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A Short History of Bankruptcy

A. ORIGINS OF BANKRUPTCY SYSTEMS

Throughout history, financial crisis has affected the lives and relationships of individuals and businesses. Regardless of the era, unemployment, illness, unforeseen disaster, and technological advance have all caused financial failure. The methods developed by societies to resolve the effects of financial crises are known as **bankruptcy systems**. Bankruptcy systems exist in any society where there are debtors (those who owe) and creditors (those who are owed). Bankruptcy systems have existed in some form from the first moment that a tribal chieftain or village elder ordered the seizure of a debtor's possessions and their distribution to multiple creditors in full or partial satisfaction of the creditors' claims.

Creditors have always sought to collect debts and debtors have always sought relief from debt. These contrasting concepts of debt collection and debtor relief are the foundation of any bankruptcy system. The primary focus of the **debt collection** features of bankruptcy systems has always been to formulate a body of rules “. . . to provide for the collection of assets of a debtor and the equitable distribution of the proceeds of those assets among . . . multiple creditors.”¹ The primary focus of the **debtor relief** features of bankruptcy systems has vacillated throughout history from one extreme to another, from punishment to forgiveness. Bankruptcy systems that have contained liberal debtor relief provisions have existed primarily in sophisticated economies where a continual reconciliation of accounts has been an economic necessity.

Bankruptcy systems: the methods developed by societies to resolve the effects of financial crises between debtors and creditors

Debt collection: the process of collecting a debt

Debtor relief: what an individual filing personal bankruptcy seeks: a discharge, exemptions, and the benefits of the automatic stay

1. Merrick, A Thumbnail Sketch of Bankruptcy History, ABI Newsletter (July/Aug./Sept. 1987).

Simpler economies have tended to contain more conservative debtor relief concepts, the mere sparing of life sometimes being considered revolutionary. The one exception to this pattern appears to be ancient Israel, in which liberal debtor relief concepts prevailed in a simple agricultural economy.

While the historical trend of debtor relief has favored punishment rather than forgiveness, our present United States Bankruptcy Code departs from this trend in its liberal treatment of debtor relief. In many respects the U.S. Bankruptcy Code is perhaps the most liberal debtor relief bankruptcy system to come into existence since the jubilee year of the Old Testament.²

The jubilee year occurred every 50 years. (Every seventh year was a sabbatical year in which some limited form of debtor relief was afforded.³) The essence of the jubilee year is contained in the biblical verse: “And ye shall hallow the fiftieth year, and proclaim liberty throughout the land unto all the inhabitants thereof; it shall be a jubilee unto you; and ye shall return every man unto his possession, and ye shall return every man unto his family.”⁴ In the jubilee year, all debts would be discharged, some mortgages released, and all indentured servants or slaves freed (the concept of **discharge**, legal relief from debt, is the basic element of debtor relief). During the intervening years any family member had the right to redeem, by payment, any property or persons that had been seized or given in satisfaction of a debt.⁵

The debtor relief provided for in the Old Testament most likely derived from even earlier regulations that existed in ancient Mesopotamia, from where the early Hebrews migrated to the region that became Israel. In the seventeenth century B.C., King Ammi-saduqa of Babylonia issued decrees releasing private debts in barley and silver and releasing people from debt slavery in an effort to resolve economic difficulties in his kingdom. This is the earliest recorded evidence of some form of debtor relief from which bankruptcy systems have evolved.⁶

Unlike ancient Israel, second chances were not generally given to debtors in the other ancient civilizations of the Mediterranean basin. Early Greek law did not seek to discharge debtors or reconcile accounts: A debt was always collectible. In the fifth century B.C., the Twelve Tables regulated only the procedures for selling an individual into slavery to satisfy a debt.⁷

Discharge: legal relief from debt provided for by Section 524 of the Bankruptcy Code

2. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”), Pub. L. No. 109-8, 119 Stat. 23 (2005), limits and restricts the scope of debtor relief as it has existed in American Bankruptcy practice from 1979 through 2005. BAPCPA demonstrates the pendulum-like nature in the treatment of debtor relief throughout history.

3. Leviticus 25:1-8.

4. Leviticus 25:10. If a portion of this verse seems familiar, it is because the phrase “proclaim liberty throughout the land unto all the inhabitants thereof” is the inscription on the Liberty Bell in Philadelphia.

5. Leviticus 25:11-55. The purpose of the jubilee year was to give debtors a second chance or fresh start. The “fresh start” concept is an essential feature of the United States Bankruptcy Code.

6. Leick, Gwendolyn, *Mesopotamia: The Invention of the City*, Penguin Books 2001, at page 187.

7. Vern Countryman, *Bankruptcy and the Individual Debtor— and a Modest Proposal to Return to the Seventeenth Century*, 32 *Cath. U. L. Rev.* 809 (1983). Under the Twelve Tables a creditor had to

The commentators concur that death, slavery, mutilation, imprisonment, or exile were the lot of debtors in ancient Greece and also in republican Rome.⁸ Roman republican law also provided that multiple creditors could, upon exhibiting a debtor in the forum for three days, divide the debtor up into pieces in satisfaction of the debts. Evidence exists suggesting that multiple creditors could also seize a deceased debtor's corpse and hold it for ransom from the debtor's heirs until the debts were satisfied.⁹ This practice would make sense in Roman culture since the body had to remain whole if it were to commence a successful journey into the afterlife. The religious significance given to the satisfaction of a debt thus acted as an incentive to repayment. This appears to have been the state of insolvency law, as such, during the Roman Republic.

During the Empire, Roman debtor relief and collection law tended toward a greater liberality.¹⁰ By approximately the second century A.D., debtor slavery had been abolished. Debtor imprisonment continued to exist, but this was distinguishable from slavery in that creditors could not use the services of an imprisoned debtor. The debtor could be held for ransom only until friends or family of the debtor paid the debt.¹¹ (Debtor imprisonment has existed throughout history, including the twentieth century.)

The Roman Empire encompassed much of present-day Europe, North Africa, and the Middle East. This vast area, comparable in size to the United States, developed a sophisticated commercial economy permitting free trade throughout its territories. All this in a civilization without motor vehicles, aircraft, computers, or any form of instant long-distance communication. In this environment, Rome developed an insolvency system that permitted exemptions (an **exemption** is property that a debtor may protect from seizure by creditors) and restrained personal execution.¹² This restraint took the form of a debtor's ceding all assets for distribution to creditors. Although this act would not discharge the debts, it did act to prohibit creditors from killing, mutilating, or selling the debtor into bondage. This procedure was known as *cessio bonorum*.¹³ The assets so surrendered were distributed according to statutory priorities similar to modern United States bankruptcy law.¹⁴ To a modern American observer this procedure would appear similar to a Chapter 7 liquidation proceeding. A form of composition agreement in which a discharge

Exemption: statutorily defined property that an individual debtor may protect from administration by a bankruptcy estate

provide a 60-day redemption period before a debtor could be sold into slavery. Payment of the debt within this period would prevent sale into slavery.

8. Id. See also Radin, *Debt*, 5 *Ency. Soc. Sci.* 33-34 (1931); Ford, *Imprisonment for Debt*, 25 *Mich. L. Rev.* 24 (1926).

9. Countryman, *supra* n.7; Radin, *supra* n.8; Ford, *supra* n.8.

10. Merrick, *supra* n.1; Radin, *supra* n.8; Ford, *supra* n.8.

11. Radin, *supra* n.8.

12. Radin, *supra* n.8 at 34, 37.

13. Merrick, *supra* n.1.

14. Riesenfeld, *Evolution of Modern Bankruptcy Law*, 31 *Minn. L. Rev.* 401, 432 (1947).

Composition agreement:
an agreement between
a debtor and multiple
creditors for the
repayment of debt

could be granted also came into use as the economy grew in sophistication.¹⁵ A **composition agreement** is an agreement between a debtor and multiple creditors for the repayment of debt. These procedures would be recognizable today as the reorganization proceedings known as Chapter 11 and Chapter 13.

When the Western Roman Empire dissolved in the fifth century A.D., the then-existing economy of Western Europe also collapsed. Whereas for approximately five centuries it had been possible to trade between London and Constantinople (modern Istanbul) with identical currency, trade practices, laws, and language, this commonality ceased to exist. The rise of the Dark Ages caused a corresponding devolution of bankruptcy laws.

B. BANKRUPTCY IN THE MIDDLE AGES

During the Dark Ages the financial system of Western Europe receded as an important factor of daily life. Debtor imprisonment returned to vogue, prevailing throughout the period.¹⁶ The Church proclaimed debt and insolvency sinful. Debtors were subject to excommunication while alive or denial of a Christian burial upon death.¹⁷ As had been the case in early Rome, religious sanctions were once again utilized as an incentive to debt repayment.

The debtor punishments of the Dark Ages were not radically different from the earlier practices of the Roman Republic. They were consistent with a simpler society in which there once again existed few entities with multiple creditors. In the Dark Ages, a serf would generally be beholden to only two creditors: the feudal lord and the Church. Certainly neither would tolerate an unsatisfied debt from a subservient soul.

The punishment of debtors was necessary to assist the land-owning and religious ruling classes to maintain their power. Forgiveness became a radical idea in this stratified economic structure. The lack of a commercial economy also eliminated any practical need for a reconciliation of accounts or balancing of books after an extended period of time.

International commerce and trade began its resurgence in the tenth century. As trade recommenced, the credit system resumed.¹⁸ As the number of

15. Id. at 439, citing Code of Justinian VII.71.8. It should be noted that Justinian reigned as emperor of the Eastern Empire during the sixth century A.D. This was after the final collapse of the Western Empire, which most historians date at A.D. 476. The consensus appears to be that Justinian's Codes, therefore, do demonstrate the evolution of a bankruptcy law during the Empire. A *composition* is an agreement between a debtor and two or more creditors that satisfies the debts for less than payment in full. See chapters 17-19 *infra*.

16. Ford, *supra* n.8 at 25; Radin, *supra* n.8 at 34.

17. Ford, *supra* n.8 at 25.

18. Radin, *supra* n.8 at 34.

debtors with multiple creditors increased, the bankruptcy system began its renaissance.

The first bankruptcy laws that arose in the late Middle Ages were to a large degree reenactments of the *cessio bonorum* of the Roman Empire.¹⁹ The focus of such statutes was twofold: the prevention of fraud upon creditors stemming from an inequitable distribution of assets and the protection of the debtor from imprisonment. If all assets were surrendered for distribution to creditors there would be no imprisonment. A discharge was not given or contemplated. These statutes were limited to use only by merchants. Loss of a trading place or bench (*banca*) in the local market would befall a debtor who fraudulently concealed or transferred assets while not paying his or her just debts. In Italy this was known as *banca rotta* and in France as *banquerotte*. This is the etymology of the English word *bankrupt*.²⁰ The composition agreement began to reappear in Western European law as early as 1256 in Spain.²¹ A composition agreement provided some form of debtor relief in that a debtor could be released from the debts due those creditors who agreed to the composition. By the seventeenth century, the composition agreement existed throughout Western Europe with the exception of England, where such statutes did not come into regular existence until after 1705.²²

C. EARLY ENGLISH INSOLVENCY LAWS

The emphasis of early English insolvency law was on punishment. Forgiveness was rarely known to English debtors prior to 1705. This is an important point to recognize in any study of American bankruptcy law because the law of England as it existed in 1776 is the direct legal antecedent of American bankruptcy law.

Anglo-Saxon England practiced debtor imprisonment, although the sale of a debtor into slavery or debtor dissection was probably not permitted.²³ The first statute akin to a bankruptcy statute was enacted in 1283. The Statute of Acton Burnell authorized the seizure of a debtor's assets to satisfy debt. If the assets seized were insufficient to satisfy the debt then the debtor would be imprisoned until the debt was paid.²⁴ We recognize at least part of this procedure today as a "writ of attachment," a common state law collection device.

19. Merrick, *supra* n.1.

20. Countryman, *supra* n.7 at 810.

21. Riesenfeld, *supra* n.14 at 439-440.

22. Countryman, *supra* n.7 at 811-812. See *infra* this chapter.

23. *Id.* at 810-811. Ford, *supra* n.8 at 26.

24. 11 Edw. (1283). Countryman, *supra* n.7 at 811.

From the thirteenth to fifteenth centuries, debtor imprisonment in England evolved under two related writs, *capias ad respondendum* and *capias ad satisfaciendum*. The former allowed a creditor to “attach” a debtor to ensure appearance at trial. The latter allowed a creditor to imprison a debtor in satisfaction of a judgment until the debt was actually paid.²⁵ Some form of debtor imprisonment existed in England until the twentieth century.²⁶ The first true insolvency law in England was not enacted until 1543.²⁷ This delay, in contrast to the rest of Western Europe, is attributable to England’s lack of substantial involvement in international trade until the sixteenth century.²⁸ The statute of 1543 permitted the seizure and distribution of a debtor’s assets to creditors and imprisonment of the debtor if the debts remained unsatisfied. The proceeding applied only to merchants and was initiated by creditors. There was no discharge for the debtor.²⁹ To the extent that this proceeding was creditor initiated, it was similar to the present-day American involuntary petition.³⁰ In 1571 the Statute of Elizabeth further refined the system of asset distribution to creditors. This statute defined fraudulent transfers as acts of bankruptcy. Transactions deemed fraudulent that occurred within a fixed time prior to the bankruptcy filing were considered void. For instance, concealing property from creditors would be one such act.³¹ This statute is a likely basis of today’s concept of an avoidable transfer, which is a major feature of our Bankruptcy Code.³² Composition agreements made their appearance in England rather late in comparison to the rest of Western Europe. When they did, compositions were permitted only in the Chancery Courts and only during a relatively short period of time (approximately 1583-1621). Another statute authorizing compositions existed for only one year, 1697-1698.³³ Because a discharge, legal relief from debt, could occur only as a result of a composition, punishment prevailed over forgiveness in early English bankruptcy law.

In 1705 England enacted a statute in which a composition with creditors could effectuate a full discharge of all debt.³⁴ The Statute of Anne appears to be the first law to recognize a full discharge or legal relief of debt by a debtor since the jubilee year of the Old Testament. Otherwise, the Statute of Anne is

25. Countryman, *supra* n.7 at 811; Ford, *supra* n.8 at 27-28. A writ of *capias ad satisfaciendum* was used in 1989 in New Jersey to place a debtor into custody. A Bankruptcy Court refused to abrogate the writ. See 76 A.B.A. J. 28 (Feb. 1990); *In re Bona*, 110 B.R. 1012 (Bankr. S.D.N.Y. 1990). The use of a writ of *capias ad satisfaciendum* was affirmed by the N.J. state courts as recently as 2000 in *Marshall v. Matthei*, 744 A.2d 209 (N.J. App. Div. 2000).

26. Ford, *supra* n.8 at 31. Ford points out that in 1921, 424 contract debtors were held imprisoned in England.

27. 34 & 35 Henry VII, ch. 4 (1543).

28. Merrick, *supra* n.1 at 12.

29. Countryman, *supra* n.7 at 811-812; Merrick, *supra* n.1 at 13.

30. See chapter 3 *infra*.

31. 13 Eliz., ch. 7 (1571); Riesenfeld, *supra* n.14 at 422.

32. See chapters 13 and 14 *infra*.

33. Riesenfeld, *supra* n.14 at 442-443.

34. 4 Anne, ch. 17 (1705).