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Bankruptcy Discharge and the Emergence of Debtor Rights
In Eighteenth Century England

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chance. What is not immediately clear is why creditors would voluntarily agree to a discharge or

but on the success of search by the bankruptcy commissioners. Thus any well-designed rules

inhibit lending. Blackstone, the leading jurist of the eighteenth century saw the bankruptcy

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In this paper, we explore one aspect of the development of a more impersonal credit market, this change in the law regarding the statutory rights of creditors to reclaim their funds.

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the right to full repayment. Furthermore, it is clear from the extant ledgers that creditors responded immediately to the discharge provision in the legislation. These results represent an important contribution to our historical understanding of the impact of the legislation in early modern England on the behavior of creditors and the resulting exit by failed entrepreneurs. Moreover, this work represents a contribution of institutional significance in that it shows how the response of creditors to a change that, on the face of it represents the loss of a property right, can benefit them, borrowers, and society alike. In summary, bankruptcy in action in England in the early eighteenth century would appear to match Blackstone

The paper is structured as follows. We begin with a description of the bankruptcy

responsibility system, found through Europe from the eleventh to the fourteenth century, as a mechanism permitting the growth of more impersonal exchange. Central to this system was the knowledge that if a merchant defaulted, a creditor could seek recourse from any other merchant within the same community as the defaulter. For example, in 1323, William Virgil, a merchant in Dover, confiscated the goods of John de Grantham, a London merchant, in repayment for a debt owed by different London merchant, Henry Nasard (Greif: 222-3). In response, the London community took action to ensure that Nasard repaid his debt. Virgil got his money and de Grantham his goods returned. This system allowed creditor/debtor resolution between any pair of merchants within community even if they did not know one another, because, in essence, the goods of every individual member had been posted as bond for the conduct of any other member.

Such a system became less useful as the range and number of independent traders grew.

effective, impersonal contract enforcement, because personal ties, voluntaristic constraints, and ostracism are no longer effe

Indeed, for Greif (228) the community responsibility system is eventually replaced with greater use of Common Law, with merchants registering their credit relations in local courts using their own goods and property as collateral. The use of local courts gave rise to the state as a third party enforcer. Economic growth, however, requires not only the development of anonymous relationships but also the development of structures that guarantee impersonality where impersonality means treating everyone the same without regard to their individual identity, which Wallis (2011) argues, along with security of property rights, ranks near the top of good

recharge barter Chevisance or otherwise, in grows or by retail, or seeking his or her trade by
were eligible under the statute (§1).¹² In 1603, I James I c 15 expanded the

(§2) The application of the statute by occupation would not change until the sweeping changes of the -mid nineteenth century. Under 21 James I (1624) access was restricted even within buying and selling by requiring that the debt owed be greater than £100.¹³ At the same time the statute was expanded to cover both citizen and alien and in all cases the statute covered both male and female debtors and creditors.¹⁴ Thus if the insolvency met these conditions, the rules regarding bankruptcy were available to all regardless of social status, gender, or occupation.

The situation facing a bankrupt was stark. The bankrupt had no legal rights to any personal assets, whether house, clothes or furniture, and no legal exit from the state of bankruptcy until and unless all debts are fully repaid. Until those debts were repaid, creditors had a claim on all future earning, having the legal right to dun or importune bankrupts or the estate. Such treatment created an incentive for the bankrupt to hide assets or to lie about the extent of assets remaining. Under sixteenth and seventeenth century statutes bankruptcy applied only to persons and not to companies. In addition, no debtor could declare him or herself bankrupt. This could only be done by a creditor.

¹² It is often incorrectly stated that the statute applies only to merchants. In fact, the statute applies to those who mad their living by buying and selling which is much broader than how the term merchant was understood in early modern England.

¹³ In real terms, this is the equivalent of £13,930 today. In income value, it

¹⁴ Creditors of insolvent debtors not covered by the bankruptcy law were forced to use suasion or an inefficient race to get to remaining assets before other creditors. For very small loans less than 6d, a small claims court could be used.

Dramatic changes occurred with 4&5 Anne I c 4 and 6 Anne I c 7.¹⁵ *an act to prevent frauds frequently committed by bankrupts* a continuity of language about a

legal position and reflects a century long discourse on the malfeasant versus the misfortunate bankrupt.¹⁶ The statute made two very important provisions to benefit compliant debtors. It specifically allows for an allowance of five percent of the value of the estate up to £200. More importantly, the statute specifies that if the debtor has been found to have complied with the bankruptcy proceedings and four fifths of the creditors by number and value of debts agreed, the bankrupt would receive a discharge from the state of bankruptcy, with all remaining debts expunged. Compliant referred to the willingness of the bankrupt to work with the bankruptcy commissioners truthfully reveal the extent of his/her assets. For bankrupts who flagrantly and deliberately sought to hide assets or to evade the commissioners, the statute specified a new penalty; such conduct, if proven in a court of law, could result in death.¹⁷ Further regardless of the conduct of the bankrupt, a discharge could not be issued if the bankruptcy was the result of gambling.

Clearly the procedure whereby a letter to the Lord Chancellor from any single creditor results in a writ of bankruptcy being issued was open to malfeasance by third parties. No debtor

¹⁵ Under 4&5 Anne, the decision to award a discharge was left to the Commissioners without input from creditors. 6 Anne (passed the following year) changed this provision and required that a full four fifths of creditors by number and value of the debt agree. If there was no objection lodged, the discharge was granted. If there was an objection, the case would be forwarded to the courts for adjudication.

¹⁶ An obvious question is why the bill was passed in 1706. For that there is no obvious answer. However, the outbreak of plague in mid-century, the Great Fire in 1666, the Stop of the Mint in 1672 and the sinking of the Assyrian Fleet in 1696 together with a growing understanding of probability and a changing perception of the structure of economic growth, must all have contributed to this fundamental shift. See Leonard (2015).

¹⁷ There is some literature pointing to the non-use of the death penalty. There were perhaps six people hanged over the century. They were not hanged for being bankrupts but for theft. At issue is the incentive embedded in the provisions of the act for truthful revelation by bankrupts.

wanted to be declared bankrupt. His or her name, reputation and standing suffered. As Adam
atest and most humiliating calamity which can befall an

¹⁸ Yet, until

4&5 Anne,

this way.¹⁹ 4&5 Anne required that creditors post a bond of £200 which would be lost in the
event that the bankruptcy was not proven. The Act also required that the declaration of
bankruptcy and all subsequent matters relating to the case be posted on multiple occasions in the
London Gazette.²⁰

The changes embedded in the Anne statutes provide the possibility that a bankrupt could
emerge from bankruptcy prior to full repayment of debts owing and also emerge with some
financial assets. These changes represent a shift from a punitive to a more lenient position
regarding the treatment of bankruptcy cases. At the same time, these changes also required
creditors voluntarily to r
than leaving the bankrupt with nothing. In order to understand why creditors might be willing to
waive full repayment of debts owing, we need to understand the objectives embodied in any set
of bankruptcy rules.

3. Simple Theoretical Model of a Bankruptcy

The literature on bankruptcy is extensive.²¹ Bankruptcy rules represent a second-best
solution. The first best would have been that the debtor repaid the contract on time. It is only
when the contract is not fulfilled, or the creditors realize that even with further time and credit

¹⁸ See Jones (1979), p.7.

¹⁹ In working with the Bankruptcy writ ledgers and the London Gazette, Hoppit argues that the number of
bankruptcies in the ledgers should be reduced to about three quarters their number as not all resulted in a
finding of bankruptcy. This does not imply impropriety but it is still a large number of cases.

²⁰ Writs of Bankruptcy are still posted in the London Gazette.

²¹ *Handbook of Law and Economics* (2008).

that the contract will not be repaid, that we get into the realm of bankruptcy. However, once one is in the realm of the second best, theoretical models

bankruptcy procedures result in economically efficient outcomes along all the dimensions

In a world in which the bankruptcy procedures are known ex ante their very existence, as White notes, creates incentives that might not be in the best interests of the creditors.²²

Hart (1995) argues that well-structured bankruptcy rules should do a number of things in the event of a default. First the procedures should maximize the proceeds paid to the creditor in the minimum amount of time. Thus should take place expeditiously. Second, the laws should generate incentives to reduce debtor fraud and encourage truthful revelation of the remaining assets. In essence, the bankrupt should work with the bankruptcy courts to reveal all assets. Third, well-structured bankruptcy rules should maintain entrepreneurial talent, skills or human capital by get the bankrupt back into the workforce.²³

To understand how these changes in the statute law affected the behavior of bankrupts, we consider a model with a single, risk neutral creditor who has $M > 0$ in funds available to lend and a single, risk-neutral borrower.²⁴ The borrower has a project that requires in investment funds. The interest rate is given and the borrower agrees to repay $(1+r)$ at some defined date. The borrower has some continuation payment C which is independent of the investment and reflects some earnings after the end of the contract. Only when the borrower has accepted the loan does the borrower learn his/her

²² Such behaviors include the use of effort by borrowers, whether to default strategically, concealment of firm assets, or the choice to invest in risky of safe assets.

²³ The significant differences across countries in the maintenance of entrepreneurial talent in the event of a default are clearly evident in the table in *The Economist*, Les Misérables.

²⁴ The intellectual origins of this model can be found in Carlos and Lamping (2010).

If θ is revealed and the borrower invests, then the s/he will receive $\frac{1}{2}V$ with probability one half and $\frac{1}{2}V - P$ with probability one half. Thus the expected payoff (prior to the repayment/truth-telling decision) to investing is:

$$\frac{1}{2}V - \frac{1}{2}(V - P) \tag{1}$$

Assuming that the investment is successful, the borrower must decide whether or not to tell the truth (and repay the loan). The expected payoff from truth-telling is:

$$V - P \tag{2}$$

The expected payoff to lying when the investment is successful is:

$$V \tag{3}$$

The borrower will decide to tell the truth about the successful investment if:

$$V - P \geq V \tag{4}$$

Simplifying, the borrower will tell the truth about a successful investment if and only if:

$$-P \geq 0 \tag{5}$$

Truth-telling, therefore, and not surprisingly, depends on the probability that the search will be successful and the size of the penalty. As the probability of a successful search increases, a borrower will be less likely to lie and hide assets. As the size of the penalty increases, the borrower will also be less likely to lie and hide assets.

To put this result in a somewhat different way, a successful investment yields expected profits given by:

$$\frac{1}{2}V - \frac{1}{2}(V - P) \tag{6}$$

The probability of a successful investment is $\frac{1}{2}$. Combining (6) (multiplied by $\frac{1}{2}$) with the payoff when the investment is unsuccessful in (1), the payoff from investing is:

$$\frac{1}{4}V - \frac{1}{4}(V - P) - \frac{1}{4}(V - P) \tag{7}$$

(8)

Assume again that $\hat{p} > \frac{1}{2}$ and that (5) holds, so that if the investment is successful, then the borrower tells the truth. Using (7) with truth-telling as the payoff from investment and (8) as the payoff from absconding, the borrower will invest if:

$$- \tag{9}$$

Or if:

$$- \tag{10}$$

Note from (10) that if (5) holds (tell the truth if the investment is successful), then (10) must hold as well. That is, (5) is a sufficient condition for (10) to hold. Thus, if $\hat{p} > \frac{1}{2}$, then (5) is sufficient for the borrower to actually make the investment

Assume (5) so that the borrower will undertake an investment and report the truth if he draws

. Then, using earlier results, a borrower will only take out a loan if the expected payoff from drawing plus the expected payoff from drawing is non-negative:

- - -

being known

there seem to be financial reasons why a creditor might grant a discharge. Without personal letter or journals we cannot say why any particular creditor would agree to issue a discharge.

Second, the model predicts, under certain conditions, an increase in socially efficient investment within the economy which will generate increased economic growth. Higher asset revelation and more socially efficient investment are conditioned on the more successful search and the penalties for non-compliance. Yet all is predicated on there being the possibility of discharge. Thus, we now examine the extent to which discharge actually occurred.

4. The Extent of Discharge

There was a formal three-part procedure to receiving a discharge. First, the bankruptcy commissioners determined if the bankrupt had complied with all that was required of him or her in the bankruptcy proceedings. Had the bankrupt handed over the books of the business; supplied all known assets; answered all questions? If the commissioners deemed that the bankrupt had behaved appropriately and conformed to the requirements of the statute, the creditors were then asked if they agreed. If four-fifths assented and signed off, then a Certificate of Conformity was issued and sent to the Lord Chancellor who would issue the writ of discharge. Nothing in the statute forced creditors to grant a discharge. In its Glossary of Bankruptcy Terms describing the Certificate of Conformity, the National Archives writes:

withheld consent until they had been paid what they considered a reasonable proportion of their debts and many, it is said, refused for spite or because they thought bankrupts had acted

²⁵ The obvious implication is that the probability of a discharge was low.

²⁵ Glossary of Useful Terms, National Archives Kew, Bankruptcy B4

The extent to which discharge actually occurred is an empirical question. Fortunately, two discharge ledgers exist from the first half of the eighteenth century.²⁶ The extant ledgers document the final phases of the discharge procedure whereby the commissioners published a notice in the Financial Gazette noting that the particular bankruptcy had confirmed and requesting creditors to meet on a certain date to vote to grant a certificate of conformity which would then be sent to the Lord Chancellor. Although not all ledgers have survived, those that did provide evidence as to the extent of discharge. The first surviving ledger covers the period almost immediately after the passing of the 4&5 Anne and 6 Anne

file being forwarded to the Lord Chancellor. These forty cases were forwarded to the courts by creditors for adjudication. In at least some of these adjudicated cases, a certificate of discharge would likely have been issued.

One of the remarkable features of the 1710 ledger is the listing of the creditors by name. See Figure 2 for an example of an entry from one of these ledgers. As a result, each certificate of conformity testifies to the intricate web of debt and credit discussed by Muldrew (1998) for a somewhat earlier period. Given the statute, these creditors must represent at least four fifths of all creditors by number and value. For some entries, the clerk has noted when all the creditors signed or if there were only one creditor.²⁸ There are twenty five cases where only one creditor is listed. Across the four years and 549 certificates, 8,424 creditors are listed - 16 creditors per bankrupt. However, the distribution is skewed with a long right tail on the number of creditors, as shown in Figure 3. There are nineteen cases with sixty or more creditors and two with more than one hundred creditors. If only four fifths of the creditors signed, this is a lower-bound estimate on the number of creditors involved in each bankruptcy. Creditors are predominantly male, with only seven percent female. Indeed, in half of the entries there were no women

bankruptcies and the breakdown of discharge should map one to one. Discharge depended on the actions of the bankrupt and the creditors; the source of the bankruptcy such as gambling; and timing played a role. It could be that commissioners or assignees died which would delay the process.

In two (and only two) cases, the amount paid to each creditor is listed. Both bankrupts lived in Bristol. Thomas Collett was a d
, as shown in
Table 2. In
paid to a creditor was £25 to Henry Pyne and the
largest £1
two creditors, Cornel Serjean and Mary Knight received £361:00:00 and £230:10:0 respectively, while John Berrow received merely £1:14:04. If these sums just meet the 8/- in the pound to get an allowance, then Collett must have owed close to £3,000 (in 1711 currency) and Hartum £1,375. These are very large sums of money in a world where the annual laboring wage was roughly £20. Looking at the amounts owed, there is a sense that bankrupts might have been seeking credit from a range of people to stave off collapse.

Networks of Creditors and Debtors

The ledger book allows insights into the networks of credit in early modern England. Recognizing that the certificate ledger provides an incomplete listing of bankruptcy in England, the names of the bankrupt and the creditors can be used to assess at least a lower bound on the role of family. F sF/F1 12 TfKs12f.200140019001D00130016>JTJETBTf.Edrom dger

appears both for the bankrupt and in the list of creditors. Thus in 28% of the cases, we see the same surname. It is not at all

In November 1720, a note appears in the Bank records that she had been declared a bankrupt.³³ We do not know what caused this bankruptcy, though she was buying in a declining market and we know that she had bills owing to Dutch merchants.

notice of the bankruptcy writ appeared in the London Gazette on December 20th 1720. It gave the dates, times and place for presentation to the commissioners of debts owing. It also stated that any debts in Dutch had to be translated and notarized. An entry in the Gazette on December 12th 1721 gave notice of a first dividend payment to all creditors scheduled for 12th January 1722. It also stated that any creditors who had not yet proved their debts could still be included. In April 1722, a further not

creditors at 7/6 in the pound. Using money he subsequently received from an uncle he opened a grocer shop and six years later went back into the textile trade. This time he was very successful. At the time of his death in 1760, he left an estate of £8,000.

6. Conclusion

Bankruptcy rules matter. Although bankruptcy is something that affects only a small proportion of borrowers, the rules themselves affect the investment climate. The more stringent are the rules, the less likely is someone to take a risk and as a result some potentially positive investments will not be undertaken. The rules will also determine how someone behaves in the state of bankruptcy. The more stringent are the rules, the more likely is a borrower to try and hide assets and, indeed, to try and not enter the bankrupt state. As a result, the creditor might have to search for assets and to experience a lengthier time to even partial repayment.

Countries differ in terms of the severity of their bankruptcy codes. In this paper we explored a major change in English bankruptcy law. In 1706, bankruptcy law allowed for the possibility of a discharge from the state of bankruptcy prior to full repayment of debts owing. The statute also allowed for an allowance to be paid to the bankrupt. Thus a bankrupt could emerge from a state of bankruptcy with some capital which could potentially be used for re-investment in economic activity. But this change required that creditors voluntarily relinquish rights to part of their estate owed to them. We provide a very simple game-theoretic framework that showed how such a change would affect the very decision to invest. We show that an increase in the size of the penalty, in this case the loss of the discharge and the allowance, increases truth telling and asset revelation by the bankrupt. We also show that, under certain circumstances, that same increase in the penalty will

change the level of investment in the economy, increasing the range of positive investment outcomes.

forces contributed to the increased rate of growth. We suggest here that the changes in the laws regarding bankruptcy must also have contributed to that growth. The rise of discharge not only encouraged more investment but the willingness of creditors to grant discharge led to the return of creditor assets and entrepreneurial talent to the economy.

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1 Jac I c. 15 Act for the better relief of the creditors against such as shall become bankrupt
21 Jac I c. 19 An Act for the description of a bankrupt and relief of creditors
4&5 Anne c. 4 An Act to prevent frauds frequently committed by bankrupts
6 Anne c. 22 An Act to explain and amend an act of the last session of Parliament for preventing frauds frequently committed by bankrupts

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Figure 1 Game Tree

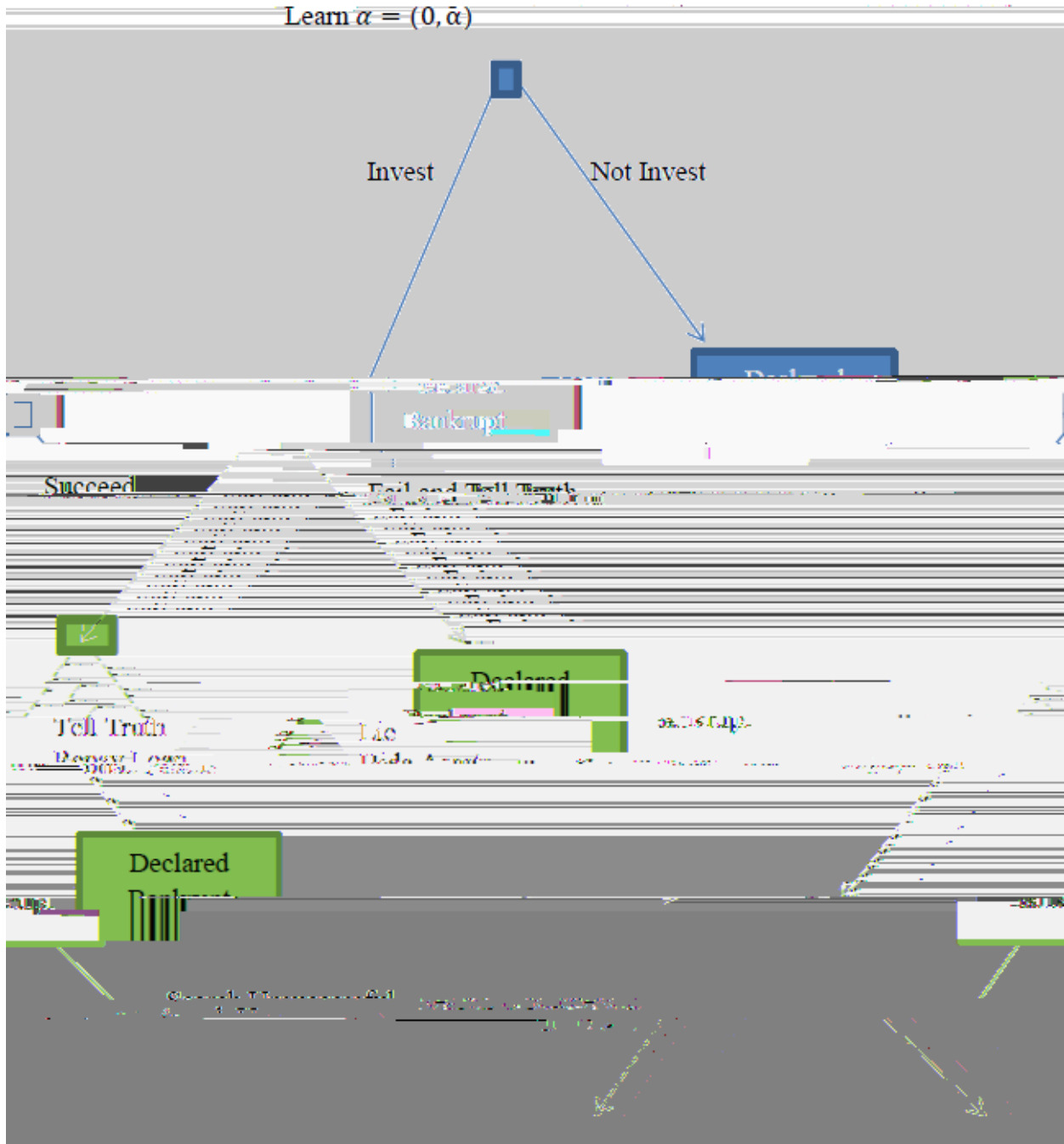
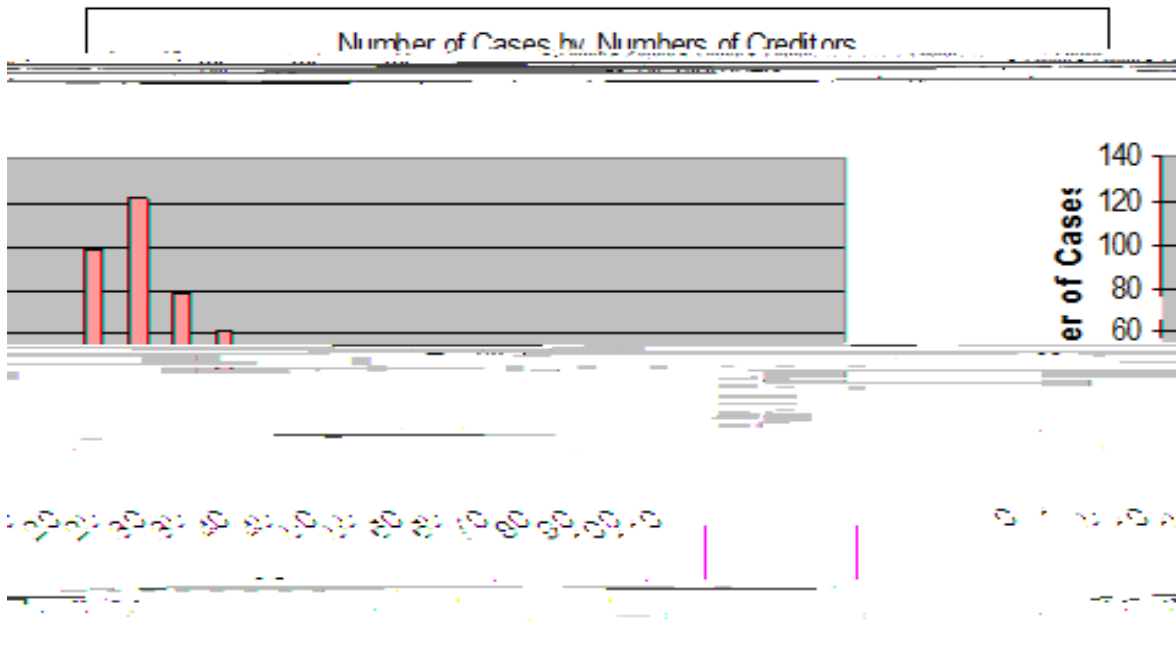


Figure 2 Sample Entry from the Register of Conformity



Source: National Archives, Kew, England - Office of the Commissioners of Bankrupts and Court of Bankruptcy.

Figure 3 Distribution of Cases by the Number of Creditors



Source: National Archives, Kew, England - Office of the Commissioners of Bankrupts and Court of Bankruptcy.

Table 1 Timeline of Bankruptcy Statutes in England

| Bankruptcy Statute | Title | Year Enacted |
|------------------------|--|--------------|
| 34 & 35 Henry VIII c 4 | An Act against such persons as do make bankrupt | 1543 |
| 13 Elizabeth I c 7 | An Act touching orders for bankrupts | 1572 |
| 1 James I c 15 | Act for the better relief of the creditors against such as shall become bankrupt | 1603 |
| 21 James I c 19 | An Act for the description of a bankrupt and relief of creditors | 1624 |
| 4 & 5 Anne I c 4 | An Act to prevent frauds frequently committed by bankrupts | 1706 |

Source: *Statutes of the Realm*.

Table 2 Payouts from Two Estates

| Estate | Creditor | Amount | Total |
|----------------|--------------------|-----------|-------------------------|
| James Hartum | Francis Freeman | 121:13:00 | |
| | Thomas Cole | 18:00:00 | |
| | Philip Tailer | 75:00:00 | |
| | Stephen Richardson | 57:00:00 | |
| | Edward Freeman | 54:10:00 | |
| | William Williams | 50:00:00 | |
| | Manaseth Whitehead | 44:00:00 | |
| | Henry Pyne | 25:00:00 | |
| | | | 545:03:00 (1362:00:00) |
| Thomas Collett | Cornel Serjean | 361:00:00 | |
| | Mary Knight | 230:10:00 | |
| | Francis Pinnell | 90:14:00 | |
| | Benjamin Turner | 68:02:11 | |
| | Francis Whitchurch | 66:02:02 | |
| | Mary Fisher | 50:00:00 | |
| | William England | 50:00:00 | |
| | John Froman | 43:17:03 | |
| | Benjamin Paget | 31:00:00 | |
| | John Cullett | 27:08:03 | |
| | Thomas Cadwallader | 14:00:00 | |
| | Arthur Plomer | 13:06:04 | |
| | Daniel Hoch | 4:08:06 | |
| | Elizabeth Arnald | 4:07:06 | |
| | John Shettleworth | 4:05:00 | |
| John Berrow | 1:14:04 | | |
| | | | 1158:16:03 (2900:00:00) |

Source: *National Archives, Kew, England - Office of the Commissioners of Bankrupts and Court of Bankruptcy*.