benett (1788), Mawson v. Stock (1801); by the same token, if assets were discovered or inherited after a debt-write had been agreed under a composition, then creditors could not sue on their initial contracts (Lord Castleton v. Lord Fanshaw, 1699)

[50] Ex parte Vere (1812).

[51] Cork v Saunders (1817), see also the model agreement by Crabb (1835, p. 309). Interestingly, this rule is the same as the one so strikingly formulated by Rousseau in *Le Contrat Social* (1762): « *La loi de la pluralité des suffrages est elle-même un établissement de convention, et suppose au moins une fois l'unanimité* » (book I, chapter 5). Or: the law of majority vote is a convention that, at least once, requires unanimity.

[52] Stock vs. Mason (1798).

[53] Report of the Commissioners (1840), p. xii; quoted in Forsyth (1841).

fairly efficient and well-protected platform for collective recontracting; but collective action was confined to the court's premises.

6. CONCLUSION

English bankruptcy law did not evolve gradually out of the Italian medieval legacy, as did the French law. After the 1621 prohibition against majority rule among creditors it remained a rather repressive, anti-market institution until two additions to the law brought about a more supportive institutional equilibrium. First, after 1705 good faith debtors were offered the possibility of a debt discharge, i.e. a form of limited liability. Second, private law practices progressively developed into a consistent body of court-enforced rules that supported negotiation among the parties, though on a voluntary, i.e. unanimity basis. Critically, this evolution rested on the slow convergence between the old, Law Merchant "composition agreement" and the trust: a perpetual civil body that offered both flexibility and legal protection, and to which the parties could convey assets so as to manage them as a going concern.

The elegance of the eventual outcome is that two distinct policy aims – ex ante market discipline and ex post recontracting – were addressed by two distinct institutions: bankruptcy and private arrangements. Still, this left the merchants with no ready instrument to address defaults caused by market failures: the failure of creditors to agree collectively, or plain creditor passivity, might have caused undue or sub-efficient liquidations. In France the overall pattern was the reverse one: traders' courts offered flexibility and legal protection while rigidity prevailed outside courts. The overall regime made it comparatively easier for them to respond to liquidity shocks, or to adjust to illiquid secondary markets for capital goods. But it presented two drawbacks: the risk of moral hazard, and the difficulty to bargain on more substantial debts and assets restructurings. Indeed, there were few permanent vehicles for the collective interests of the parties, a constraint that probably increased over time as businesses became more capital-intensive. Maitland actually noted in *Moral Personality and Legal Personality* (1904) that the long-standing resistance of French law to perpetual civil organizations did not extend to businesses. In fact, this bias resurfaces in the case of their failure.

Here however is the point of convergence between these two experiences. In both traditions, bankruptcy remained structured, though in different ways, by the unique strength that derives from free, individual commitments. The point is that the narrow entry, voluntary character of the English composition-cum-trust supported a renegotiation of initial contracts that could be far more comprehensive than under the open access, majority rule that governed the French *Concordat*. Individual adhesion, provided it was obtained, warranted in England a degree of irreversibility in the restructuring of property rights which a mere adjudication in France would not support.

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TABLE 1 - Medieval and Early-modern statutes sanctioning majority vote within bankruptcy

Italy	Bologna (1509), Florence (1322, 1415, 1585), Siena (1619), Venice (1395), Genoa (1589)
Flanders (Antwerp)	Statute (1615)
Republic of Geneva	*Statuts de la République de Genève* (1713)
Hamburg	Statute on bankruptcy (1753)
Nuremberg	Statutes (1517, 1634)
Prussia	Code Prussien (?)
Austria	Statute 1734, 1781
Spain	*Ordenanzas* of Bilbao (1737)
Low Countries	Amsterdam 1659 statute (*Kamer van der Desolate Boedels*)
France	Bounyn (1586), Mareschal (1625), *Le stile de la jurisdiction royale établie dans la ville de Lyon* (1657), *Ordonnance sur le commerce* (1673)

TABLE 2 - English and French early modern bankruptcy law: A summary comparison

	England, 1625–1880s	France
	Bankruptcy Statutes	
Possible outcomes	Liquidation only	Liquidation or renegotiation
Institutional structure	Administrative	Judicial
Signal/criteria	Acts of bankruptcy	*État de faillite*
Initiation	Involuntary only	Involuntary and voluntary
Role for discovery	Limited	Important
Qualified majority vote	Impossible, then limited	Standard
Debt discharge and fresh start	After 1705	Always there
Distinction between penal and civil dimensions	Late and difficult	Intrinsic
Main expected benefit of the law	Ex ante market discipline	Ex post absorption of exogenous shocks
Main downside risk of the law	Undue liquidations	Moral hazard
	Out-of-Courts Arrangements	
Private agreements	Most common	Most common
Capacity to design permanent, post-negotiation, collective arrangements	Large (from late 18th c. onwards)	Inexistent
Willingness of the courts to sanction private innovation	Substantial	Limited