SECURITY FOR A COMMERCIAL LOAN: HISTORICAL & INTERNATIONAL PERSPECTIVES

EDWARD A. TOMLINSON*

Historians disagree about when the commercial and intellectual life of Western Europe reached the nadir known as The Dark Ages. Did that point arise with the collapse of the Roman Empire triggered by the Barbarian Invasions of the fifth century, or did it occur later with Arab expansion in the late seventh and early eighth centuries?¹ On the other hand, most historians agree that by the twelfth century Europe was experiencing a revival whose effects continued at least until the arrival of the Black Death in the mid-fourteenth century.² That revival featured the appearance, first in the Italian city states and then throughout northern Europe, of a substantial merchant class that developed trade networks extending from England in the north to the Crusader States in the east. That economic revival was accompanied by an intellectual revival whose hallmark was the study of Roman Law, primarily the Corpus Juris Civilis of the sixth century Eastern Roman Emperor Justinian.

The feudal system in which these developments occurred was not particularly responsive to the legal needs of merchant creditors. From a modern perspective, the creditor’s security derives primarily from the availability of an effective legal system providing remedies for enforcing the debtor’s duty to pay. In most cases, the availability of effective legal remedies provides the debtor with sufficient encouragement to pay when due without any need for the creditor actually to sue. Remedies available in feudal courts did not perform that function for merchant creditors. Rather, those courts focused on resolving disputes over land, including

---

¹ Professor of Law, University of Maryland School of Law. This paper was presented at a March 1999 Conference of the Society of Ancient Near Eastern Law, sponsored by John Hopkins University and the University of Maryland School of Law, on Security for a Debt. A slightly revised version will appear with the other papers presented at the Conference in Security For A Debt in Ancient Near Eastern Law, to be published in 2000 by E.J. Brill, Leiden, the Netherlands. I would like to thank Stephen Derby, Michael DeVinne, Andrew King, and William Reynolds for helpful comments on earlier versions of this article.

² The latter theory, espoused by the noted Belgian historian Henri Pirenne, has received considerable criticism. See Bryce Lyon, The Origins of the Middle Ages (1972).

the services which tenants holding land owed to their lords. The procedures utilized by the courts were slow and often involved primitive methods of proof (e.g., trial by battle or ordeal) that assumed God would intervene to assist the righteous. Such a forum was not a propitious one for a nonresident merchant contemplating a lawsuit to collect a debt. Moreover, feudal law viewed a man’s body, as well as his lands, as belonging to the lord. Therefore, it normally precluded the creditor from proceeding against the debtor’s person by imprisoning him and from seizing the debtor’s land to satisfy a judgment.3

A. Development of Creditors’ Remedies in Medieval England

Creditors encountered similar problems in England despite that country’s lead in developing effective legal institutions. By the twelfth century, the strong, centralized Anglo-Norman monarchy had created a system of royal courts applying a new body of law common to the entire kingdom.4 One of the most significant remedies afforded by this new body of common law was the action for debt, “a procedure for compelling debtors to pay their obvious dues.”5 However, the procedures in an action for debt were cumbersome and allowed the debtor to escape liability by waging his law, i.e., by recruiting from among his friends a certain number of compurgators (in effect, character witnesses) who supplied their oaths in support of the debtor’s oath that he did not owe the money.6 In addition, the common law courts gave the creditor no remedy against the debtor’s person. As explained by the leading historians of medieval English law, the common law knew at the time “no process whereby a man could pledge his body or liberty for payment of a debt.”7


4. The medieval common law was indigenous to England; it remained largely unaffected by Roman law. This situation contrasts sharply with the reception of a revived Roman law by most continental legal systems. The standard explanation for this English exceptionalism is chronological, that is, the Anglo-Norman kings in the generations after the Norman Conquest of 1066 developed their own legal system before the revival of Roman law had occurred. On the Continent, on the other hand, effective legal institutions arrived later at a time when Roman law was available as a model. See R.C. Van Caenegem, An Historical Introduction to Private Law 3 (1992).


6. Id. at 115-16.

7. II Frederick Pollock & Frederick William Maitland, A History of English Law before the Time of Edward I 596 (1895). The situation on the Continent was less clear. Pollock and Maitland suggest that imprisonment for debt was permissible through-
The creditor could therefore proceed only against the debtor’s property, which in effect meant the debtor’s personal property but not his land. This limitation appeared in the common law writs of execution which allowed the sheriff to seize the debtor’s personal property to satisfy a judgment, but did not allow the debtor’s dispossession from land, the chief source of wealth. The law treated the land as belonging to the debtor’s lord; at most, the sheriff could levy on the crops or other proceeds from the land.8

The last three decades of the thirteenth century (the reign of King Edward I) brought significant changes to English law on “the fundamental business of debt-collecting.”9 Change came in the form of statutes, enacted by the newly inaugurated Parliament, which dealt harshly with defaulting debtors. Parliament excused this severity in the preamble to the first of these statutes (the Statute of Acton Burnett of 1283) on the ground that foreign merchants would not do business in England unless they were given a ready means for securing payment of their debts.10 Plainly, the statute’s drafters believed that a creditor’s best security was the availability of effective legal remedies against a debtor who did not pay. Accordingly, the Statute of Acton Burnett, soon superseded in 1285 by the more comprehensive Statute of Merchants, gave the creditor three significant procedural weapons.

The creditor’s first procedural weapon was a system of debtor recognizance. The Statute of Merchants required mayors to enroll debtors’ bonds under the royal seal in local borough courts; in these bonds, debtors acknowledged their indebtedness. Creditors actively sought these recognizances because they eliminated any need to bring an action for debt; execution against the debtor, without any need for a trial or other procedures, followed immediately upon the presentation to a court of a bond in default.11 For at least a century, the borough and fair or market

8. See Plucknett, Concise History, supra note 5, at 390.
10. See Plucknett, Legislation, supra note 9, at 139. The Statute of Acton Burnett proved to be an interim one; in 1285, Parliament superseded its provisions by enacting the Statute of Merchants.
11. Id. at 144.
courts where these enrollments occurred had resolved commercial disputes informally by applying merchant custom, but their territorial jurisdiction was limited, and they lacked power to enforce a judgment outside the borough. This situation changed with the Statute of Merchants, which authorized the royal courts to enforce summarily debtors’ recognizances enrolled in the borough and fair courts.\footnote{In the fourteenth century Parliament established a similar machinery of debtor recognition in staple courts for the convenience of foreign merchants dealing in wool, leather, and other staples. See PLUCKNETT, CONCISE HISTORY, \textit{supra} note 5, at 393.}

To assure execution of these recognizances against debtors, the Statute of Merchants gave creditors, as a second procedural weapon, the power to obtain from both the local and royal courts the immediate imprisonment of a debtor in default. The debtor’s imprisonment had a coercive impact; it was intended to encourage the debtor to gather his assets together and to sell them to satisfy the debt. If the debtor did not satisfy the debt within three months, creditors received, as a third procedural weapon, the right to seize all the debtor’s property, including both borough and feudal lands. Thus, the Statute of Merchants gave merchant creditors a remedy that the common law had long refused, i.e., the ability to control the debtor’s land. Creditors became tenants or holders of the land by “statute merchant” and no longer needed to rely on the often uncooperative sheriff to collect the land’s proceeds. In sum, these procedural weapons made the creditor more secure by creating a legal system which gave him “more chance of getting his money.”\footnote{See PLUCKNETT, LEGISLATION, \textit{supra} note 9, at 142. For the debtor’s imprisonment, see \textit{id.}, at 142-43. For the creditor’s tenancy by statute merchant, see PLUCKNETT, CONCISE HISTORY, \textit{supra} note 5, at 393.}

The borough, fair, and later staple courts did not outlast the Middle Ages, but the royal or common law courts, which by the late fifteenth century had acquired most of the kingdom’s mercantile litigation, implemented similar creditor friendly procedures. First, the Statue of Westminster II, enacted the same year as the Statute of Merchants (1285), allowed a judgment creditor in the royal courts to hold one-half of the debtor’s land until the debt was satisfied.\footnote{See PLUCKNETT, CONCISE HISTORY, \textit{supra} note 5, at 390-92.} Second, the royal courts, starting in the thirteenth century, allowed creditors, before the creditor actually parted with his money, to pursue to judgment an action for debt. The Statute of Westminster II regularized this procedure by providing that such a debt of record (also called a recognizance) was not subject to further challenge.\footnote{\textit{Id.} at 393-94. Summary judicial proceedings based on written instruments are often unfair; the instrument may be a forgery. To give the debtor some protection, the}
the royal courts to imprison nonmerchant as well as merchant debtors. The first such law, called by a leading historian of the common law "one of the most drastic enactments in our history," authorized the royal courts to imprison servants and bailiffs whose accounts were in arrears.\textsuperscript{16} A 1352 law extended this power to all actions for debt but required the creditor to choose between proceeding against the debtor’s person (imprisoning the debtor to coerce him or his friends to satisfy the debt) or against the debtor’s property (seizing the debtor’s property to satisfy the debt). For centuries English law forced the creditor to make that choice.\textsuperscript{17} It appears that the latter route was generally the more popular one.

B. \textit{Bankruptcy as a Creditor’s Remedy}

On the Continent, the legal changes which afforded the merchant creditor greater security took a quite different form. Starting in the twelfth century, the Italian city states developed their own legal systems applying a mixture of merchant custom and revived Roman Law.\textsuperscript{18} Subsequently, similar systems appeared in fair towns and free cities throughout Europe. These new courts proceeded more informally and rapidly than did the preexisting feudal courts. More importantly, they afforded merchant creditors the potent remedy of "bankrupting" a defaulting debtor.\textsuperscript{19} This initiative came from the Italian cities, which by the late thirteenth century had adopted statutes regulating bankruptcy proceedings. Bankruptcy itself derived from Roman law, which had recognized a creditor’s right to initiate a proceeding against a defaulting debtor for the collective execution and distribution of the debtor’s assets.\textsuperscript{20}

The bankruptcy process, as it appeared in the medieval Italian city states, was purely a creditor’s remedy. Its purpose was to make creditors

\textsuperscript{16} See PLUCKNETT, CONCISE HISTORY, supra note 5, at 389.
\textsuperscript{17} Id. at 389.
\textsuperscript{19} The word "bankrupt" itself derives from the Italian "banco rotto," meaning counter or business broken. See J. PERCROU, DES FAILLITES, BANQUEROUTES ET LIQUIDATIONS JUDICIAIRES 14 n.1 (2d ed. 1935).
\textsuperscript{20} On the history of bankruptcy, see PERCROU, supra note 19, at 3-67; J. KOHLER, LEHRBUCH DES KONKURSRECHT (1891); LOUIS EDWARD LEVINTHAL, THE EARLY HISTORY OF BANKRUPTCY LAW, 66 U. PA. L. REV. 223-50 (1919).
more secure and not to give the debtor a fresh start nor to allow a failing business to survive by reorganizing. These concerns, which often motivate modern bankruptcy legislation, were absent from bankruptcy's early history. Rather, the bankruptcy statutes of the Italian city states afforded creditors an effective remedy against defaulting debtors. The mere stoppage of payment by a merchant allowed creditors to secure the debtor's arrest by the court. The creditors then elected a magistrate (later called a referee or judge) who designated a curator (now generally called a trustee) to collect and manage the debtor's assets. The liquidation which followed was largely creditor-controlled, and the debtor received a discharge only to the extent that creditors actually received payment. The debtor thus remained liable for any unsatisfied debts. Finally, the court could impose on a bankrupt person criminal penalties for any fraud or lesser fault. Even if the court found that the debtor committed no crime, a determination of bankruptcy was considered infamous, disqualifying the bankrupt person from many occupations and offices.

Creditors no doubt hoped that the repressive nature of bankruptcy proceedings would deter debtors from defaulting. For those debtors who did default, imprisonment was available as a means to coerce payment, as was the power of the referee to question the bankrupt under oath about the location of his assets. The only aspect of the procedure favorable to the debtor was the survival, alongside creditor-initiated bankruptcy proceedings, of the Roman law institution of bonorum cessio. That institution allowed the honest debtor to avoid bankruptcy by acknowledging his own insolvency rather than fleeing or being forced into bankruptcy by his creditors. The honest debtor could thus avoid the ignominy and imprisonment of bankruptcy if he turned over all his assets to his creditors. The threat of punitive bankruptcy proceedings provided the debtor with a strong incentive to cooperate with his creditors in this fashion.21

Bankruptcy did not officially arrive in England until 1542 when Parliament enacted the first English bankruptcy statute.22 Earlier the borough and fair courts had developed, as part of the law merchant, procedures for the collective distribution of a defaulting debtor's assets,23 but these courts had faded by the sixteenth century. Creditors found the common law remedies inadequate and obtained from Parliament in 1542 a statute directed "against such persons as do make Bankrupts." The statute's Preamble complained that debtors had avoided payment by concealing their

21. On the bankruptcy statutes of the Italian city states, see PERCEROU, supra note 19, at 9-14 and Levinthal, supra note 20, at 241-44.
22. 34 and 35 Henry VIII, ch. 4 (1542).
23. v. SIR WILLIAM HOLDSWORTH, A HISTORY OF ENGLISH LAW 97-98.
assets, fleeing the country, or avoiding arrest by "keeping house" (i.e., by claiming their dwelling as a sanctuary). Parliament's initial response to this problem was penal; it enacted a criminal statute that did little more than punish debtors "who made very prodigal expenses and then made off."\textsuperscript{24}

One might wonder how creditors could use the 1542 statute against debtors whose dishonesty was less flagrant. To remedy that defect, Parliament developed more comprehensive bankruptcy procedures in subsequent statutes, principally ones enacted in 1570 and 1603. Under those statutes, as on the Continent, only merchant debtors were subject to bankruptcy. Commissioners, acting on behalf of the creditors, could imprison the debtor, seize his property, and examine persons (including the bankrupt) believed to be concealing the debtor's property from creditors. Finally, the creditors, acting under the commissioner's supervision, could administer and ultimately distribute the debtor's assets on a rateable basis. As on the Continent, the debtor did not receive a discharge from unsatisfied debts. That innovation did not come until a 1705 statute, and then only applied to debtors whose bankruptcy was attributable to misfortune. The earlier bankruptcy statutes had been strictly punitive; they sought to deter default by intimidating the debtor. For example, a 1623 statute provided that a debtor who failed to show that his bankruptcy was due solely to misfortune was subject to the pillory and the loss of an ear.\textsuperscript{25}

Bankruptcy entered French law by the Ordinance of 1673 (France's initial commercial codification) and by the \textit{Code de Commerce} enacted in 1807 under the First Empire. The latter statute, as proudly noted by the leading French scholar on bankruptcy, has had a grand influence in Europe, "both by the strength of our armies and by its own merits."\textsuperscript{26} Its

\textsuperscript{24} Louis Edward Levinthal, \textit{The Early History of English Bankruptcy}, 67 U. Pa. L. Rev. 1, 7 (1919). With Gallic aplomb, Professor Percereau castigates the 1542 English statute as "very inferior." \textit{See} PERCEROU, supra note 19, at 15 n.7.

\textsuperscript{25} On the English bankruptcy statutes, \textit{see} Levinthal, supra note 24. The general discharge provided by the 1705 statute was evidently intended as an interim measure occasioned by the hardship generated by the War of the Spanish Succession. \textit{See} xi HOLDSWORTH, supra note 23, at 445. Jay Cohen argues that the 1705 statute survived, even though it gave merchant bankrupts a fresh start while nonmerchant debtors languished in prison, because it responded to a felt need to provide honest business owners with some form of limited liability. Owners can now limit their personal liability by doing business in corporate form, but that alternative was not available in the eighteenth century. \textit{See} Cohen, supra note 3.

\textsuperscript{26} \textit{See} PERCEROU, supra note 19, at 36. Percereau is of course referring to Napoleon's armies, which in 1807 occupied most of Europe. Many of the occupied countries adopted one or more of the Napoleonic Codes. The leading German authority on bank-
merits most assuredly appealed to creditors, given the exceptional severity of its treatment of merchant debtors, the only debtors covered by the Code. This hostility to debtors followed a number of spectacular business failures which evidently displeased Napoleon. The Emperor did not find severe enough the draft Code submitted to him for his approval upon his return to France after meeting with Emperor Alexander of Russia at Tilsit; Napoleon insisted (successfully, of course) that it be amended to require the automatic imprisonment of the bankrupt. In addition, the 1807 Code eliminated the Roman Law *honorum cessio*, which had been codified in the 1673 Ordinance promulgated by Louis XIV. Under the 1807 Code, therefore, all bankruptcies were either criminal or at least infamous, thus disqualifying the bankrupt from most trades and professions. In addition, the creditors took charge of administering and distributing the debtor’s estate, and the bankrupt, unlike in England, did not receive a discharge for unpaid debts.

The French experience under the 1807 Code demonstrates that severe treatment of the bankrupt may not be the creditor’s best security. The problem seems to be that not all bankrupts are crooks, and that those who are crooks are likely to dissipate most of their assets before their arrest by the bankruptcy court. The limited statistics available suggest that creditors rarely received anything close to full payment from the bankrupt’s estate and that, at least until the French Parliament amended the *Code de Commerce* in 1838 and again in 1889 to revive the Roman Law *honorum cessio* (now called judicial liquidation), there were more liquidations through informal agreements between the debtor and his creditors than there were bankruptcy proceedings. As confirmed in Balzac’s novel *César Birotteau* (first published in 1837): “There are as many liquidations as bankruptcies in Paris. One thereby avoids the dishonor, the judicial delays, the attorneys’ fees, and the depreciation of goods. Everyone believes that bankruptcy will produce less return than liquidation.”

The Parliament responded, in 1838 and then definitively in 1889, by enacting new laws allowing insolvent debtors, who surrender their assets to

ruptcy acknowledges that it is indeed the French *Code de Commerce* which has served as the source of modern German bankruptcy law. *see Kohler, supra* note 20, at 51.

27. *Id.* at 36. Napoleon also believed that the law should provide only a modest allowance for the bankrupt’s wife, but Cambacérès and other wiser heads prevailed on that point.


29. *Honoré De Balzac, Histoire de la Grandeur et de la Décadence de César Birotteau* 309-10 (1972) (translated by myself with sentence order slightly changed). In the novel Balzac placed the event described in 1819.
the courts, to obtain the judicial liquidation of their assets without being stigmatized as a bankrupt.

Modern bankruptcy laws further demonstrate the limitation of bankruptcy as a security device for creditors. Take, for example, the federal Bankruptcy Act, enacted in 1898, which provides a uniform law of bankruptcy throughout the United States. Under that Act, the debtor may initiate bankruptcy proceedings, may obtain a discharge for unpaid debts, may escape imprisonment or any serious stigma, and may keep, subsequent to discharge, a considerable amount of exempt property, often including a dwelling. Modern bankruptcy law plainly serves other interests, which often conflict with the creditor’s interest in security. It seeks to give debtors, today viewed more as unfortunates than as crooks, a fresh start, to protect employees and the tax collector, and, most importantly, to allow failing businesses to survive through reorganization. Accomplishing those goals sometimes requires the sacrifice of creditor interests. Often a failing business can survive only if the creditors agree to a suspension or even a partial discharge of claims so that the business can raise new funds and eventually pay off at least some of its prior debts. Such reorganizations in bankruptcy are commonplace in the United States.30 The situation is now similar in France where the objectives of bankruptcy, as specified in the 1985 amendments to the French Bankruptcy Code, include “the survival of the enterprise, the maintaining of production and jobs, and the satisfaction of debts.” Under this formulation, creditors’ interests take third (and last) place.31

C. Contemporary Security Devices

The problems described above encouraged nineteenth and twentieth century creditors to seek more effective security for the payment of debts. Three principal techniques have emerged in Western Europe and the United States. First, the creditor’s use of the debtor’s real or personal property as collateral for a loan. If the debtor defaults on the loan, the creditor looks to the property for security. Second, the creditor’s acquisition of more accurate information on the risk that his debtor will not repay a loan. Acquisition of this information allows the creditor to secure himself by choosing more intelligently to whom he loans money. Third, the creditor’s arranging with other creditors to share the risk of the

30. For an overview of contemporary federal bankruptcy law, see DAVID G. EPSTEIN, DEBTOR CREDITOR LAW IN A NUTSHELL (5TH ED. 1995).
31. See JAUFFRET, supra note 28, n° 929, at 609-10. The present French Bankruptcy Code, more properly called the Loi relative au redressement et liquidation judiciaires des entreprises, appears as an Appendix to the Code de Commerce. As its title indicates, it applies only to businesses.
debtor's default so that each creditor assumes that portion of the risk he is best able to evaluate and handle. This risk-sharing approach, widely employed today in international trade through letter of credit transactions, provides merchant sellers with a degree of security which their medieval forbearers could never have imagined.

1. The Debtor's Property as Security

The use of a debtor's property as "collateral" or security for a loan derives from the ancient legal transaction known as pledge. However, the pledge, when it first appeared in early Germanic law, did not function as a security device.³² Rather, it served as a provisional sale or, in the alternative, as a provisional method of payment. In the first case, the pledgor pledged his property (usually goods) to obtain from the pledgee property which he wished to purchase, while in the second case the pledgor pledged his property to satisfy the pledgee's claim for some wrong committed by the pledgor. These transactions were in effect cash transactions; not surprisingly, they occurred frequently in primitive societies that did not have a fixed medium of exchange (what we call money).

In both cases, the pledgor gave the pledgee whatever property he had available at the time of the transaction, with the understanding that he could substitute more appropriate (or equivalent) property at a future date. However, the pledged property did not serve as security for an underlying debt. The pledgor had no obligation to reclaim it; if the pledgor chose not to do so, the pledgee simply became its new owner. More importantly, the pledgee had no obligation to account for any surplus nor any right to obtain any deficiency, as he would have had if the pledged property had served as security for an underlying debt. Those features, essential aspects of a security transaction, were absent from the original pledge idea as found both on the Continent and in England. It was not until the late Middle Ages (fourteenth century and later) that the Germanic legal systems recognized that pledged property could serve as security for an underlying debt. In that case, the creditor (the pledgee) was liable for any surplus (the value of the property in excess of the debt) and could sue the pledgee for any deficiency if the value of the property did not cover the debt. In addition, if the debtor defaulted, the new law of pledge normally required the creditor to initiate a judicial or at least a public sale of the pledged property; the creditor could not simply keep the property

³² On the history of pledge, see John H. Wigmore, The Pledge Idea: A Study in Comparative Legal Ideas, 10 Harv. L. Rev. 321 (1896); 10 Harv. L. Rev. 389 (1897); 11 Harv. L. Rev. 18 (1897). Professor Wigmore was one of the first great American comparativists. His magisterial study on the pledge idea remains unsurpassed.
by declaring a forfeiture.\footnote{33} The use of the debtor’s property as a security device was of limited utility until the nineteenth century. The principal difficulty was the requirement, applicable to pledges of personal property, that the creditor or a neutral third person actually take possession of the pledged property. No doubt a creditor is quite secure if he has possession of a debtor’s goods equal in value to the debt, but most debtors are not in a position to offer that type of security. Would-be debtors normally seek credit to purchase goods or operate a business; the credit is of no utility to the debtor unless the debtor retains possession of the goods or business because the debtor expects to use them to generate profit. Despite the debtor’s need for possession, the civil law systems on the European Continent have generally followed Roman law in requiring the creditor to take possession of pledged goods. This solution was codified in article 2076 of the Napoleonic Civil Code of 1804, which explicitly provided that a creditor retained a security interest in the pledged property only as long as the property remained in the possession of the creditor or of a third person agreed to by the parties. That text remains in effect today.\footnote{34} By mandating the debtor’s dispossession, article 2076 assures that other creditors or potential creditors of the debtor receive notice that the pledged property is not available to satisfy any judgment they may obtain against the debtor.\footnote{35}

English law took a similar approach in treating the debtor’s possession of pledged property as a fraud on the debtor’s other creditors. In a well known 1601 decision, Twyne’s Case, the Star Chamber allowed the debtor’s other creditors to avoid or set aside such a pledge on the grounds that the secured creditor’s allowing the debtor to remain in possession of the pledged property was a fraudulent conveyance.\footnote{36} As a result, the secured creditor lost his security interest in the property, an interest which would have given him priority over other creditors in enforcing his claim. Twyne’s Case later became a lead precedent, cited on
both sides of the Atlantic as demonstrating the common law's abhorrence of nonpossessory security interests.37

This condemnation of "secret" liens did not apply, of course, if a carrier or warehouse rather than the debtor possessed the goods. In such cases, the common law readily recognized that documents of title (bills of lading or warehouse receipts) could be used, not only to control movement of the goods, but also to give the creditor a security interest in the goods. In addition, the condemnation of secret liens also did not apply to pledges of land (i.e., mortgages) because, even though the debtor remained in possession, the debtor's other creditors could receive notice of the pledge through public land records. However, land often proved to be an inadequate security device because the courts, particularly equity courts, intervened to protect the debtor's interest in preserving the family homestead or business. Thus, the creditor had to follow cumbersome procedures and wait many years before foreclosing a defaulting debtor's right to redeem his ownership of the land by paying the debt.38 Creditors, impatient to collect their money, needed a more timely and effective remedy.

In nineteenth century America, the need for credit made intolerable these common law restrictions on the use of the debtor's property as security. Manufacturers needed credit to buy goods (usually raw materials), to operate factories which turned raw materials into finished products, and to maintain an adequate inventory of goods for sale to their customers. Sellers and lenders responded by extending credit; those creditors took what the debtor had to offer, i.e., a security interest in the actual goods, machinery, or inventory. To protect the creditor's interest, creative lawyers drafted documents called chattel mortgages, conditional sales agreements, or trust receipts that purported to allow the creditor to seize and sell the property if the debtor defaulted. Sometimes courts enforced these contracts to give the secured creditor priority (at least with respect to the pledged property) over the debtor's other creditors and sometimes the courts did not. To achieve greater certainty, as creditors have no interest in gambling on enforceability, their lawyers then turned to the legislatures for relief in the form of statutes validating these new contracts. Legislatures responded affirmatively by enacting laws recognizing chattel mortgages, conditional sales, and other instruments creating nonposses-

38. See Plucknett, Concise History supra note 5, at 603-08 and 690. French law also does not require the debtor's dispossession for real estate mortgages (hypothèques), but in France real estate rarely serves as security for debts other than those incurred by buyers in purchasing the land.
sory security interests in personal property. Under these laws, a central-
ized recording system gave both the debtor’s other creditors, as well as
potential buyers from the debtor, legal notice of the creditor’s security in-
terest in the debtor’s property. That notice dissipated the suspicion of
fraud generated by the debtor’s retention of possession. As a result, the
secured creditor’s interest in the property received priority over the inter-
est of other creditors and of buyers.39

The most widespread of these new security devices was the personal
property or chattel mortgage. By the early twentieth century, all forty-
eight states had enacted statutes validating the chattel mortgage. These
statutes favored the creditor by providing him with the remedy of self-
help. Upon the debtor’s default, the creditor could seize and sell the
property without court intervention if he could obtain possession without
a breach of the peace and if he followed statutory procedures (mainly
giving notice) for a private or nonjudicial sale. While the creditor could
not simply declare the property forfeit, he could purchase it at the sale,
paying for it by forgiving all or part of the debt.40 While protective of
creditors, these statutes were popular because they served the interest of
both creditors and debtors. Creditors wanted security and debtors (at least
honest ones) wanted to be able to offer them security so that they could
more readily obtain a loan.

The chattel mortgage statutes also addressed, but did not fully re-
solve, the more difficult problem of enforcing a shifting or floating lien.
Goods in the debtor’s possession do not remain static. Rather, the debtor
uses tools, machinery, and other equipment (all of which wear out and
eventually need replacing) to transform raw materials into finished prod-
ucts—goods which the debtor then maintains in inventory until sold to
customers and replaced by new finished products hot off the assembly
line. This constant processing and replacement of goods by the debtor
posed a real problem for the common law, which had always viewed a
creditor’s lien as attaching to a specific piece of property. Upon that
property’s transformation, the creditor’s security interest disappeared.
Many merchant debtors therefore could not offer adequate security; the
goods they possessed changed daily. The lawyers’ response to this prob-
lem was to create a floating lien which followed the debtor’s property
through all these transformations. Specifically, this lien applied to prop-
erty acquired by the debtor after the creation of the creditor’s security in-

39. On the history of security interests in personal property, see Grant Gilmore &
Allan Axelrod, Chattel Security I, 57 YALE L. J. 517 (1948) and Grant Gilmore, Chattel
Security II, 57 YALE L. J. 725 (1948).

40. See 2 GILMORE, SECURITY INTERESTS supra note 37, § 43.2, at 1184-90 and §
44.1, at 1211-16.
terest and to proceed from the sale of secured property. These innovations received confirmation in the Uniform Trust Receipts Act drafted by Professor Karl Llewellyn in the early 1930s. That model statute recognized a new generic instrument, called a trust receipt, creating a security interest in personal property which the creditor entrusted to his debtor.\footnote{See Gilmore, Chattel Security II, 57 Yale L. J. at 761-65.}

The culmination of this historical development was the Uniform Commercial Code, a statute drafted during the 1940s and enacted by forty-nine of the fifty states by the late 1960s.\footnote{Louisiana remains a partial hold-out. Much of its private law derives from the French Civil Code of 1804.} Like the Uniform Trust Receipts Act, the new Code was the product of a movement to make more uniform the commercial law of the various states. The Code's drafters, spearheaded by Professor Llewellyn, were an elite group of judges, professors, and practicing lawyers joined together in the American Law Institute and the National Conference of Commissioners on Uniform State Laws; they presented their Code as a model for adoption by state legislatures. State legislatures responded enthusiastically by adopting it largely unchanged.

The Code itself covers the sale of goods (Article 2), negotiable instruments (Articles 3 and 4), and security interests in personal property (Article 9).\footnote{The American Law Institute and the National Conference of Commissioners on Uniform State Laws publish the Official Text of the Code. The fourteenth edition appeared in 1995. Professor Grant Gilmore was the principal drafter of Article 9. For his magisterial summary of its provisions, see 1 Gilmore, Security Interests, supra note 37, at 287-400.} Those latter provisions codify all the advances made during the prior century. In particular, they present a simplified and unified structure for the creation of a security interest in personal property. Under the Code, a single instrument (called a security agreement) replaces the chattel mortgage and other instruments previously recognized by the law. The creditor obtains a security interest in the debtor's personal property by means of the security agreement. Upon perfection of that interest (usually obtained by recording the agreement), the creditor obtains priority, at least with respect to the secured property, over the debtor's other creditors and over most buyers from the debtor. Furthermore, the Code ratifies the creditor's self-help and private sale remedies and preserves the floating lien by recognizing the creditor's secured interest in proceeds and other after-acquired property of the debtor. Finally, while the Code does not address what happens if the debtor goes bankrupt, federal bankruptcy law recognizes that secured creditors may enforce their interests in secured property in bankruptcy. Even if the bank-
ruptcy court orders the reorganization of the bankrupt, thus allowing the bankrupt to keep his property, the creditor must receive a note promising payment in full from the reorganized business. In sum, the creditor's security is considerable. No doubt the secured property may deteriorate in value and there may be competing secured creditors, but secured creditors who adequately monitor their debtors are likely to receive payment in full.

Security interests in personal property have played a lesser role in modern civil law systems. Civil Codes normally retain the traditional rule that the creditor must acquire possession of the property to obtain an enforceable security interest. In many civil law countries, nonpossessory security interests in personal property play a minimal role. Other countries, such as France and Norway, have enacted special legislation recognizing nonpossessory security interests in specific types of property used for business purposes. In France, a 1909 statute allows a creditor to obtain a security interest in a debtor's *fonds de commerce* (trade name, good will, leases, equipment) and a 1951 statute, intended to promote post-war recovery, recognizes security interests more generally in a business's tools and equipment. Both statutes give the secured creditor a priority over the debtor's other creditors. However, no civil law system appears to have adopted anything comparable to the unitary security interest recognized by article 9 of the Uniform Commercial Code.

On the other hand, civil law systems tend to provide the unpaid seller with more generous protection than does the common law. For example, an unpaid seller may, within generous limits, reclaim from a defaulting or even bankrupt buyer the goods sold. In addition, in many


45. See supra text accompanying note 34.

46. HARRY RAJAK, ED., *EUROPEAN CORPORATE INSOLVENCY* at 183-84 (Germany), 378-79 (Italy), and 574-75 (Spain) (2d ed. 1995).

47. Id. at 120-22 (France) and 487-88 (Norway).

48. Alfred Jauffret, *La loi du 18 janvier 1951 sur le nantissement de l'outillage et du matériel d'équipement*, 7 Revue Trimestrielle De Droit Commercial 202 (1954). The 1909 statute presents the disadvantage that the debtor can only offer security to one creditor. Id.

49. See PHILIP R. WOOD, *COMPARATIVE LAW OF SECURITY AND GUARANTEES* (1995). The closest analogy is the fiduciary trust recognized by case law in Germany and by the 1992 Civil Code in the Netherlands. Id. at 16-20. England and most other common law countries recognize a unitary or universal floating lien. Id. at 11-12.

50. For example, the new Dutch Civil Code allows the unpaid seller to demand the
civil law countries, the seller may include in the sales agreement a clause retaining the seller’s title in the goods sold until the buyer pays for them in full. This retention of title clause creates a property and not just a security interest. This difference is significant because it allows the creditor to withdraw the property from the debtor’s estate not only before any creditor claims are recognized but also before any reorganization of the debtor. Thus, under the 1985 French Bankruptcy Law, unpaid sellers of goods who retained title enjoy full priority, while the interests of secured creditors are often sacrificed given the priority accorded by the new law to reorganizing (and saving) the enterprise.51

2. Information as a Security Device

Today, in the United States, over 1,100 credit reporting companies supply creditors with information on the credit-worthiness of American consumers.52 Creditors believe it worthwhile to purchase this information because it allows them to reduce their risks by declining to loan money to persons with poor credit ratings. In addition, the credit rating system gives creditors increased leverage in collecting existing debts. Many a debtor scrambles to pay when told by the creditor that a bad credit rating provoked by default will foreclose the debtor’s access to future credit. The focus of the contemporary credit reporting industry is the consumer debtor, but when the industry first appeared in the 1840s, its purpose was to provide creditors with information on potential merchant debtors.

Business in early nineteenth century America operated on a sea or web of credit.53 Indeed, one could say that America had been founded on credit, as the majority of the early white settlers obtained their transatlantic passage on credit by agreeing to work as indentured servants for four to seven years after their arrival.54 Even after American independence the

return of the goods within six weeks after the debt has become due or sixty days after delivery. See RAJAK, supra note 46, at 456-57.

51. See supra text at note 31. One leading international practitioner goes as far as to say that in insolvency proceedings in France “security must be regarded as virtually worthless or at least highly unpredictable.” See WOOD, supra note 49, at 159.


54. See FRIEDMAN, supra note 53, at 82-85. At least in theory, these settlers were “free-willers” who had voluntarily agreed to work in return for their passage. In the seventeenth and early eighteenth century most of the northern colonies also enforced indentures for labor; a debtor in default could escape prison by agreeing to work under an indenture for a set number of years. PETER J. COLEMAN, DEBTORS AND CREDITORS IN
chronic shortage of currency made the granting of credit inevitable. Foreign merchants sold goods on credit to American importers; importers or wholesalers in the large Eastern seaboard cities sold goods on credit to "country merchants" or retailers in the interior; and retailers then sold goods on credit to their consumer customers. Both the foreign merchant and the Eastern city wholesale merchant or "jobber" primarily relied for security on the development of long-standing relationships with particular importers or retailers. In other words, they extended credit to persons whose prior record of trustworthiness made it likely that they would repay the loan. A few of the larger firms hired investigators to obtain information on strangers seeking credit, but most merchants found that option too expensive. In addition, some creditors solicited letters of recommendation from prospective debtors, but often those letters proved to be untrustworthy.

Starting in the 1830s, at least two factors seriously undermined the security of the wholesale merchant. First, the construction of canals and railroads greatly expanded the market area in the interior of the United States. More and more country or retail merchants who were unknown to the wholesale merchants presented themselves at the latters' showrooms. Thus, America's rapid expansion made the creditor's personal knowledge an inadequate basis for deciding whether to grant credit. Second, an accentuated cycle of booms followed by busts made it likely that, in the hard times following a bust, some debtors who had always paid on time in the past would be forced to default. A debtor's past record on payment therefore no longer provided adequate security for a new loan. The Panic of 1837 proved to be a particularly severe bust, forcing many honest merchants to default on their debts.

The credit reporting industry originated in the 1840s as a response to the growing need of wholesale merchants for more up-to-date information on the credit-worthiness of retail merchants seeking credit. Its founder—Lewis Tappan—was a true American original. Tappan's career exemplifies de Tocqueville's contemporaneous observation that America

---


was a nation of joiners. A militant opponent of slavery and an outspoken Evangelical Christian, Tappan was, in the words of his biographer, a member of "any and every league that had been founded for almost any purpose whatsoever, as long as it was benevolent, pious, and teetotaling." Tappan also pursued several business careers and was a partner in his brother's silk goods wholesale business in New York when the Panic of 1837 struck, forcing that business to suspend payments for a time after its own debtors defaulted.

Tappan's business experience led him to found in 1841 the Mercantile Agency, the world's first credit reporting firm. To obtain up-to-date information on the credit-worthiness of the country merchants now arriving in droves in New York and other Eastern cities, Tappan retained as "correspondents" hundreds of lawyers and bankers living in the interior. Abraham Lincoln, then an aspiring young lawyer in Illinois, served as one of Tappan's early correspondents. These correspondents were charged with the responsibility of making inquiries on the retail merchants in their community and of presenting written reports to the Mercantile Agency in New York. As demonstrated by the following credit report, Tappan encouraged his correspondents to include information on the merchant's personal life and morality.

James Samson is a peddler, aged 30; he comes to Albany to buy his goods, and then peddles them out along the canal from Albany to Buffalo. He is worth $2,000; owns a wooden house at Lockport . . . has a wife and three children . . . drinks two glasses cider brandy, plain, morning and evening—never more; drinks water after each; chews fine cut; never smokes; good teeth generally; has lost a large double tooth on lower jaw, back, second from throat on left side . . . purchases principally jewelry and fancy articles.

At least initially, Tappan did not pay his correspondents for their reports but promised them that, in return for their services, he would assure

59. ALEXIS DE TOCQUEVILLE, 1 DEMOCRACY IN AMERICA.
60. See Wyatt-Brown, supra note 58, at vii. Wyatt-Brown is paraphrasing Henry James' classic portrayal of the antislavery lady, Miss Birdseye. See HENRY JAMES, THE BOSTONIANS 27 (1956).
61. See Wyatt-Brown, supra note 58.
62. On the history of the Mercantile Agency, see Wyatt-Brown, supra note 58, at 229-47; see also Bertram Wyatt-Brown, God and Dan & Bradstreet, 40 BUS. HIST., REV. at 432-50 (1966).
63. See Wyatt-Brown, supra note 58, at 235.
the referral to them of debt collection work. Tappan compiled the correspondents‘ reports in ledger books which were accessible to merchants who had subscribed to his service by paying an annual fee. By the late 1840s, the Mercantile Agency had over seven hundred correspondents and nearly eight thousand merchant subscribers. This remarkable growth occurred even though Tappan’s well known Abolitionist views made it difficult for him to recruit correspondents in slave states and even though Tappan himself refused any dealings with distilleries or other businesses he considered to be immoral.

By the end of the nineteenth century, commercial credit reporting agencies had evolved from a novel enterprise to an established business institution. Tappan’s original Mercantile Agency eventually became the well-known firm of Dun & Bradstreet. Over time, paid employees replaced the network of unpaid correspondents, and printed reference books and weekly updates replaced the ledger books inspected at the credit agency’s office. The arrival of the telegraph made practicable the more rapid dissemination of up-to-date information. These innovations allowed Dun & Bradstreet and other credit reporting agencies to give subscribing merchants speedy access to the up-to-date credit information they needed about their customers.

Credit reporting services thrived in nineteenth century America because, once a merchant extended unsecured credit, the means to assure payment were often woefully inadequate. In the absence of a federal Bankruptcy Act, the law of debtor and creditor remained a state concern. Not surprisingly, given the continuing cycle of booms followed by busts, the matter of debtor relief often became a hot political issue. Since debtors outnumbered creditors, many state legislatures found debtor relief politically irresistible. Most state legislation therefore favored debtors. By the Civil War, most states legislatures had abolished imprisonment for debt, thus depriving the creditor of a means for coercing his debtor to pay. In addition, Homestead Acts, enacted in most western and southern states, exempted the debtor’s real property from execution. As in the feudal system of the Middle Ages, it was not possible for the creditor to satisfy a judgment by attaching the debtor’s land, often the principal asset available. Finally, numerous state insolvency acts gave debtors a delay in payment or even a discharge from their debts. These statutes afforded

64. Madison, supra note 57, at 186.
65. Congress enacted Bankruptcy Acts in 1800, 1841, and 1867, but each of those laws was quickly repealed. An 1898 Bankruptcy Act proved to be more permanent; although much amended, it remains in effect today. See Charles Warren, Bankruptcy in United States History 1935.
66. See Friedman, supra note 53, at 246.
debtors relief without providing creditors the advantages traditionally associated with bankruptcy proceedings. Creditors could not, as they could in bankruptcy, initiate a collective, inquisitorial-type proceeding designed to assemble and then distribute all the debtor’s assets.67

Creditors fought back against this wave of debtor relief legislation. Usually, they found the courts more responsive to their concerns than state legislatures. Federal courts, for example, held unconstitutional state insolvency statutes that purported to discharge debts incurred before the date of their enactment.68 Courts also tended to enforce the new security interests in personal property created by creditors’ lawyers—the chattel mortgage and conditional sales agreements discussed in the prior section. Finally, state legislatures themselves often proved responsive to creditor interests if those interests corresponded with broader public interests. For example, legislatures enacted statutes giving mechanics and other artisans a lien on real property for improvements for which they had not been paid. In addition, state legislatures made debt recovery easier by enacting statutes which gave all persons better access to the courts and which simplified the often archaic common law procedures for debt collection. In particular, new statutes allowed judgment creditors to “garnish” money, wages, or goods owed the debtor by third persons.69 These reforms presaged the enactment in the twentieth century of legislation such as the Uniform Commercial Code which sought to balance more equitably debtor and creditor interests.

3. Spreading Risk as a Security Device: Sureties and Letters of Credit

A creditor can reduce the risk of a debtor’s nonpayment by securing promises from third parties to pay the debt if the debtor does not. Those third party promisors, known as guarantors or sureties, are familiar figures on the contemporary legal scene. As in Roman law, their liability is normally secondary or accessorrial in that the creditor can demand that they pay the debt only if the principal debtor has refused to pay.70 Sure-

67. For these debtor relief measures, see Id. at 245-48, 269-75; see also COLEMAN, supra note 54, at 249-60.
68. Sturges v. Crowninshield, 17 U.S. (4 Wheat) 122 (1819) (holding such laws violated the federal constitutional prohibition on impairing the obligation of contract).
69. See FRIEDMAN, supra note 53, at 243-45; see also COLEMAN, supra note 53, at 262-68.
70. William H. Loyd, The Surety, 66 U. Pa. L. Rev. 40 (1917) (describing the history of surety at common law); see also WEILL, supra note 35, ch. 7 at 32 (see especially Footnote 26, describing accessorrial liability of surety or caution under present French Civil Code); see also Arts. 765-78 BGB (German Civil Code) (see especially Art. 771 on
ties nevertheless provide a creditor with considerable security, particularly if chosen for that role on account of their financial solvency. The creditor knows that he has recourse against a party of unquestioned solvency if the debtor defaults. However, commercial sureties expect a fee for their services and will not guarantee a debt unless they feel secure that they will be able to enforce against the debtor their own claim for reimbursement of any payments made to the creditor. Commercial sureties are therefore not likely to be available if the debtor is unable to provide them with security. Sureties remain useful in spreading the risk for the creditor, but they do not create security where none exists.

In early Germanic law, the surety played a more independent role. Custom often expected that relatives, friends, patrons, and even lords would fulfill the role of surety. That role was an onerous one because the creditor could hold the surety hostage until the debt was satisfied. Indeed, custom required obligors to provide hostages (pledges)\textsuperscript{71} on all sorts of occasions, e.g., to guarantee the payment of a debt, an appearance in court, the execution of a judgment, or the preservation of the peace. Unlike Roman and modern law, early Germanic law normally treated the surety's or pledgor's obligation as primary if not exclusive. The creditor thus looked to the surety for payment and often had no further remedy against the debtor once he took a surety hostage. Holding the surety hostage was a means of putting pressure on the debtor, as it was assumed that the surety would do everything possible to convince the debtor to pay. By the twelfth century, the practice of the creditor's taking a surety hostage seemed to have disappeared, perhaps because creditors balked at the cost of feeding hostages. As the old adage goes, "The banquet of a hostage is a costly banquet." Suretyship, at least in England, became a contract, one of the few consensual contracts the common law enforced. However, until the end of the Middle Ages, the surety's liability remained primary and sureties were not usually commercial entities but rather individuals with personal ties to the debtor.\textsuperscript{72}

In the modern commercial world, the documentary sale under a letter of credit is the paradigmatic device utilized to provide security by spreading the creditor's risk.\textsuperscript{73} Take the case of a merchant seller in

\textsuperscript{71}. In early medieval times a "pledge" (plegias) was almost always a person, not a thing, see Plucknett, Concise History, supra note 5, at 603 n.2.

\textsuperscript{72}. On the surety in early Germanic law, see Brisaud, supra note 7, at 571-74 and II Pollock & Maitland, supra n.7, at 191. For the banquet quotation, see Brisaud at 572-73. For the primary liability of the medieval surety, see Loyd, supra note 69, at 50-51.

\textsuperscript{73}. On the letter of credit, see John F. Dolan, The Law of Letters of Credit.
country A desiring to sell goods to a merchant buyer in country B. Modern communications permit the parties to agree on a sale without leaving their respective countries and before the seller ships the goods. However, the buyer is unlikely to want to pay for the goods until he obtains control over them in country B, and the seller is unlikely to agree to ship the goods until assured of payment. Shipping on credit is simply too risky for the seller even if the buyer has agreed to pay on delivery. The buyer may be unable to pay on account of insolvency or may reject delivery of the goods because the buyer no longer wants them or believes them to be nonconforming. Given the distance between the two countries, the seller may have no means of obtaining adequate information about the buyer to ascertain whether these problems are likely to occur. In addition, the seller may feel quite uncomfortable about pursuing legal remedies against the buyer in the unfamiliar legal system of country B, the forum where any dispute between the buyer and an unpaid seller is likely to be resolved.

The irrevocable letter of credit responds to the seller's insecurity about shipping on credit. It does so by expanding the transaction between the seller and buyer to include the buyer's bank, the seller's bank, the carrier, and the insurer of the goods. Each of these parties assumes, for a fee, some of the risk that the seller would otherwise bear. To simplify a good deal, the buyer obtains from his bank in country B an irrevocable letter of credit payable to the seller for the purchase price of the goods. While irrevocable, the credit is only payable when the issuing bank receives from the seller a bill of lading confirming the seller's shipment of the goods. That bank, located in country B, naturally has better access to information about the buyer than does the seller; it also has greater familiarity with the legal system of country B. The buyer's bank therefore makes its own contractual arrangements with the buyer (usually called the applicant) for payment of the sum designated in the letter of credit. The bank is usually willing to extend credit to the buyer as long as the bank retains the bill of lading because that document of title gives the bank a security interest which the bank may enforce against the goods if the buyer does not pay the bank.

COMMERCIAL AND STANDBY CREDITS (rev. ed. 1996) (American law); see also JEAN STOUFFLET, LE CRÉDIT DOCUMENTAIRE - ÉTUDE JURIDIQUE D'UN INSTRUMENT FINANCIER DU COMMERCE INTERNATIONALE (1957) (French law and international practice); see also BORIS KOZOLCHYK, LETTERS OF CREDIT (1979) (comparative study) (Professor Kozolchyk's book is part of the International Encyclopedia of Comparative Law). For a marvelously clear, albeit simplified, presentation on letters of credit, see RALPH H. FOLSON ET. AL., INTERNATIONAL BUSINESS TRANSACTIONS IN A NUTSHELL 140-50 (5th ed. 1996).
The buyer, of course, needs the bill of lading to obtain delivery of the goods. Prior to releasing the bill of lading to the buyer, the buyer's bank normally expects either payment or the execution of another instrument giving the bank a security interest in the goods. In the United States, that instrument used to be the trust receipt, which has now been subsumed under the unitary security agreement recognized by the Uniform Commercial Code. The trust receipt allowed the buyer to process or even sell the goods without the entrusting party (the bank) losing its security interest. The buyer could therefore use the goods to make the money which he needed to pay the bank.\(^4\)

The international letter of credit, however, primarily benefits the seller. Remember that the seller does not ship (i.e., deliver the goods to a carrier in return for a bill of lading) until the seller obtains an irrevocable letter of credit. That letter makes the buyer's bank the primary debtor, thus providing the seller with additional security before he ships. Banks do occasionally fail, but they are more likely than merchant buyers to be solvent and to pay their debts on time. In addition, most sellers obtain a confirmation of the letter of credit by a bank in their own country (country A). By confirming the letter of credit, the seller's bank becomes the primary debtor. The seller's bank is better able than the seller to inform itself about the banking system in country B and about the risk of default by the buyer's bank. The seller's primary security when he parts with the goods is therefore the confirmation by his bank of the letter of credit issued by the buyer's bank. While it is conceivable that the seller's bank could become insolvent and not pay (letters of credit are not insured by the government, as are savings deposits in the United States), that risk is one that most sellers feel comfortable about appraising and handling.

The letter of credit also assures that the seller receives prompt payment for the goods. There is a time gap between the seller's shipment and payment. The seller must ship first, but once he ships he can submit the bill of lading, proof of insurance, export license, and other required documents to his bank to obtain payment under the letter of credit. In other words, the seller receives payment before the buyer receives the goods because both the seller's bank and then the buyer's bank honor the letter of credit upon presentation of the documents submitted by the seller. Of course, the banks and other intermediaries all receive a fee for their services and any early payment received by the seller is always discounted to take into account the time value of money. For this reason,

\(^4\) See Kozolchyk, supra note 73, at 61-66 (describing the more limited security devices available to the buyer's bank in other countries). Professor Kozolchyk's comprehensive analysis confirms the superiority of the Uniform Commercial Code in recognizing security interests in personal property.
sellers and buyers who know and trust each other often do not go to the trouble of including a letter of credit as the payment term for a sale. Thus, most sales within one country and many sales within the European Union do not involve letters of credit. Under those circumstances, a seller desirous of obtaining security before shipping may feel sufficiently comfortable if he simply retains a security interest in the goods.\(^75\) That technique is less likely to prove effective when the buyer is in a distant country with a different legal system.

The letters of credit transaction described above originated in mid-nineteenth century England. Largely the creation of the London banks, it depends for its operation on the existence of functioning banking systems in both country A and country B. It also requires currency convertibility and cooperation between banks at the international level. Mercantile interests have insured that cooperation has occurred. In most countries, however, the law on letters of credit remains largely customary.\(^76\) Commencing in 1929, the International Chamber of Commerce headquartered in Paris has acted to standardize practices by issuing Uniform Customs and Practice (UCP) for Documentary Credits. The most recent revision dates from 1993.\(^77\) The UCP rules are not mandatory, but most sales agreements providing for payment by letter of credit incorporate them by reference. In the United States, on the other hand, legislatures have intervened, and Article 5 of the Uniform Commercial Code, adopted in all fifty states, provides rules on letters of credit. Once again, most of these rules are not mandatory but apply only if the parties do not provide otherwise by agreement. Both the UCP and the Code rules seek to insure that the seller receives payment upon presentation of facially adequate documents. Any dispute between the buyer and the seller over the quality of the goods or other matters must be resolved later, most likely in a lawsuit brought by the buyer in the seller’s home forum.

D. Conclusion

There is one security device—potentially a very effective one—which the Anglo-American common law has, fortunately, almost never adopted: debt slavery. The common law did at one time authorize courts, at a creditor’s behest, to imprison debtors, but the purpose of the imprisonment was coercive, i.e., to pressure the debtor to disclose his assets or the debtor’s family and friends to come to his aid. The debtor could not be forced to work, and, in most jurisdictions, the creditor was responsible

\(^{75}\) See \textit{Id.}, at 1-2.

\(^{76}\) See \textit{Dolan}, supra note 73, \S\ 3.05, at 3-22.

\(^{77}\) \textit{Id.} at 12-19.
for paying for the debtor's upkeep. Debtors' prison was therefore not debt slavery. Even if a debtor agreed to work for his creditor to pay off a debt, the courts normally refused to enforce the agreement. No doubt colonial courts did enforce some indentures for service,\textsuperscript{78} but the Supreme Court decisively condemned debt slavery in \textit{The Peonage Cases} in the early twentieth century. In those cases, the Court found unconstitutional, under the 1866 constitutional amendment abolishing slavery, efforts by Southern states to require poor Blacks to work for landowners to whom they were indebted.\textsuperscript{79}

The lesson of \textit{The Peonage Cases} is that there are limits on the security which a creditor can expect from the law. A debtor is a human being, and the common law has traditionally imposed limits on an individual's power to renounce the autonomy which is a hallmark of that humanity. As recognized by John Stuart Mill, voluntary slavery is an oxymoron. One cannot be free not to be free. Therefore, an agreement by which a person would sell himself as a slave is null and void.\textsuperscript{80} This bedrock proposition receives little confirmation from statutes or reported cases, perhaps because it is so basic that no one challenges it. Mill's value judgment nevertheless pervades our legal system and makes it unlikely that \textit{The Peonage Cases} will arise again. Creditors may be a bit less secure as a result, but we are a better society for it.

\textsuperscript{78} See supra note 54 and accompanying text.


\textsuperscript{80} \textsc{John Stuart Mill}, \textit{On Liberty}, in \textit{Three Essays} 125 (Oxford University Press ed. 1912).