On market discipline:
Bankruptcy, debt discharge, and renegotiation in England and France (17^{th}-19^{th} century)

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ABSTRACT

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The impact of law on economic development is often considered to run through its role as a mediator between state actions and private contracting agents. La Porta and other (1997, 1998) have then famously insisted on the differences in this respect between the English and French "legal origins". Here, we consider bankruptcy procedures as a critical example of such interaction, that is observed specifically when contracts are broken and redistributive risks maximal. The comparison of the respective legislations, between the 17th and 19th centuries, first underlines differences as regard the institutions in charge. In England, Bankruptcy Commissions were ad hoc creations of the executive arm of the government. France took over from the Italian legacy the primary role given to courts; during long periods of time, bankruptcies were even dealt with by largely self-managed, elected trade courts.

The main difference however is on the extent to which contracts could be renegotiated after a default. France built on the Italian experience of the *Concordato,* or arrangement: a comprehensive, open-ended private contract which is voted by a qualified majority of weighted creditors, and then confirmed by the court so as to bind dissenters. This was historically the standard route for debt discharge and fresh start. The assumption was that the absorption of exogenous liquidity shocks could be effectively supported by contingent rules and courts. Between the early 17th century and the latter half of the 19th century, English law reflected the opposite premise, as arrangement were forbidden. Allowing debtors to freely negotiate their way out of default was expected to create pervasive moral hazard. Conversely, straightforward liquidation and eventual discharge (after 1705) were better for markets, just as *ex ante* discipline is superior to *ex post* re-negotiation; or so it was assumed.

Keywords : bankruptcy, courts, moral hazard, market discipline, re-negotiation

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1- Introduction

The literature on law and economic development is organised along two main methodological lines. On one hand are researchers who emphasise the flexibility of the law and legal institutions. As economic conditions change, they would converge towards some adequate or superior pattern. Law is thus conceived as a mostly "reflective" and endogenous institution, i.e. the by-product of a set of more fundamental variables that would actually drive economic development. This is typically the case of Marxist historiography, where law is an archetypal "super-structure" that should adjust to the succession and evolution of "modes of production". The Law and Economics approach also defends such a utilitarian or materialist approach: in the medium run, competing private interests shape legal institutions to the best of their interests, unless entrenched rent-seeking agents successfully resist the adoption of the optimal solution. Narrative history thus unfolds along this convergence path, which reference, end-point model is rather a matter for abstract, analytical research to account for.

On the other hand are research directions that insist on the capacity of the law and legal institutions to bear on historical outcomes: their history is not a mere side-plot within a broader text, but one of the strategic scenes out of which long term, differentiated growth patterns may emerge. Hence, a conception of the law that is more "institutive" than "reflective", exogenous than endogenous. A good example is offered by the many authors who defend that economic development is path-dependent: institutions, even countries as a whole, would keep over time specific features that bear on incremental changes, colour their history, and make it in some sense unique. Global history would be less dominated by trends towards convergence and unification, than by parallel, self-contained histories.

This approach was radicalised in a series of articles contributed by La Porta, Lopez de Silanes, Shleifer and Vishny (1997, 1998), who defend that growth patterns across countries reflect their respective "legal origin": other things equal, legal families would have a permanent, defining impact on successive institutional arrangements, hence on growth, financial development or entrepreneurship. Specifically, the English Common law would have historically offered a stronger, embedded protection of private rights and a better capacity to adjust to the demands of an open competitive economy. The Civil law tradition, conversely, would be characterised by poorly protected private rights, rigidity in front of economic change, and a propensity to work as a vehicle for state discretionary interventions. This argument was completed by Glaeser and Shleifer (2001): they first argued, after many others, that English and French legal traditions diverged already in the Middle Ages; and from there on, they reached directly to present days: the centuries-old set of contrasts would still be at work in a superior economic performance of Common law countries over Civil law ones.

Obviously, these two authors, just as La Porta and his colleagues, don't care much with the legal, institutional, political and even economic developments of intervening centuries. They make a statement rather than a historical demonstration, or a structured argument. But their point is clearly resonant with a large body of Anglo-French comparisons - one of the canonical topos of pre-modern and modern economic historiography. France is most generally considered to have been historically endowed with an interventionist, often dysfunctional State machinery, which regularly rode roughshod over property and contractual rights. The perennial fiscal crisis of the Ancien Regime is a well-known issue in this history, but the post-revolutionary, centralised Napoleonic institutions are often considered a further source of economic dead-weight. These patterns are then contrasted with the more market-oriented political and fiscal constitution established in England after 1688. The Civil law vs. Common Law argument thus fits nicely into this literature, alternatively as an illustration, a sub-line or a defining scene, depending upon the position adopted in the above-mentioned methodological dispute.

This article explores this broad comparative theme, though from a restrictive viewpoint. First it does not look at the whole, almost millennial parallel evolutions of English and French law; neither does it attempt to appraise the whole legal structure that governed the respective economies, societies and polities during the period under review (17^{th}-19^{th} centuries). The focus is on commercial law, which should be indeed the core of the "legal origin" debate, as far as economic development is an issue. The implication is that the reference as regard the French experience should not be the *Coutumes* of the Ancien Régime or the 1804 Civil code, but two lesser known, though towering statutes: the 1673 *Ordonnance sur le commerce*, and the 1808 *Code de commerce*, respectively mandated and enacted by Louis XIV and Napoleon. These texts actually structured the evolution of commercial law, in France and in large parts of Continental Europe.

Within this field the scope is then further limited to bankruptcy procedures. Here is of course a defining institution for any capitalist market economy, which also has a long, well-identified history : its main features were already visible in the Italian trading cities of the late Middle-Ages and they can be traced till present days[1]. Hence a good candidate for comparative analysis, which functions are moreover self-limited and easy to identify. First a bankruptcy procedure should control moral hazard on the debtor's side (he may run away or hide assets), and the risks of a brake-up of collective action among creditors: they may also run on assets, or the powerful, the better-informed, or the local people may exploit outsiders. The negotiations should then be supported, guided or even organised so that the parties converge towards a solution to the default (typically continuation or liquidation) that will be

[1] Goldschmidt (1875), Percerou (1935), Santarelli (1964).

both equitable in distributive terms, and economically efficient (no undue dismemberment of the firm, for instance).

This finality suggests however that a bankruptcy law does not merely regulate a class of contracts (such as letters of exchange) or a legal entity (such as a company and its various governing bodies); neither does it directly police market transactions (for instance markets for credit, shares, or labour). In fact bankruptcy is not exactly or exclusively about rights, but about the micro-economic rules of the game once contracts, specifically debt contracts, have been broken and agents are to exit the market place. A bankruptcy law designs an arena that is regulated by public agents, such as judges, where private agents bargain on past contractual rights and on residual assets, so as to sort out the consequences of the failure and find a way back to the market. It is a secondary issue at this point whether the original firm or a restructured one will start trading, or whether the going concern is to be dissolved, in which case factors are returned to the respective markets for capital goods, labour or real-estate.

The historical experience then tells that governing this remarkable arena is not a matter for a weak, decentralised public agent, not to speak of a private sub-contractor, or a mere mediator. At least since modern times, bankruptcy procedures have always been anchored in, and operated by core sovereign institutions - generally a court, if not an agent of the central administration. If indeed the conflicts of interests raised by the default are to be solved, then the capacity of individual agents to opt out of collective action, or to hold-out decisions, should be effectively curtailed; and the sole authority which may actually curb their legal and contractual rights, or suspend and even redefine them, is the Sovereign, in a rather classical Lockean definition[2].

A paradigmatic bankruptcy procedure, since centuries, is thus opened and closed with a judicial sentence – that is, a sovereign act. At this moment, specific rules of interaction are imposed on agents that will be withdrawn when they will enter again free-wheeling, market-based transactions. Individual remedies are suspended, debts are accelerated, interest payments are stopped, commercial secret and

[2] Collective action dilemma are compounded by a second, different motive of public interference: social preferences. This is most directly reflected in the hierarchy of creditors, when the proceed of liquidation is to be distributed: privileges granted to the fiscal administration, workers, innkeepers, doctors or Churches differ widely across countries and over time. And of course, this is a matter for statutory law to settle. Then, take prison for debt which has been abandoned in Europe during the 1860s and 1870s. In England as in France, this marked the end of a decades-old campaign run mostly on humanitarian grounds – i.e. on a notion of what a decent society should not impose on its members. This implied as well a collective value-judgement on what should be the limits of market principles, or market discipline. Still today, a principled, fully consistent defence of creditors' rights and the "sanctity of contracts" should call for the reintroduction of prison for debt, or even death penalty, if this were to reduce the risk of moral hazard. Yet another example is the English approach to debt discharge, already introduced in the early 18th century: it was motivated, commented, and is still acclaimed as a reflection of the society's collective interest in supporting risk-taking and entrepreneurship – obviously a public policy issue that may impose undue costs on individual creditors.

correspondence are thrown open, the debtor may be put in prison, some contracts entered into recently may be suspended or cancelled, etc. The whole process thus unfolds at a far distance from the usual rules and practices of commercial life. Most consequential however, the law imposes on creditors a decision-making rule based on qualified majority vote (generally three quarters of weighted votes). And once the judge has confirmed the decision, dissenting minority voters are legally bound: their contracts are re-written and their wealth possibly taken away. Under a liberal constitution, creditors, even a qualified majority among them, cannot impose this on each others.

This is the key point. The post-default collective action problems between the parties may certainly be solved on a private, decentralised basis; but the evidence build over centuries is that the strong hand of the sovereign is often called for in order to discipline dissenters. This was observed and accounted for in 15th century Genoa, in 17th century Lyons, in 19th century London – and also in 21st century New York. And if the problem remains unsolved, de-coordinated individual agents may regularly reach sub-optimal collective results : the regulation of defaults would remain chronically dysfunctional and markets may decline. But then the solution to the problem may also proved worst than the problem. What could actually be more threatening than, first, having one's contracts broken, and then being put in the hands of a self interested, unwieldy sovereign? Or those of a dictatorial majority?

Hence the critical issues in bankruptcy for economists and historians, which have a distinct constitutional dimension: how is this arena governed? How much leverage and discretion does the sovereign's agent has in this process? How are private rights altogether defended under its exceptional rules? And how far does the parties' freedom of choice extend, as regard the outcome of the procedure?

A first result of this article is to point a number of clichés that the Common law and Civil law traditions have entertained one on the other, on issues of bankruptcy. It is indeed striking how limited mutual knowledge they share, a point that is well reflected by the respective bibliographies, especially in the 20th century literature. A case in point is the English tradition of debt discharge that has been hailed for generations as a unique pro-business feature, which would be specific to the Anglo-American experience. In fact, Continental traditions have made such decisions an everyday practice since the Middle-Ages.

Second and more important, there is no confirmation that the respective legal traditions would unevenly protect creditors' rights after the default; at least, such a bias is not observable in the law books. What comes out is a somewhat different, arguably more complex question. It is the degree to which bankruptcy should be shaped as an open though exceptional negotiation framework, or whether the range of possible outcomes should remain as close as possible to the original intents and

commitments of the parties. In other words, the question is whether the underlying norm is to remains as faithful as possible to the pre-bankruptcy distribution of rights. Or does the default makes it legitimate and efficient to support a much broader negotiation, which would open up on a wholly new generation of contracts, possibly even a new structure of the firm? Still today, the debate on bankruptcy reform is structured by this opposition between the priority given to *ex ante* private rights, and two competing principles: collective action between private agents, and social preferences, as expressed by the state[3]. The main difference is that the notion of a "creditors' bargain" is not much contested anymore, while in the past the discussion was also whether the possibility for such bargain would not expose the whole procedure to uncontrollable moral hazard.

For instance, from the early 17th century till the 1860s', English bankruptcy law was exclusively an instrument of debt-collection: its finality was to seize the debtor's assets *against* the strong protections to private property offered by the Common law, since medieval times. The procedure thus worked rather as a continuation of private remedies, with different, collective, legal instruments. French law on the other hand adopted the Italian legacy, which had fashioned bankruptcy as a flexible, open-ended instrument. Before and after the 1808 Code, it explicitly offered a menu of options to the parties, and the law basically stated that it was up to them to decide on how they wanted to exit the default. In England, where liquidation was the sole possible outcome, the critical decision was whether or not to enter the institution; inside, the private parties did not have much to say anymore. On the Continent the institution was build indeed as a place where they could talk and bargain. This contrast is most clearly reflected in the judicial character of Continental bankruptcies, against their executive/ administrative dimension in England.

The eventual link with market discipline then comes out clearly : the liquidation-only option implied that the failure to pay one's debt was immediately sanctioned in the harshest way, whereas the possibility to renegotiate softened the risk. The rationale beyond the English approach was thus to address *ex ante* expectations, while the French option posited that institutions should help agents address shocks on an *ex post* basis, even if this implied more room for moral hazard. Over the long run, however, both countries eventually converged. Post-revolutionary France first shed the most discretionary instruments that had allowed the sovereign to offer debt moratoria to distress agents; procedural rules around the negotiation of concordats were also very much strengthened. Then, from the 1860s' onwards, continuation arrangements were re-introduced in England and became a major tool in the restructuring of large businesses, with huge balance sheets. At the end of the 19th century, the respective bankruptcy procedures had never been so close since three hundred years : England's

[3] See for instance Jackson (1982), Baird (1987) and Warren (1987).

long solitary experiment with single-exit bankruptcy laws was a thing past, and the old Italian *concordato* had become a major instrument for financial and industrial restructuring[4].

Section 2 presents a brief, summary sketch of the history of bankruptcy law, from the Middle-Ages till the modern era. Section 3 compares the structure of the institutions in charge of bankruptcy: the English *commissions* and the French courts, later the *Tribunaux de Commerce*. Section 4 analyses how bankruptcy procedures worked in France, under the Ancien Régime and under the 1808 *Code de Commerce*. Section 5 does the same with the simpler, more economical English experience and summarises its main common points and differences with the French traditions. Section 6 concludes.

2- A historical sketch

Modern bankruptcy laws emerged in the trading cities of Northern Italy, in the 13th and 14th centuries (Florence, Pisa, Genoa, Venice, etc). Their rules already implied a clear brake with normal time contractual interaction: the debtor could be imprisoned, he could not trade anymore, his accounting books and correspondence were opened, etc. These rules were operated by merchants, within their own elected courts, though municipal authorities offered strong guarantees of execution. But this division of labour could come under pressure, for instance when the authorities considered that public order was being threatened, for instance in the case of a banking crisis (Venice).

The negotiation ended up, typically, either in immediate liquidation or a continuation arrangement (*concordato*). The economic rationale beyond this alternative choices should be understood in Coasean terms. In those times, exchange took place in highly fragile, unstable market environments which were fraught with informational problems. Credit based on reputation and personal networks implied unstable monetary conditions, so that in the absence of large banks or modern Central Banks, rumours and panics were endemic. This made liquidity shocks a permanent threat on payments, i.e. on the integrity of contractual commitments and the survival chance of firms. Hence the key regulatory issue of how to deal with the short term incapacity to pay, by an otherwise solvent or viable business. In principle, illiquid firms should take the route of the concordat and insolvent ones should be liquidated. The centuries-long practice of continuation arrangement actually relied on this assumption. However, making the difference between these two states is famously difficult, today and even more in those days. Hence the risks that the road of concordats may be taken by insolvent traders, who could then escape market sanction. This is why the main underlying analytical issue in the concordat vs. liquidation trade-off is how rules and institutions may help agents dealing with liquidity, i.e. informational problems.

[4] See also Sgard (2006)

The core principles designed in Northern Italy were then exported to Northern European fairs (Champagne, Ypres, St Yves) and also to the larger trading ports (Barcelona, Marseilles, Lyons, Bruges, Lübeck, etc). The extra-territorial status of merchants was reflected again in the self-regulatory dimension of their courts as of their law: this was the golden age of the Law Merchants, a de facto relatively unified legal body, with limited differentiation across Europe, which governed long distance exchanges. Local sovereigns however offered again executive guarantees (typically against a fee) and thus became a key element in enforcing market discipline.

During the 16th century, emerging modern States confirmed the principle that the proceeds of a bankruptcy should be shared on a proportional basis. But the main innovation they introduced were specific and exclusively repressive acts against fraudulent debtors[5]. This is where the difference originated between pure contractual disputes among traders, that remained very much in the hands of their specific courts (*faillite*), and their being qualified as fraud, which implied prosecution (*banqueroute*). Conflict between self-regulation and repression would remain a long term feature of this history, which was further aggravated by the dual origin of the respective legal regulations.

Starting in the early decades of the 17th century, both in England and France, the old medieval Law merchant was progressively absorbed, and more or less thoroughly re-written by the State's legal and judicial institutions. Laws designed for discrete fairs and trading cities, that worked at specific places and specific times, then became the founding stones of an emerging commercial legislation enacted by emerging territorial, mercantilist States. They started to operate on a continuous basis, both in space and time. In England the Law Merchant was progressively absorbed by the Common law courts, which shed the largest part of their Italian/ Roman legacy: it was to a large extent remodelled on the basis of the existing English property and contract law. In the case of bankruptcy, however, case law as opposed to statutes had a decidedly secondary influence: since then and until present day, in England as in all other Common law countries, bankruptcy would remain firmly in the realm of statutory law, voted by the Parliament.

During the 18th century, the major English reform was the 1705 Act of Anne, which introduced debt discharge as a normal conclusion of a bankruptcy process. Then the 1732 act codified the whole respective legal body and remained the touchstone of English legislation on bankruptcy until 1825. At that time a new rapid cycle of reforms was started that would mainly revolve around the question of continuation arrangements (1831, 1843, 1849, 1861, 1869, 1883).

[5] These first such statutes were enacted respectively in 1543 and 1571 in England, and in 1536 and 1560 in France.

In France, path-braking evolutions first took place in the early decades of the reign of King Louis XIV (1661-1715). The starting point was the old merchant law that had governed the Champaign fairs in the past and had then been transferred to Lyons, during the course of the 16th century. This being a major financial place, where lots of Italians traders and bankers had settled, the *Conservation de Lyon* became the key intermediate legal text, which summarised the Italian and Lex Mercatoria legacy. It was then transferred into the emerging French commercial law. First, in 1688 the King offered its full guarantee of execution to this body of law and to the *Consulat* of Lyons: i.e. the elected traders' court which had jurisdiction over all disputes arising during the four yearly fairs[6]. Then, five years later, in 1673, the Italian/ Lyons legal heritage became the major source of influence on the *Ordonnance du Commerce*, *de facto* the first modern commercial code. It was to have a large influence on the Continent, and latter on the 1808 *Code de commerce* that also had a large trans-national impact, thanks this time to Napoleon's armies. Compared with the English experience, the 19th century has seen less reforms in France, the most important being the end of prison for debt, in 1866, and the introduction of the *Concordat préventif* in 1889 – under the influence of recent English reforms.

3- Who governs? Courts, officials and third parties

France

Commercial jurisdictions in France, just as the law per so, was designed on the basis of the Italian experience, namely that of the *Consulato*, which had shape the Lyons's *Consulat*. Starting already in 1549, the monarchy established an increasing number of new *Tribunaux Consulaires*, in the major, latter in the secondary trading cities[7]. Compared with the Italian experience these were rather late creations, initiated from above, though they inherited the most striking features of their predecessors: justice was rendered on a summary basis, as a rule appeal did not suspend execution, justice was free, the parties could directly argue in front of the court, and judges were traders elected every other years by their peers. These characters remained a permanent fixture of French commercial jurisdiction, until present days. For four centuries and a half, it has also been relentlessly criticised and attacked, mostly by professional magistrates, for its lack of professionalism and vulnerability to corruption[8]. But the *juges consulaires* survived and even resisted attempts to add only a single professional judge to their courts – the last time in 2002.

[6] Guillon (1904) states that already by the late 16th century, the *Consulat de Lyon* had extended its jurisdiction to commercial disputes arising outside quarterly fairs; this convergence was written into law in 1655 and thus marked an important towards the "territorialisation" of this institution.
[7] Guillon (1904), Hilaire (1985)
[8] In his massive (1032 pages) *Histoire de la Justice en France*, J.-P. Royer (2001) does not mention once the experience of commercial jurisdiction, neither that of commercial arbitration.

Jurisdiction over bankruptcy was however a major stake in this conflict. They travelled a lot between commercial and civil courts, ended up with the former after 1673 and were given back to ordinary courts in 1739. Finally, the 1808 Code gave again preference to commercial judges, who kept control over them till these days. As regard the standard procedure of *faillite*, the 1673 *Ordonnance* was remarkably light: it merely offered a series of sign-posts that would guide the parties and the judges as they bargain on a solution to the default; and it even did not envision precise punishments if rules were not respected. In this sense, it was a very liberal, open-ended institution that was more proposed to traders than imposed on them. Even penal prosecution against the debtor (*banqueroute*) was to be initiated by creditors, at some procedural cost, a point which suggests that adjudicating between rightful and delinquent behaviour was partly something up to traders to decide upon.

The 1808 *Code* built on many elements that had aggregated around the *Ordonnance* over the past decades, such as the *syndic* or the increasingly tight regulation as regard the verification of debt titles and accounting books. A thorough complexification of the procedures then went hand in hand with relative decentralisation as regard the institutional framework[9]: the *Cours* became *Tribunaux de Commerce* and regained jurisdiction over bankruptcies[10]. The *faillite* was now an intricate machinery where the different steps of the procedure, the role of the different actors, the conditions under which decision could be made were exactly defined. The result was certainly to shift a large part of the control from the parties to clerks (the *juge-commissaire* and his aids) and to professionals (like the *syndic*). But the possible outcomes remained unchanged: either liquidation or a continuation agreement, now called a *Concordat*. And the court was to confirm the qualified majority decision so as to bind minority dissenters. In this sense, the interaction between judicial sovereignty and collective action among creditors remained the core axis of the procedure.

England

From 1543 onwards, bankruptcies in England were managed by ad hoc Commissions, which were created on a case by case by the Chancellor of the Exchequer, after a creditor had petitioned him; control over, and ownership of the debtor's assets were immediately transferred to them. Commissions were thus a short-lived public authority, initially regulated by a loose procedure[11], which members

[9] Statistics published in the annual edition of the *Comptes Généraux de la Justice Civile et Commerciale* shows that the number of appeal judgements on sentences rendered by commercial courts were comparatively small. Note also that the *Cour de Cassation*, which is the top jurisdiction of the penal, civil and commercial order, did not have a specialised *Chambre* for commercial affairs until 1947.

[10] In some minor cities, where there was no commercial courts, all trade-related cases went to the civil courts; but this was by far the exception rather than the rule.

[11] During the 17th 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).

were initially chosen among local notables and fellow traders; during the 18th century they underwent a process of professionalisation that increased the stability of its recruitment and, arguably, its quality.

A key character, however, is that Commissions derived from the executive/ bureaucratic arm of the government: they were not a jurisdiction, and when bankruptcy courts were established in 1831, commissioners remained key, separate players. Historically, English bankruptcies were hence very much under the control of officials, or at least agents chosen by the administration. The contrast with the French approach was most notable under the Ancien Régime's much decentralised, self-regulated model. The 1808 *Code de commerce* brought French practices much closer to the administrative, English tradition. When defining the role and rights of the *juge-commissaire*, who was to supervise the procedure, the Emperor's lawmakers actually made direct reference to the English Commissioner; the *syndic* was also compared to the trustee, tough the distance between them is probably larger than in the former case.

Beyond institutional design, English commissioners like *syndic*s and *juges-commissaires* in France were expected to act in very comparable ways. They were expected to control the debtor's assets as well as its person; they would take him in and out of jail, audition him, audit his accounting books (*livres de raison*), check the quality of debt titles, built a credible balance sheet, and finally make a judgement on the responsibilities of the debtor and the basis for possible prosecution. In France, the main steps mentioned in the *Ordonnance*, then in the latter *Déclarations* by the King, in the Code and in the precedents very much addressed the same issues. This should not be very surprising, since both institutions had to fight with comparable problems: moral hazard had to controlled steadfastly, information had to be collected and redistributed, fairness among creditors was to guaranteed, etc. The closeness of the respective regulations should not be a surprise. The difference the English and French approaches come one step later, when the actors and agents are to make decisions and when the law may bear on how they bargain and what they may decide.

4- French Outcomes

Whether in England, France, or elsewhere, today as in the past, going to the court is, first and foremost, a collective failure: a dispute could not be solved on a private basis, and massive costs will be incurred by all parties - financial and reputational. The mere fact of bringing a dispute to public light and putting forward ones' arguments and proofs is contrary to both the ethics and the interest of Under the Ancien Régime, the law offered no less than four different options in order to address

financial distress or default; and these four entry gates then lead to a minimum of eight different possible exits (table 1).

i. The *faillite* was the standard procedure and the direct heir to the Italian *fallimento;* this was the reference option, around which all post-1808 non-penal reforms will be developed. It could end up first in liquidation (or *contrat d'union*): the proceeds of the auction were then distributed on a pro-rata basis among non-senior creditors; senior rights were by definition protected. And the residual post-liquidation debts also remained binding, so that in the future individual creditor may again go after the debtor and his possible new assets, whether they would be acquired by inheritance, marriage or work. Lastly, the debtor would not regain his civic and professional rights unless he reimbursed all his debts, as César Birroteau did at the end of Balzac's novel immediately before dying. All these features were not present in the 1673 *Ordonnance* but had been assembled by the middle of the 18th century; they would then be codified and hardened in 1808. That being said, in a comparative perspective, the main point in this framework is that liquidation did *not* open on debt discharge and fresh start, as was the case in England.

Secondly the *faillite* could lead to a continuation arrangement called a *contrat d'attermoiement,* or latter a *Concordat*. Here, the actual content of the accords were left for the parties to bargain and agree upon : there was no notion that the law or any official could restrain their choice. Moreover, a confirmed concordat would give the debtor all the professional rights which he had lost when the procedure was open. He could then agree with his creditors on a very large array of possible decision :

- a typical restructuring agreement, that would give back to the debtor the control and management of the business; he would then commit himself to new debt payments against concessions by the creditors: longer maturities or debt reduction.
- a concordat could also allow, explicitly or not, a "self-liquidation" arrangement whereby the debtor would be allowed to sell his own commercial assets, over two to three years for instance. It was probably expected that the return of the liquidation would be higher than in a straightforward liquidation; and the personal cost for the debtor would be much reduced, both in reputational and financial terms. This was the main road towards debt discharge and fresh start[12].
- but a *contrat d'attermoiement* could also support a second generation of separate contracts with one or several creditors, such as the "demi-commission": the debtor would pay a percentage of his total sales (for instance 2%) until his restructured debt would be fully repaid. This suggests both substantial confidence in the viability of the business (see the open time-frame) and a

[12] There is uncertainty among commentators as whether debt reduction was full and definitive, or whether the debtor still had a moral obligation towards his creditors, if he later became able again to re-imburse them. However, we did not any indication that this obligations has been considered binding by courts. French law, before and after 1808 never included a "clause de retour à bonne fortune", as other Contienental countries.

recognition that success rested on specific assets that could not be easily ceded, namely a network of personal relations[13].

ii. The second route towards financial restructuring were private moratoria, granted either by the *Conseil du Roi*, the *Chancellerie* or the regional Parliaments (or courts) – hence exclusively under the Ancien Regime. The *Lettres*, as they were called, and most generally the *Lettre de Répit*, were granted upon the demand of the debtor and allowed him temporary relief in order to negotiate an *attermoiement*[14]. Contrary to the *faillite*, who was shaped as a private, collective contract to be confirmed by the judiciary, here the decision is the Sovereign's own discretionary one: he actually suspended private proceedings. But asking for a *Lettre* clearly suggested that direct negotiation with the creditors had failed, arguably because the latter had not much trust in the debtor. It was thus perceived as an instrument to arm-twist reticent creditors and was associated with much more reputational cost than a standard arrangement.

Though, in the Middle-Ages, the *Lettres* were very much an unconstrained privilege, like grace in the case of conviction, they became increasingly regulated, especially after 1673; forinstance, proofs of the financial difficulties of the debtor had to be offered, his books should be opened, and for moratoria of five years and more, creditors would have to agree by vote[15]. However, many evidences suggest that the *Lettres* have raised considerable and probably increasing resistance during the course of the 18th century: they were seen as a major source of fraud and dissimulation[16]. The 1789 *Cahiers de Doléances* often called for their suppression, and the 1808 Code then suppressed any form of moratorium; even short-term arrangement that would help absorb a liquidity problem by an otherwise solvent and viable firm were made impossible – outside la *faillite*. During the 19th century, the legal profession (the academics and the judiciary) long remained strongly opposed to any such possibility, where they would see a return to pre-1789 arbitrariness. Only in 1889 did the new *Concordat préventif* opened again the possibility of agreement reached under some judicial protection, though not the heavy and costly *faillite*; but even at that time the shadow of the *Lettres de Répit* extended over the Assemblée Nationale[17].

iii. The third option, the *cession* was a direct legacy of an early, archaic form of bankruptcy that originated in ancient Rome and had re-emerged in the Middle-Ages, within the civil (not commercial)

[13] I thank Anne Wegener Sleeswijk for pointing this model of contract.
[14] The *Lettres de Répits* were issued by the Chancellerie, and the *Lettres de Défense Générale* by courts ; the *Arrêt de surséance*, finally, was issued by the Conseil du Roi.
[15] Note also that since the 14th century, the « dettes de foires » could not be affected by the Lettres – another indication of the extra-territorial dimension of the large fairs.
[16] See for instance Le nouveau commentaire des loix du commerce, 1787; or Bornier (1749) and Denisart (1771).

law. The logic was that the debtor surrendered all his goods and assets to his creditors, who then proceeded with selling them and sharing the return on a pro-rata basis – hence the collective action element that identifies this institution as a model of bankruptcy procedure. The main benefit for the debtor is that individual (private) proceedings against him were cancelled: typically, he would be freed from prison, and not threatened anymore of imprisonment. There were however two forms of *cession:*

- the *cession judiciaire* was decided by the court and imposed upon creditors; it was considered highly infamous and implied permanent losses of civic and professional rights (unless the whole debt was latter reimbursed);
- the *cession volontaire* was initiated by the debtor and was actually a contract with creditors, that included the write-off of all residual (post-liquidation) debt. Hence another instrument for debt relief and fresh-start, which was considered as he last available option, once all other routes had been closed; it was a common instrument for non-traders (who did not have access to *la faillite*), and during the first decades of the 19th century in the case of the poorer strata of the population; its relevance however fully disappeared after prison for debt was suppressed in 1866.

iv. *La banqueroute* was finally the penal procedure associated to the *faillite* in the case of fraud. It originated in the early, exclusively repressive statutes adopted during the 16th century, at a time when there was no other statutory law addressing defaults and insolvencies. Both in France and England one of the main trend of bankruptcy reform, during the whole period under review, was then the difficulty to strike a balance between carrots and sticks:that is, between the call for positive incentives, that would support cooperation and conciliation, and repression and dissuasion. Both countries threatened fraudulent debtors with death penalty, but neither seems to have actually executed more than a few debtors. But prison, galleys and permanent loss of rights were certainly also on the menu, especially under the 1808 Code, that introduced the *banqueroute* simple and *frauduleuse*.

If the whole set of options to address financial distress is now summarised, it is possible to rank them from the least to the most shameful, taking into account the symbolic costs attached to bankruptcy[18].

[17] Note also that in France and England, like in the rest of Europe, there was no tradition of general, universal debt moratoria, comparable to those very often declared by individual States, in the US, until the 1930s. (see Bolton and Rosenthal, 2001); France suspended enforcement rules for private debt only in 1848 and 1871.

[18] The *déconfiture* is not presented here, as it does not address traders' debt but, basically, what we would call today consumers' debt. The difference remains very stark till today, as a consequence, of the specific construction of the commercial courts in France.

Box 1 - Scaling shame:
the reputational costs of bankruptcy

private (unpublicised) arrangement;
continuation arrangement within a *Concordat*;
continuation arrangement after a *Lettre de Répit*;
agreement for self-liquidation;
liquidation under a *Concordat*;
cession volontaire;
cession judiciaire;
banqueroute simple, then *frauduleuse*

5- English Outcomes

When compared with the complex French landscape, which different procedures originated in different legal sources (commercial, public, civil and penal law), the English case is much simpler.

i. With some variations, the Italian *concordato* was exported by the medieval Law Merchant over all Europe, including England. In a context of emerging absolutism, both the Privy Council and the Chancery then attempted in the latter decades of the 16th century to develop a standard procedure for the confirmation of voted agreements[19]. This trend was further developed during the 1610s' under Francis Bacon, though the emerging practice did evolve differently than in France. As mentioned above, confirmation was judicial in this latter case and came at the end of a procedure that was supervised by the elected, decentralised *Cours Consulaires*. In England, confirmation took the form of *Bills of Conformity*, issued by the executive/ bureaucratic arm of the government, which was also the authority beyond the Bankruptcy Commissions[20].

These Bills were thus increasingly attacked in the Parliament, for their discretionary character, a bit like the *Lettres de Répits* in France would be later criticised. However, the resistance to confirmation did not arise from the traders classes, but from two main social actors : the landed property that dominated the Parliament, and the Common law courts which were then engaged a the decades-long fight for the jurisdiction over commercial issues – in the Middle-Ages they did not deal with them[21].

[19] Holdsworth (1914), Treiman (1938), Jones (1979).
[20] Smith (2006).
[21] Common law courts were *not* a commercial jurisdiction in the previous centuries. Gerard Malynes's *Lex Mercatoria or the Ancient Law Merchant*, published in 1622 in London, puts a lot of emphasises on the difference between a fraudster and the "honest but unlucky trader", who should benefit from an arrangement. Here is how he summarises the 1621 episode : "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

This fight was won in two acts, passed in 1621 and 1624: first Bills of Conformity were abolished; then any attempt to reach a separate agreement with some creditors was qualified as an 'Act of Bankruptcy' that could immediately trigger imprisonment and the opening of a procedure, hence liquidation.

This was the beginning of long, separate course of English, latter anglo-saxon bankruptcy law. Bankruptcy in England became exclusively an instrument for seizing of the debtor's assets, in order to sell them and share the proceeds on a ratable basis; the residual debt was not forgiven. Several attempts at re-introducing arrangements were made during the latter 17th century, the most well-known in 1696-97, though without result[22]; the issue then disappeared from the policy agenda until the 1820s'.[23]

This does not mean, however, that accords were impossible, but that they were exclusively negotiated on a private basis, outside any judicial control or legal regulation. There is little doubt that this practice was widespread and that it actually helped manage financial distress, although available analysis and documentation is sparse – these accord being private and secret, the available archive are apparently rare and fragmented.[24]

ii. In the early 18th century, a major complement to the 1621-24 turn was added : the 1705 *Act of Anne* introduced debt discharge as the normal outcome of the procedure[25]. Hence the "fresh start" dimension, that actually freed "honest but failed debtors" from further proceedings and imprisonment, and also gave them back their civic and professional rights. This reform has been hailed since then as the true birth of modern English bankruptcy laws. It actually provided much more balance to the whole institution : debt write-off made fresh start possible, so that failed debtors could indeed work and invest with the expectation that benefits would not be pre-empted by their past creditors[26].

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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".

[22] Treiman (1938) mentions three attempts at re-introducing arrangements, in 1679, 1693 and 1696.

[23] In his much quoted treaty of commercial law, published in 1813, Wyndham Beawes allocates more than a hundred pages to bankruptcy issues, including a rather detailed comment of the 1673 Ordonnance; but he does not mention once the attermoiement or concordat. In the case of the Netherlands, he suggests that traders "may find some method to settle with the creditors".

[24] See Giles (1729), Hoppit (1987), Luckett (1992).

[25] See Boshkoff (1982), Tabb (1991, 1995). On 18th century bankruptcy practices in England see i.a. Hoppit (1987).

[26] This point is usually illustrated in the literature by Blackstone's comment: « Thus the bankrupt becomes a clear man again ; and (…) may become a useful member of the commonwealth" (488). See Cooke (1799), Cullen (1800) and Beawes (1813) for other examples, or Tabb (1991) for a more recent one. Indeed, Daniel Defoe, himself a bankrupt, provided a dire description of the pre-1705 institution: 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 wholly to the Destruction of the Debtor, and yet very little to the Advantage of the Creditor » (Defoe, 1697).

There is no doubt that the relative ease, both legal and reputational, with which English traders could enter bankruptcy and be discharged was well-recognised abroad, with admiration, incredulity or both. However, as mentioned above, debt discharge had also been common practice on the Continent, since the Italian founding era. But it would typically be decided within a *Concordato*, so that it originated in a private agreement and could be part of a broader continuation accord; in England, debt discharge necessarily implied the full transfer of the all the debtor's assets, and liquidation of the business. In this sense, the post-1705 English approach very much resembled the old Roman *cession*[27].

This logic of the English bankruptcy should thus be understood in the light of the 1621/24 decisions. Since then, the only route towards discharge was unanimity agreements, so that the business risk incurred by entrepreneurs and investors was extremely large – including de facto, life-long prison. This was further compounded by the absence, under English law, of any company statute of the *commenda* type. This other legacy of the Italian commercial law, that was well alive on the Continent, had also been rejected on the basis of a unilateral defence of private rights, against majority-based collective action[28]. This specific structure also explains the unique place given in the Anglo-American legal literature to the question of initiation: that is, whether bankruptcy should be only involuntary (i.e. initiated solely by the creditors) or also voluntary (initiated also by the debtor)[29]. A procedure established primarily as a mechanism for fresh-start actually needed a strong gate against widespread opportunism. Conversely, if the procedure was construed as framework for negotiation, there was no reason to restrict entry: mutual control would take place inside. Hence the dual approach to initiation in the Continental tradition : its aim, then as now, was to incite debtors to enter negotiation at an early time, when they might not have lost all their wealth.

iii. Starting in 1825, England entered a long series of reform which two main objects were to end prison for debt, and to (re)introduce judicially sanctioned arrangements[30]. Hence, remarkably, the parallel creation of bankruptcy courts (183KK) and the shift to an involuntary and voluntary procedure.

- the 1825 Act was the first to explicitly reintroduce the possibility (and the term) of a 'composition', though this option remained highly restrictive: the voting threshold is extremely high (nine tenth of

[27] The point is also underlined by Blackstone (1811, p. 472)
[28] Under the 1705 act, discharge was personal and did not extend its effects to partners and associates.
[29] « 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 (1998).
[30] On this period see i.a. Duffy (1985) and Lester (1995); also Welbourne (1932) for a very literary and highly-coloured description of early 19th century bankruptcy procedure in London.

weighted votes) and its interpretation seems to have remained close to that of procedure for discharge.[31]

- 1849 marked the introduction of real arrangement, comparable to the practice on the continent; two models were proposed: private deeds who should be accepted by six seventh of the creditors, in sums and number; then arrangement reached at the initiative of the debtor, under the supervision of the Bankruptcy court, with a three-fifth majority threshold. However, the courts seem again to have interpreted the act as a variant of the cessio, i.e. of the traditional English approach were the debtor was expected to dispose of his entire wealth – and this again made continuation agreement impossible[32].
- the 1861 Act included the possibility of an judicially-confirmed arrangement, that had to be accepted by three quarter of creditors, in sums and number; it was also construed as not implying the cession, but this raised a lot of insatisfaction again (fraud, arm-twisting, etc)[33].
- after the interlude of an almost libertarian, though flawed, law adopted in 1869, the 1883 law marked the eventual convergence point of this long trial and error process. The law thus stabilised on the basis of a menu approach, close to that adopted in Belgium and some years in France, thaw the practice remained much closer, apparently, to private agreement with limited oversight, than to the continental approach where the judicial procedure remained very much in the centre.

Since the early 19th century English-language literature has remained largely indifferent, not to its own re-discovery of arrangements, but to its own, unique historical experience in this regard: its early divergence vis-à-vis the legacy of the Italian medieval law, its long separate course, over some two centuries and a half, and finally the re-convergence at a time when continental countries were also looking for a modernised form of *concordats.*

6- Conclusion

The parallel developments of bankruptcy laws in England en France, between the 17th and 19th centuries, have first highlighted their joint origin in the early mercantilist period: they were part of the first attempts at building a national trade legislation, which would also include for instance payment and debt instruments, or the first company statutes. Bankruptcy procedures also became a major stake in the fight between courts for the jurisdiction over commercial issues : this was reflected in the centuries-long struggle between the *Cours Consulaires* and the civil courts in France, and in the more

[31] Holt (1827, p. liv) interpretes the act in this perspective, without giving it much further consideration.
[32] Holland (1864).
[33] Robson (1888).

indirect drive of the Common law courts. In other words, the expectation was confirmed that bankruptcy procedure are indeed established on a critical dividing line between the sovereign and the world of private contracting agents. And this interaction appeared as a complex, evolving, differentiated one.

The defining pattern in this history is the tension between the competing demand by traders for social autonomy and for judicial guarantees. On the one hand, this was a world where they defended strongly their right to settle disputes on their own and to choose their own rules. Hence the resilience of self-managed fora often inherited from the Middle-Ages, and also the importance of private contractual institutions (as deeds of arrangement in England, or contracts signed by notaries in France). On the other hand, legislation and judicialisation should not be interpreted solely as the act of a growing fiscal and administrative state, which would have progressively brought free traders under its paternalistic protection. In fact, traders also faced problems of their own which they were not equipped to solve: namely post-default collective actions problems, and the differentiation between the "honest but unlucky trader" and the swindler – that is, not the prosecution of the latter but the protection and survival of the former.

This is where the English and French experiences diverged sharply. In England, in the early 1620s', an alliance between the Parliament and the Common law courts effectively blocked the evolution towards judicially confirmed private arrangements. From then on, and until the 1860s', the sole outcome of a bankruptcy would be liquidation : it was a single entry, single exit institution. However, after the introduction of debt discharge in 1705, the overall framework gained a new coherence : either a unanimity agreement was reached on a private basis (i.e. outside court), or the estate would be liquidated and the debtor would benefit from a fresh start. The implicit assumption was that liquidity and collective action problems could be, or should be addressed by the parties on their own : it was not up to public institutions to take care of private bargaining and transaction costs; at best, the threat of liquidation would just discipline agents while they bargain in the shadow of the law. In this perspective, contingent rules would have only caused problems, specifically moral hazard : this was actually the reason brought forward in 1697 when the Parliament repelled a law that had reintroduced arrangement the year before.

On the other hand, the defining character of bankruptcy laws in France, and more generally on the Continent, was not a specific repressive or anti-commercial bias, as is often mentioned. Both legal families actually addressed the "fresh start problem"; they also assumed explicitly that people staying in jail for years was not a good thing and that the absence of discharge created adverse incentives. The main difference is that a bankruptcy procedure in France was explicitly designed as an alternative, contingent and collective rule of re-negotiation. It was assumed that after exogenous shocks and

defaults, the parties may have a legitimate interest in redesigning the whole balance sheet of the firm, on the basis of a new business plan[34]. Public, or publicly-endorsed institutions like the *Cours consulaires*, should then help reducing the underlying costs and risks of transaction. The emphasis was thus on collective action, the protection of the going concern, and the regulatory role of independent, often elected courts.

Discretionary interventions by the sovereign were arguably more widespread than in England, but they did not affect directly the core procedure – the *faillite*. They were embedded primarily in the *Lettres de Répit* that were abandoned lately, in 1808. In England, the interaction between the core procedure and sovereign intervention seems to have played out in a very different way. First, the confirmation of arrangements came with *Conformity Bills*, that were enacted by the executive/ administrative arm of the government, with limited procedural guarantees – hence the accusation of arbitrariness, that was further strengthened by the non-judicial character of the Bankruptcy Commissions. Then, the Common law courts resisted strongly all measures that would support collective action between private agents, typically under the form of qualified majority decisions. This is where the protection of property rights actually came in, that is before judicial confirmation by the sovereign; this bias would be again observed in the first decades of the 19th century, but also in the parallel history of company laws.

The main difference between the two countries is thus in the power or value given to initial contractual commitments. French law-makers assumed that in an unstable world, the absorption of exogenous shocks could be supported by contingent rules and professional courts, especially if the latter were established at a fair distance from the Monarch. Institutions could actually regulate private competitive markets without causing excessive incentive risks. Post-1705 English legislation operated exactly on the opposite premise: straightforward liquidation and discharge were less dangerous than allowing debtors to negotiate their way out of default. Of course, firms might then be liquidated which could have survived, but that was the cost to pay for stronger markets. Shock absorption was a matter for minimal rules and forward-looking individual discipline.

[34] Fremery (1833, p. 416) defines a concordat as : "un accord dans lequel les parties ont fait par appréciation un partage équitable de l'accroissement de valeur espéré, qui sera le fruit du travail et des soins du failli ».

TABLE 1 - Bankruptcy procedures in France

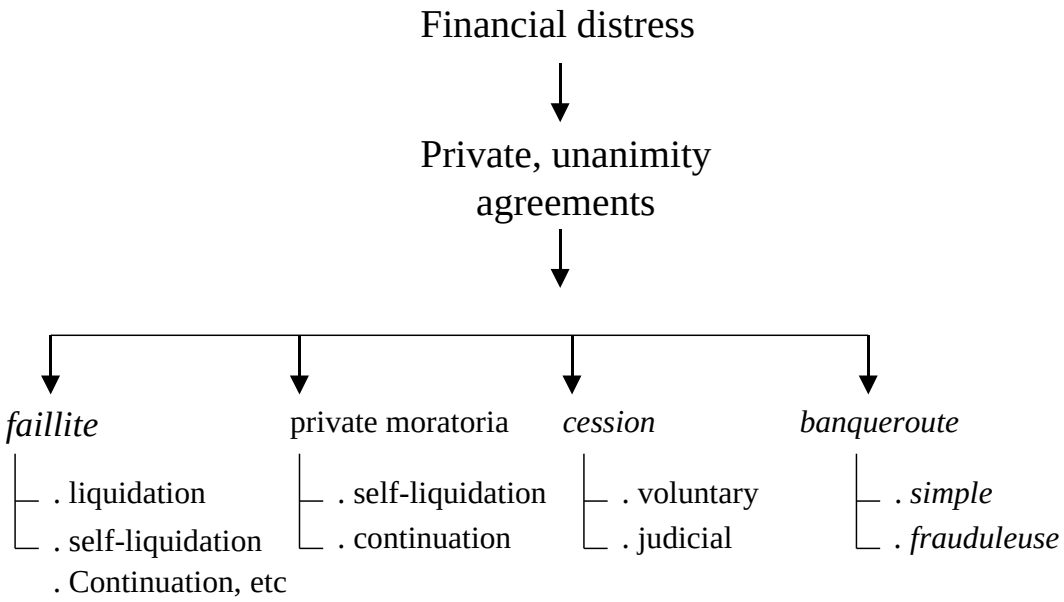
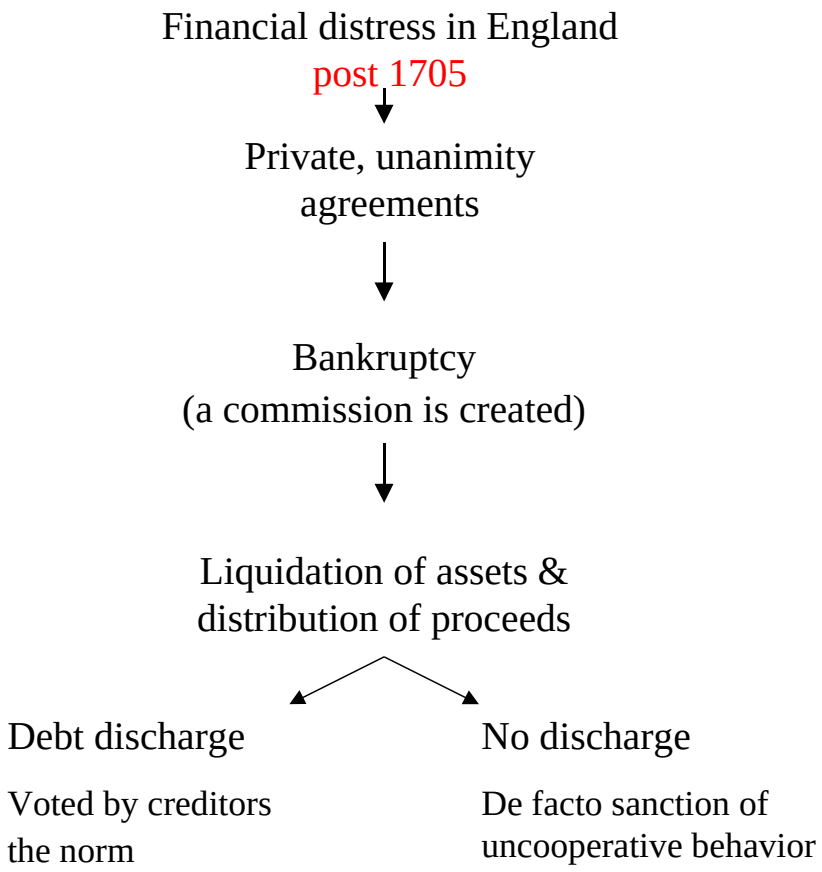


TABLE 2 - Bankruptcy procedures in England



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