

# LAW, LAWYERS, AND SELF-GOVERNANCE DURING THE HEYDAY OF THE LONDON STOCK EXCHANGE

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## I

### INTRODUCTION

During the nineteenth and much of the twentieth centuries, the London Stock Exchange (LSE) was arguably the most important economic institution in the capitalist world.<sup>1</sup> Together with other major stock exchanges, it directed enormous flows of capital from investors in rich nations to firms and governments around the globe. By the First World War, nearly one-third of all securities, whether issued by public or private entities, were listed on the LSE.<sup>2</sup> Like other exchanges, the LSE also was self-governing.<sup>3</sup> Its membership criteria determined who could trade, its rules and regulations determined the form of transactions, and its governing committees or private arbitrators—not the courts—resolved disputes among members. The LSE enforced its rules and decisions not by legal coercion, but extralegally, by suspending or expelling members who refused to comply.

In these ways, the LSE resembled other merchant communities that enforce agreements in accordance with specialized rules and through extralegal rather than legal sanctions. Private legal systems of this sort have attracted much academic attention, resulting in a large and interdisciplinary literature in law, economics, history, sociology, anthropology, and beyond.<sup>4</sup> This literature has

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1. Larry Neal & Lance Davis, *The Evolution of the Structure and Performance of the London Stock Exchange in the First Global Financial Market, 1812–1914*, 10 EUR. REV. OF HIST. 279, 279–80 (2006).

2. *Id.* at 280.

3. Marc Flandreau, *Sovereign States, Bondholders Committees, and the London Stock Exchange in the Nineteenth Century (1827–68): New Facts and Old Fictions*, 29 OXFORD REV. ECON. POLICY 676 (2013), <https://academic.oup.com/oxrep/article/29/4/668/481954> [<https://perma.cc/JRN2-EV9V>] (last visited Oct. 6, 2019); Larry Neal & Lance Davis, *The Evolution of the Rules and Regulations of the First Emerging Markets: The London, New York and Paris Stock Exchanges, 1792–1914*, 45 Q. REV. OF ECON. & FIN. 297 (2005), <https://linkinghub.elsevier.com/retrieve/pii/S1062976905000189> [<https://perma.cc/5PXH-9JHJ>] (last visited Oct. 6, 2019).

4. See, e.g., ROBERT C. ELLICKSON, *ORDER WITHOUT LAW: HOW NEIGHBORS SETTLE DISPUTES* (1991); AVNER GRIEF, *INSTITUTIONS AND THE PATH TO THE MODERN ECONOMY: LESSONS FROM MEDIEVAL TRADE* (2006); BARAK D. RICHMAN, *STATELESS COMMERCE* (2017); Lisa Bernstein,

produced important insights about how private legal systems operate and why some economic communities opt for private over public enforcement. Perhaps the most fundamental insight is that, in some transactional settings, contracts are more secure when enforced extralegally.<sup>5</sup>

The LSE is a straightforward example of this benefit. LSE members engaged in transactions, such as time bargains and options,<sup>6</sup> that English law deemed unenforceable or outright prohibited.<sup>7</sup> Until 1860, Barnard's Act outlawed forward transactions unless the seller retained the shares until closing.<sup>8</sup> The Gaming Act of 1845 declared contracts "by way of gaming and wagering" null and void,<sup>9</sup> and Leeman's Act of 1867 invalidated contracts speculating in bank shares.<sup>10</sup> These and other laws meant that LSE members could not rely on the English courts to enforce many contracts. By resolving disputes privately, and threatening non-compliant members with expulsion, the LSE assured that members would honor bargains.

However, the LSE does not merely illustrate a private legal system in action. Examination of its practices also reveals a gap in the literature and helps to fill it. Studies of private legal systems generally examine *how* members enforce bargains and thus focus attention on exclusion and other extralegal mechanisms. Law and legal actors recede into the background. Yet a rather different picture emerges if we shift our attention away from the problem of "enforcing agreements in exchange"<sup>11</sup> and toward sources of friction between the private legal system and the state itself. A community that aspires to self-governance must do more than facilitate trade. In many cases, it will also have to navigate a constantly-shifting relationship with the state itself.

Certainly this was true of the LSE. As economic historian Larry Neal has written:

[T]he particular form of self-regulation of the London Stock Exchange was shaped by the peculiarities of English common law and constrained ultimately by statute and the ever-present threat of additional legislation. The influence of statute and judicial

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*Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 21 J. LEGAL STUD. 115 (1992).

5. See generally Barak D. Richman, *Firms, Courts, and Reputation Mechanisms: Towards a Positive Theory of Private Ordering*, 104 COLUM. L. REV. 2328, 2342–45 (2004).

6. E. VICTOR MORGAN AND W. A. THOMAS, *THE LONDON STOCK EXCHANGE; ITS HISTORY AND FUNCTIONS* 20–21, 60 (1962). A time bargain is an agreement to sell securities in the future at a specified price. Securities often did not change hands on the settlement date; instead, closing simply involved payment of any difference between the contract and market price. *Id.* at 60.

7. On English securities regulation through the mid-nineteenth century, see, e.g., STUART BANNER, *ANGLO-AMERICAN SECURITIES REGULATIONS: CULTURAL AND POLITICAL ROOTS, 1600–1860* 88–122 (1998).

8. RUDOLPH E. MELSHEIMER & WALTER LAURENCE, *THE LAW AND CUSTOMS OF THE LONDON STOCK EXCHANGE* 20–21 (1879).

9. MORGAN & THOMAS, *supra* note 6, at 147–48; MELSHEIMER & LAURENCE, *supra* note 8, at 25.

10. Flandreau, *supra* note 3, at 676; MELSHEIMER & LAURENCE, *supra* note 8, at 25.

11. Gillian K. Hadfield, *The Many Legal Institutions that Support Contractual Commitments*, in *HANDBOOK OF NEW INSTITUTIONAL ECONOMICS* 175–200 (Claude Ménard & Mary M. Shirley, eds., 2008).

constraint . . . [led to] various responses by the members of the self-regulating London Stock Exchange . . . The relationship between formal regulation and informal regulation of the London Stock Exchange over time was therefore much more complex than simply reflecting a common law society governed by central government.<sup>12</sup>

To put the point a bit differently, the LSE did much more than ensure that members would honor bargains. Much of its work was devoted to creating and maintaining room to operate with minimal state intrusion. This type of work was especially important, as financial crises repeatedly spawned interest in tightening state regulation of securities transactions.<sup>13</sup> Yet the problem of maintaining independence was not unique to the LSE; to a degree, it will occupy the attention of any self-governing community.<sup>14</sup>

This Article draws on original archival research, including the minutes of LSE committee meetings and correspondence with solicitors, to examine how the LSE managed its relationship with English courts and common law in the late nineteenth and early twentieth centuries.<sup>15</sup> By studying that problem—rather than the problem of enforcing bargains—we can see the artificiality of any neat dichotomy between private and public legal systems.<sup>16</sup> To keep English courts from disrupting its affairs, the LSE used both extralegal tools—for example, expelling members who filed prohibited lawsuits—and legal tools—such as monitoring judicial developments and funding litigation. Regardless of the nature of the tool, lawyers often shaped its response, and their advice was guided by explicitly legal concerns.<sup>17</sup>

The LSE has attracted a great deal of academic study, often by economic historians.<sup>18</sup> Some of the literature discusses the role of lawyers in LSE business

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12. Larry Neal, *The Evolution of Self- and State Regulation of the London Stock Exchange, 1688–1878*, in *LAW AND LONG-TERM ECONOMIC CHANGE: A EURASIAN PERSPECTIVE* 300, 302 (Debin Ma & Jan Luiten van Zanden, eds., Stanford Univ. Press 2013).

13. See BANNER, *supra* note 7, at 88 (stating that when “stock prices endured a period of sustained decline, Parliament would again consider legislation designed to limit the perceived excesses of stockjobbers”).

14. W. Mark C. Weidemaier, *The Role of Lawyers in Removing Economic Activity from State Supervision*, 2019 *J. DISP. RESOL.* 1 (2019).

15. My focus on English courts and common law means that I do not address the separate question of how the LSE responded to the recurring threat of regulation by Parliament. On the history of English securities regulation, see, e.g., BANNER, *supra* note 7.

16. Cf. Hadfield, *supra* note 11, at 200 (noting the “complexity and multiplicity” of institutions that support contracting); Marc Galanter, *Justice in Many Rooms: Courts, Private Ordering, and Indigenous Law*, 19 *J. LEGAL PLURALISM* 1, 18 n.25 (1981) (“Since indigenous systems frequently incorporate cultural elements from the official law and since their sanctioning systems are often entwined with the official ones, no dichotomous distinction can be made.”).

17. Throughout this Article, I refer to material found in the LSE archives at Guildhall Library in London. I reference these sources with the citation format MS X/Y/Z, which includes the MS number of the relevant file or folder (X), the volume number (Y), and the page number or range (Z). Where available, I also include the date or date range of the relevant meeting minutes in parentheses after the citation. Digital files of all archival material referenced are on file with me.

18. Primary histories include RANALD C. MICHIE, *THE LONDON STOCK EXCHANGE: A HISTORY* 1 (1999); MORGAN & THOMAS, *supra* note 6, at 9.

and disputes, but lawyers generally occupy a peripheral place in the story.<sup>19</sup> And lawyers are almost entirely absent from the broader literature on private legal systems.<sup>20</sup> This Article's account brings lawyers to the fore, examining their role in creating and maintaining space for the LSE to engage in self-governance. In practice, the LSE could not entirely prevent English courts from interpreting, applying, and deciding whether to respect its rules. To the contrary, courts routinely heard lawsuits in which the litigants disputed the applicability or meaning of LSE rules and customs. A significant part of the work performed by the LSE's governing committees involved monitoring and responding to such legal developments. This Article thus provides a case study of how one self-governing community created and worked to maintain the integrity of its rules in the face of repeated incursion by state legal actors.<sup>21</sup>

Part II briefly situates this Article within the broader scholarship on private legal systems. Part III describes the LSE's operation and the benefits it derived from private rule-making and adjudication. Part IV then examines the role of English law and courts, which the LSE viewed both as a potential source of default rules and as a constraint on its freedom of action. Part IV focuses on interactions with solicitors. When asked to apply existing rules, or to promulgate new ones, the LSE's governing committees frequently sought legal advice. The solicitors tended to be conservative and prioritized avoiding legal conflict over maximizing room for self-governance. Because the LSE generally deferred to this advice, the effect was to subtly constrain the reach of its private legal system.

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19. For example, Davis, Neal, and White briefly discuss the role of lawyers in resolving the dispute between "optionist" and "constructionist" factions of the LSE. The dispute pitted established against younger members, like Jacob Ricardo, who favored trading in options. Lance Davis, Larry Neal & Eugene N. White, *The Development of the Rules and Regulations of the London Stock Exchange, 1801–1914*, 14–17 (Feb. 27, 2004), <https://as.vanderbilt.edu/econ/sem papers/Neal.pdf> [<https://perma.cc/5XF4-AA6E>] (Unpublished seminar paper, Vanderbilt University). Michie's foundational history of the LSE also discusses the role of lawyers in determining whether the LSE was required to admit women as members after Sex Disqualification (Removal) Act of 1919. MICHIE, *supra* note 18, at 201–02.

20. Perhaps the most direct comparison is to the literature on the International Swaps and Derivatives Association (ISDA), at least some of which explores how ISDA interacts with national legal systems. *See, e.g.*, Sean M. Flanagan, *The Rise of the Trade Association: Group Interactions Within the International Swaps and Derivatives Association*, 6 HARV. NEGOT. L. REV. 211 (2001) (providing a pro-ISDA perspective to its history and activities); Colin Scott & John Biggins, *Public-Private Relations in a Transnational Private Regulatory Regime: ISDA, The State and OTC Derivatives Market Reform*, 13 EUR. BUS. ORG. L. REV. 309, 323–29 (2012).

21. This Article also serves as a mild corrective to scholarship that seems to draw neat distinctions between public and private systems of governance. *See, e.g.*, Edward Peter Stringham & Ivan Chen, *The Alternative of Private Regulation: The London Stock Exchange's Alternative Investment Market as a Model*, 32 ECON. AFFAIRS 37, 37 (2012) ("To most people the choice is between government oversight and no oversight, and the latter sounds undesirable. What they overlook is oversight from the private sector, which historically was the norm.").

## II

## THEORETICAL BACKGROUND

This Article connects to an extensive literature examining the institutional structures that provide transactional assurance to parties who cannot or will not rely on public courts for enforcement.<sup>22</sup> Others have ably reviewed this literature, and I will not repeat their work here.<sup>23</sup> Nevertheless, some brief background will illustrate how this Article differs in its focus from much of the related scholarship.

Parties to any transaction may ask state-funded courts to resolve disputes and can anticipate that other state actors will enforce the judgments of these courts. The literature on private legal systems takes as its subject merchant communities and other groups who opt out of this public legal regime. These parties instead resolve disputes outside of the public courts—often in arbitration<sup>24</sup>—in accordance with specialized rules, and ensure compliance by excluding non-compliant parties from future transactions.<sup>25</sup> Despite its richness and breadth, the literature on such private legal systems tends to focus on a limited set of inquiries.

Perhaps the most central inquiry concerns why parties opt for private over public enforcement. In some cases, the answer is that parties lack access to effective public courts, perhaps because a transaction is unlawful, or because they view public courts and judges as lacking power or competence.<sup>26</sup> Yet even when effective public courts exist, private enforcement may offer efficiency gains.<sup>27</sup> For example, private arbitration may yield cheaper, more accurate results, or might better protect parties who want confidentiality.<sup>28</sup> More fundamentally, private enforcement mechanisms may provide greater incentives to honor agreements. Disputes arising from small transactions, for instance, may not justify the time and expense of litigation, but the threat of exclusion might still induce

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22. Richman, *supra* note 5, at 2329. There is also related literature on self-regulation, which often studies securities exchanges and other financial markets institutions. See, e.g., Paul Mahoney, *The Exchange as Regulator*, 83 VA. L. REV. 1453 (1997); Saule Omarova, *Wall Street as Community of Fate: Toward Financial Industry Self-Regulation*, 159 U. PA. L. REV. 412 (2011); Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2365 (1998).

23. See e.g., RICHMAN, *supra* note 4.

24. See, e.g., Stephen J. Ware, *Private Ordering and Commercial Arbitration: Lasting Lessons from Mentschikoff*, 2019 J. DISP. RESOL. 1 (2019).

25. There are other ways to provide transactional assurance, including vertical integration within a firm. See Richman, *supra* note 5, at 2348–50.

26. See, e.g., Curtis J. Milhaupt & Mark D. West, *The Dark Side of Private Ordering: An Institutional and Empirical Analysis of Organized Crime*, 67 U. CHI. L. REV. 41 (2000); John McMillan & Christopher Woodruff, *Private Ordering Under Dysfunctional Public Order*, 98 MICH. L. REV. 2421 (1999–2000); Ariel Porat, *Enforcing Contracts in Dysfunctional Legal Systems: The Close Relationship Between Public and Private Orders*, 98 MICH. L. REV. 2459 (1999–2000).

27. Richman, *supra* note 5, at 2336–37.

28. See *id.* at 2341 (describing potential efficiency gains from private dispute resolution); see also Bernstein, *supra* note 4, at 124–126 (discussing advantages of arbitration in protecting secrecy and in resolving common disputes in accordance with industry custom). Note that arbitration is private, but not necessarily confidential. The obligation to maintain confidentiality must come from a different source. See Amy J. Schmitz, *Untangling the Privacy Paradox in Arbitration*, 54 U. KAN. L. REV. 1211, 1211 (2006).

compliance.<sup>29</sup> Indeed, private enforcement may offer efficiency gains even for very large transactions. Exclusion and other reputational penalties deny breaching parties the opportunity to gain from future transactions.<sup>30</sup> When these prospective gains are sufficiently large, exclusion imposes costs that may dwarf the expected gains from breach. Private legal systems are thus most likely to arise in relatively close-knit communities, where members are repeat players who will view exclusion as a significant penalty.<sup>31</sup>

The literature on private legal systems is defined by the close study of particular merchant communities and the mechanics by which these communities engender trust, often by reducing information asymmetries.<sup>32</sup> For example, where transactions require a high degree of trust—say, contracts for the sale of valuable and easily-stolen goods like diamonds<sup>33</sup>—a system of arbitration can reveal credible information about the trustworthiness of prospective counter-parties.<sup>34</sup> Other mechanisms for enhancing trust include selective membership criteria and the dissemination of information about a member's propensity to honor agreements.<sup>35</sup>

As noted, however, the literature generally pays relatively little attention to the law and to lawyers. To be sure, law is not entirely absent from the picture. For example, Lisa Bernstein's classic study of the diamond industry notes that, although the threat of expulsion generally assures that members comply with industry arbitration awards, expelled members may have an incentive to challenge their expulsion in court.<sup>36</sup> Even here, though, the law is a bit player. Center stage is occupied by private actors using extralegal tools to enforce bargains.

The LSE has been the object of similar close study, yielding rich accounts of its practices, the regulation of securities markets, and the role of political

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29. Richman, *supra* note 5, at 2343.

30. Bernstein, *supra* note 4, at 124; Karen Clay, *Trade Without Law: Private-Order Institutions in Mexican California*, 13 J. L. ECON. & ORG. 202 (1997).

31. See John McMillan & Christopher Woodruff, *Private Ordering Under Dysfunctional Public Order*, 98 MICH. L. REV. 2421, 2422 (1999–2000) (“In close-knit communities, where people interact with each other frequently and information flows freely, people may adhere to social norms of cooperation because it is in their long-term interest to do so.”).

32. See Avner Greif, *Reputation and Coalitions in Medieval Trade: Evidence on the Maghribi Traders*, 49 J. ECON. HISTORY. 857, 864–65 (1989) (discussing information asymmetries inherent in overseas business transactions through agents).

33. See Barak D. Richman, *How Community Institutions Create Economic Advantage: Jewish Diamond Merchants in New York*, 31 LAW & SOC. INQUIRY 383, 394 (2006) (noting potential gains from cheating and difficulties in ensuring cooperation).

34. Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms, and Institutions*, 99 MICH. L. REV. 1724, 1745 (2001); Paul R. Milgram, Douglass C. North, & Barry R. Weingast, *The Role of Institutions in the Revival of Trade: The Law Merchant, Private Judges, and the Champagne Fairs*, 2 ECON. & POL. 1, 3 (1990); Richman, *supra* note 33, at 396–97.

35. See, e.g., Bernstein, *supra* note 34, at 1765.

36. Bernstein, *supra* note 4, at 129. Bernstein also explains how industry rules discourage such lawsuits by offering expelled members the opportunity for readmission (likely to be denied if the member files a lawsuit challenging the expulsion). The story highlights how law constrains the use of private enforcement tools, and how industry rules seek to minimize the constraint.

considerations in shaping English financial markets.<sup>37</sup> Yet here, too, law and lawyers play peripheral roles.<sup>38</sup> A different story emerges if we shift the focus of inquiry, away from how the LSE enforced bargains, and towards questions about how it managed its relationship to English law and legal institutions. Public attitudes towards the LSE and its members shifted widely over time, as one might expect of an institution associated with recurring financial crises.<sup>39</sup> Moreover, it proved impossible to completely privatize the process of resolving disputes arising from Exchange transactions. Thus, the LSE's practices were frequently considered both before Parliament and before the English courts. Much of its internal work consisted of managing these interactions.

### III

#### THE LSE'S PRIVATE LEGAL SYSTEM

Although its origins date to the mid-eighteenth century, the LSE formally came into existence in 1801 as the Stock Subscription Room.<sup>40</sup> From its inception, the LSE separated ownership from operational control. The construction of the Exchange building was financed by issuing shares to the public. These shareholder-proprietors controlled the building and set subscription fees to be paid by members—from which the proprietors derived their income—but did not make membership decisions or otherwise dictate LSE practices.<sup>41</sup> The Committee of Trustees and Managers represented the proprietors' interests, but its role was largely confined to matters related to the management of the building.<sup>42</sup> The Committee for General Purposes (CfGP) represented the members and conducted day-to-day operations of the Exchange. It established admissions criteria, admitted and expelled members, and wrote and enforced the rules governing Exchange transactions.<sup>43</sup>

The CfGP delegated much of its work to sub-committees. For example, the Sub-Committee on Rules and Regulations wrote, interpreted, and revised rules

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37. Seminal accounts of LSE practices and history include MICHIE, *supra* note 18, MORGAN & THOMAS, *supra* note 6, and DAVID KYNASTON, *THE CITY OF LONDON I-IV* (1994-2001). On the history of English securities regulation, see BANNER, *supra* note 7. For analysis of the intersection between politics and English financial markets, see, e.g., BRUCE G. CARRUTHERS, *CITY OF CAPITAL: POLITICS AND MARKETS IN THE ENGLISH FINANCIAL REVOLUTION* (1996); Bruce G. Carruthers, *Homo Economicus and Homo Politicus: Non-Economic Rationality in the Early 18th Century London Stock Market*, 37 *ACTA SOCIOLOGICA* 165 (1994).

38. See Davis, Neal & White, *supra* note 19. As noted, there are exceptions, although even here lawyers are not the primary subject of interest.

39. BANNER, *supra* note 7, at 88.

40. MICHIE, *supra* note 18, at 15–36.

41. Ranald C. Michie, *The London and New York Stock Exchanges*, 46 *J. ECON. HIST.* 171, 172–73 (1986); Larry Neal & Lance Davis, *Why the London Stock Exchange Dominated the First Age of Globalization, 1801–1914*, 11–12 (Oct. 1, 2005) (unpublished manuscript).

42. See Neal & Davis, *supra* note 1, at 283 (“The Trustee and Managers were responsible for maintaining the building and setting the annual fees.”).

43. See, e.g., MICHIE, *supra* note 18, at 173; Neal & Davis, *supra* note 1, at 282–84. In 1943, control was unified in the Council of the LSE. MICHIE, *supra* note 18, at 297.

governing the conduct of business on the Exchange. If a member challenged a sub-committee's decision, or if the decision implicated a matter of significance to the broader membership, the CfGP's review of that decision could be searching. In most cases, however, confirmation of sub-committee decisions by the CfGP was pro-forma.

Transactions in securities typically involved multiple contracts and multiple parties, only some of whom were LSE members. To take a simple example, a non-member customer might place an order to buy or sell securities through a broker, an LSE member. The broker might carry out these instructions by transacting with a jobber, that is, a dealer, who made a market in the relevant securities. Even such a simple transaction involved multiple contracts. The first was between the broker and his customer.<sup>44</sup> This contract, subject to the law of agency, obliged the customer to indemnify the broker for costs incurred in the ordinary course of LSE business.<sup>45</sup> The second contract, for the purchase and sale of securities, was between the two members. If the selling member did not own the securities, he would have to find someone who did, and this would create yet a third contract. In such a case, the process of settlement—described in more detail later<sup>46</sup>—would ultimately produce a contract between the two non-members, in LSE parlance, the ultimate buyer and seller.<sup>47</sup>

From the LSE's perspective, the contract between members was the one that mattered. LSE rules required members to fulfill bargains "according to the rules, regulations, and usages of the Stock Exchange," whether or not the transaction was permissible under English law and even if the transaction did not comport with the instructions given by the broker's principal.<sup>48</sup> As noted, many contracts—such as forward contracts and options—were unenforceable under English law. The LSE not only enforced such contracts, it treated them as nearly irrevocable.<sup>49</sup> The CfGP could annul bargains, but its powers in this regard were

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44. The LSE resisted admitting women as members until the 1970s. MICHIE, *supra* note 18, at 201–03, 483–84.

45. MELSHEIMER & LAURENCE, *supra* note 8, at 30. As the law developed, it became increasingly clear that English courts would impose this indemnity obligation even when the transaction involved a forward contract or option. *See generally* RUDOLPH E. MELSHEIMER & SAMUEL GARDNER, *THE LAW AND CUSTOMS OF THE STOCK EXCHANGE* 42–43 (1905) (describing cases in which the English courts enforced the indemnity obligation). Moreover, even before the law had developed to this extent, there were contractual workarounds. For example, a broker might require the customer to post a bond for the amount that might be owed on an option contract, and there were judicial decisions allowing brokers to recover against the bond despite the speculative nature of the underlying transaction. *See* MORGAN & THOMAS, *supra* note 6, at 63.

46. *See infra* Part IV.A.1.

47. *See* MELSHEIMER & LAURENCE, *supra* note 8, at 83.

48. *Id.* at 134.

49. Thus, Henry Keyser's 1850 treatise on the law relating to LSE transactions would note "[t]hat [Barnard's] Act has utterly failed to effect its object is well known, for it is alike anomalous as notorious that a numerous and highly-respectable body of men earn their livelihood by the daily and hourly violation of the clauses of the statute." HENRY KEYSER, *THE LAW RELATING TO TRANSACTIONS ON THE STOCK EXCHANGE* 152 (London: Henry Butterworth, 1850).



much more limited than those of a court applying English contract law.<sup>50</sup> LSE rules permitted annulment only in cases of fraud or willful misrepresentation.<sup>51</sup> In the view of the authoritative, contemporaneous guide to LSE practices, “the very notion of attempting to render any bargain void on account of a quibble or technical omission is altogether repugnant to the feeling of the Stock Exchange, and is regarded as dishonourable and discreditable in the highest degree.”<sup>52</sup>

The LSE also tried to limit opportunities for outside legal actors to intervene in its affairs. This desire partly explains rules preventing members from having significant business or debtor-creditor relationships with non-members. For example, members originally could not be incorporated bodies and could form partnerships only with other members.<sup>53</sup> Although the restriction complicated efforts to raise capital, it also eliminated a major source of disputes between members and non-members, which would otherwise have been resolved in the English courts.

The LSE’s system of private dispute resolution was central to its efforts to deter scrutiny by outside legal actors. LSE rules forbade members to sue other members, or another member’s principal, without consent.<sup>54</sup> Instead, disputes between members were resolved through a system of arbitration or by the CfGP itself, in cases where no arbitrator could be found or the dispute affected the general interests of the LSE.<sup>55</sup> The CfGP could suspend or expel any member for refusing to comply with its decisions or an arbitration award, violating LSE rules, or being “guilty of dishonourable or disgraceful conduct.”<sup>56</sup> An aggrieved member might defy these rules and seek recourse in the English courts, but the threat of expulsion kept most in line.<sup>57</sup>

Yet the involvement of non-members kept the LSE from fully privatizing the process of dispute resolution and enforcement. Although customers could voluntarily submit disputes to arbitration or to the CfGP, neither legal compulsion nor extralegal sanctions could prevent customer lawsuits.<sup>58</sup> Indeed,

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50. MELSHEIMER & GARDNER, *supra* note 45, at 104–05 (stating that “[t]he Committee have from the first strenuously insisted upon the carrying out of all bargains irrespective of the view the law might take.”).

51. MELSHEIMER & LAURENCE, *supra* note 8, at 135.

52. MELSHEIMER & GARDNER, *supra* note 45, at 105. The sentiment would have been familiar to members of other merchant communities, for whom a good reputation meant honoring bargains rather than raising legalistic objections. Christian R. Buset, *Merchant Courts, Arbitration, and the Politics of Commercial Litigation in the Eighteenth-Century British Empire*, 34 *LAW & HIST. REV.* 615, 620 (2016).

53. MICHIE, *supra* note 18, at 97.

54. MELSHEIMER & LAURENCE, *supra* note 8, at 134.

55. *Id.* at 135.

56. *Id.* at 127–28.

57. MELSHEIMER & GARDNER, *supra* note 45, at 85. Members also had to apply for readmission each year, and expelled members could seek readmission—the prospect of which provided a further deterrent to filing prohibited lawsuits.

58. Although English law evolved significantly over the time period of interest here, agreements to arbitrate, especially those involving future disputes, were often treated as revocable. On this history, see generally Paul D. Carrington & Paul Y. Castle, *The Revocability of Contract Provisions Controlling Resolution of Future Disputes Between the Parties*, 67 *LAW & CONTEMP. PROBS.*, Winter/Spring 2004, at

English judges frequently presided over customer lawsuits against brokers. A disappointed customer also might file a lawsuit against the jobber involved in the transaction.<sup>59</sup> These are just examples. Litigation could implicate the LSE's interests in many ways.<sup>60</sup>

In most such disputes, English law treated the LSE's written rules, and even its informal customs, as binding on non-members.<sup>61</sup> However, there were exceptions, including for situations in which the transaction was illegal or a court deemed the custom unreasonable.<sup>62</sup> These exceptions proved fertile ground for litigation. Lawsuits involving non-members routinely asked English courts to interpret and apply LSE rules, to adjudicate the reasonableness of these rules, and in other respects to intrude on LSE business. In part for this reason, LSE rules purported to grant the CfGP permission to "intervene in cases where the principal of a member shall attempt to enforce by law a claim which is not in accordance with the rules, regulations, and usages of the Stock Exchange."<sup>63</sup>

#### IV

##### THE LSE'S RELATIONSHIP TO ENGLISH LAW AND COURTS

Like other private legal systems, the LSE's primary enforcement mechanisms were extralegal.<sup>64</sup> Yet to focus entirely on extralegal sanctions is to miss much of the story. English law both informed and constrained LSE rules and practices. Moreover, the LSE's governing committees routinely consulted solicitors and deferred to their advice, which was usually conservative. The ongoing involvement of lawyers limited the reach of the LSE's private legal system, potentially more than the law would have required.<sup>65</sup>

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207, 208 (2004). Moreover, even if it had wanted to do so, the LSE could not credibly threaten customers with extralegal sanctions, such as a bar on future orders placed through the LSE. If nothing else, such a rule would have been almost impossible to enforce.

59. MELSHHEIMER & LAURENCE, *supra* note 8, at 73. Jobbers also might sue another member's principal, although only with the CfGP's permission. *Id.* at 72; MELSHHEIMER & GARDNER, *supra* note 45, at 104.

60. For example, a member who could not fulfill his obligations was declared a defaulter and ceased to be a member. Although LSE rules did not purport to displace the bankruptcy laws, they established an Official Assignee empowered to wind up the defaulter's estate in cases where all creditors were LSE members. Not surprisingly, defaulters occasionally failed to disclose the existence of non-member creditors. In a subsequent bankruptcy, these creditors might challenge the Official Assignee's disposition of assets—for example, as a fraudulent transfer. MELSHHEIMER & GARDNER, *supra* note 45, at 144–46.

61. See MELSHHEIMER & LAURENCE, *supra* note 8, at 73–74 (noting that "on the completion of the bargain between broker and jobber . . . there is a good and valid contract between the principal and the jobber . . . which will be of course interpreted with reference to the customs of the Stock Exchange").

62. Under Barnard's Act, for instance, a broker's right to indemnity from his principal did not extend to purely speculative transactions in which no exchange of securities was contemplated. *Id.* at 42.

63. *Id.* at 134.

64. Barak D. Richman, *Norms and Law: Putting the Horse Before the Cart*, 62 DUKE L.J. 739, 759–60 (2012).

65. See Neal, *supra* note 12, at 300 (noting that the LSE "evolved circumspectly to avoid state regulation").

### A. English Law as a Source of Default Rules and a Constraint on Tailored Rules

Trade associations and similar organizations can support private ordering by promulgating and enforcing standardized rules, by providing information about breach, and by organizing the community's response.<sup>66</sup> To use an example from the time frame relevant here, Jérôme Sgard has documented how the London Corn Trade Association used standardized contracts and a system of private arbitration to create a transnational legal order governing transactions in corn.<sup>67</sup> The LSE played a similar role for securities transactions in London, the preeminent global capital market.

To an extent, its rules were derived from custom that had evolved over many years of securities trading. But the choice of rules was also informed by legal considerations and the guidance of solicitors. This Subpart provides two examples of this pattern. The first reveals how the LSE deferred to English law as a source of default rules for LSE transactions. The second involves deliberation over whether the CfGP should assume a broad power to annul bargains and to bind non-members by the decision. In both examples, the LSE was guided by its solicitors' advice and stopped short of exercising its full rule-making powers.

#### 1. English Law as a Source of Default Rules for LSE Transactions

The first example—and some of those to follow—requires an understanding of how transactions were settled. Although transactions took multiple forms, which evolved over time, here is a simplified description of transactions in registered securities: members would strike an oral bargain for the sale of securities, recording the basic details on slips of paper but not producing a formal written contract. The transaction was consummated later that month during a series of settlement days, although settlement could be delayed even longer.<sup>68</sup> Settlement took several days, one of which—the “name” or “ticket” day—was devoted to identifying the ultimate buyer and seller of the securities.<sup>69</sup> The actual transfer of ownership did not happen until later. Registered securities required the preparation of a transfer deed, which could take time. LSE rules therefore allowed ten days after settlement for the delivery of transfer deeds.<sup>70</sup>

Settlement had two important consequences. First, it discharged the broker and jobber from further liability under their contract. Second, it created a contract between the ultimate buyer and seller, each of whom had now been identified. Of course, given the extended period between bargain and settlement,

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66. McMillan & Woodruff, *supra* note 26, at 2435–45 (2000); Jérôme Sgard, *The Private Governance of a Global Market: The London Corn Trade Association, 1885–1914* (May 2019) (unpublished draft version), <https://extranet.sioe.org/uploads/sioe2019/sgard.pdf> [<https://perma.cc/8P95-BE8G>].

67. *See generally* Sgard, *supra* note 66.

68. *See generally* MELSHEIMER & LAURENCE, *supra* note 8, at 5–20; MELSHEIMER & GARDNER, *supra* note 45, at 9–26.

69. MELSHEIMER & GARDNER, *supra* note 45, at 23.

70. *Id.* at 26.

it was always possible that some event would affect the value of the securities. LSE rules determined who bore the risk of such events. Disputes under the first contract, between members, would be resolved in its private legal system. Disputes under the second contract might wind up in court, but English law deemed LSE rules binding on non-members except in unusual cases.<sup>71</sup>

The first example, from 1927, involved uncertainty over how LSE rules applied to transactions in so-called Renunciation Letters. These letters were used to transfer a seller's right to receive securities that had not yet been issued. After receiving the seller's executed Renunciation Letter, the buyer would deliver the letter to the issuer of the securities, which would record the new owner. In cases where the seller had only partly paid for its allotment of shares, the issuer might call for the balance due before the new owner was registered. If that happened, and the seller made the payment, it could seek indemnification. But from whom—the jobber it had dealt with directly, the broker that had bought the shares from the jobber, or the broker's client, the ultimate buyer of the shares?

In a transaction observing the usual form, the answer was clear. After settlement, the obligation fell on the ultimate buyer. The reason, again, was that settlement discharged the broker from liability and created a contract between the ultimate buyer and seller. However, in a typical transaction, the ultimate buyer's identity was revealed on ticket day.<sup>72</sup> Transactions involving Renunciation Letters departed from this model, in that brokers did not provide a ticket identifying the ultimate buyer. Did this mean the broker was on the hook to the seller?<sup>73</sup>

A dispute between two member firms involving this question arose in July 1927. Brodie James & Co. sold an allotment of shares to Denny Bros., a firm of brokers acting for multiple buyers. The issuer made a call on Brodie James's client, the ultimate seller, for the balance due on the shares. Thereafter, Brodie James sought confirmation that Denny Bros. would indemnify its client for this expense.<sup>74</sup> Having gotten no response, Brodie James asked the CfGP to decide the question.

There appears to have been neither a written rule on the question nor a relevant custom. Rather than announce a rule to fill the gap, the CfGP requested a written opinion from a solicitor, Harold G. Brown, of Linklaters & Paines.<sup>75</sup> Brown opined that, in the absence of an LSE rule or custom, transactions of this

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71. Subject to some uncertainty discussed *infra* at note 159, LSE rules and customs were binding if reasonable or known to the customer. See MELSHEIMER & GARDNER, *supra* note 45, at 42 (noting that the court in *Reynolds v. Smith* held that LSE Rule 94 was not unreasonable and thus binding).

72. The buyer's identity could prove important. The seller could not object to a reasonable buyer but could cancel the transaction in some cases—if, say, the ticket named a buyer who lacked capacity to contract.

73. Recall that under the law of agency, the broker could likely demand that his principal reimburse the expense.

74. See Guildhall Library, MS 14612/6/16 (Aug. 3, 1927). The binder containing these meeting minutes is marked with both a 5 and a 6 on the spine. I use the number 6, which appears on the inside.

75. See THE LAW LIST 411 (London: Stevens & Sons, Ltd. 1908).

sort “would be governed by the ordinary law,” under which “each vendor would be entitled to an indemnity from his immediate purchaser.”<sup>76</sup> The rule implied that Brodie James should indemnify its own client but could then seek reimbursement from Denny Bros., which could, in turn, seek reimbursement from its own clients, the ultimate buyers. The dispute settled before the CfGP made a decision, with Denny Bros. apparently arranging for the issuer of the securities to obtain payment from the ultimate buyers directly.<sup>77</sup>

The episode is noteworthy, in part, because everyone involved seemingly accepted without question that English law would govern. This was not necessarily so. The primary constraint on the CfGP’s discretion came from the risk that the ultimate parties, all non-members, would refuse to accept the outcome. Assume, for example, that the CfGP issued a ruling that purported to immunize Brodie James from any obligation to indemnify its own client. If the ultimate seller sued Brodie James anyway, the court might resolve the dispute in accordance with English law given the lack of an applicable LSE rule or custom. In this sense, English law was clearly *relevant* to the CfGP’s inquiry. Yet the law was not dispositive. For instance, nothing prevented the CfGP from deciding that the brokers should indemnify the ultimate seller whatever English law might have to say on the subject.<sup>78</sup> But there is no indication that the CfGP ever considered resolving the dispute except in accordance with English law—although of course the settlement meant there was no final decision.

The dispute between members did prompt the CfGP to ask the Sub-Committee on Rules and Regulations to consider whether to amend LSE rules. After considering the solicitor’s letter and little else, the Sub-Committee recommended no change.<sup>79</sup> The result left a gap in the rules, presumably to be filled by English law.

## 2. English Law as a Constraint on Tailored Rules

The preceding example illustrates how English law supplied default rules for some LSE transactions. This is, of course, an important function of state-created law. Parties may defer to state-created law because it matches their preferences or because they find it prohibitively costly to draft better rules.<sup>80</sup> So perhaps it is to be expected that the LSE borrowed default rules from English law. Yet even

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76. Guildhall Library, MS 14612/6/15 (Aug. 3, 1927).

77. The letters notifying the CfGP of the settlement bear the same date as the solicitor’s letter, although it is not clear whether Brown’s opinion influenced the settlement or was even known to the member firms. The letters from the member firms do not reference Brown’s letter and give the impression that Denny Bros. had been working for some time to resolve the matter. Guildhall Library, MS 14612/6/16–17 (Aug. 8, 1927).

78. The brokers would have complied with the decision or risked expulsion, and could in any event seek reimbursement from their own clients.

79. Guildhall Library, MS 14612/7/6–7 (July 11, 1933).

80. See, e.g., Charles J. Goetz & Robert E. Scott, *The Mitigation Principle: Toward a General Theory of Contractual Obligation*, 69 VA. L. REV. 967, 971 (1983) (“Ideally, the preformulated rules supplied by the state should mimic the agreements contracting parties would reach were they costlessly to bargain out each detail of the transaction.”).

when the LSE seriously considered adopting rules tailored to its own needs, English law could be a constraint. A second example illustrates the point.

In this example, the Council of the LSE (the Council), the CfGP's successor, considered expanding its power to annul bargains.<sup>81</sup> Interest in the change was prompted by public controversy about trading in Italian sovereign bonds and related debt in the wake of the end of the Second World War. In April 1947, the Italian government agreed on the outline of a plan to resume payments on prewar debt due to Britain.<sup>82</sup> Implementation of the agreement was delayed, and negotiations continued into early 1948.<sup>83</sup> The settlement terms were officially revealed on January 29, 1948, but a leak of information appears to have prompted significant trading on the day before the announcement.<sup>84</sup> Many LSE members believed trades had been based on inside information and demanded an investigation.

The Council acted quickly, announcing the following day that it had canceled a number of bargains with the consent of all parties. Although it asserted that no LSE member had known the terms of the settlement, the Council apparently was not satisfied that "the clients concerned were innocent of prior knowledge."<sup>85</sup> At the time, Rule 74 allowed the Council to annul bargains only "upon a specific allegation of fraud or willful misrepresentation or upon *prima facie* evidence of such material mistake in the bargain as in their judgement renders the case one which is fitting for their adjudication."<sup>86</sup> Contemporaneous press reports noted that the rule did not allow annulment of bargains in which one party traded on inside or confidential information.<sup>87</sup> If an English court shared that understanding, non-members could have sued to enforce transactions annulled over their objection. For that reason, the Council limited its intervention to cases in which all parties agreed to cancel the transaction.

The episode prompted the LSE to consider rule revisions to expand the power to annul bargains and to make clear that annulment bound non-members. As usual, the question was delegated to the Sub-Committee on Rules and Disputes, the successor to the Sub-Committee on Rules and Regulations. One proposal was to grant the LSE sweeping power to annul bargains, without any substantive standard to guide the decision. As revised, the rule would have provided: "The Council may annul any bargain if, after making such enquiries as

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81. The Council was the LSE's governing body after the merger of the Committee for General Purposes and the Committee of Trustees and Managers. See MICHIE, *supra* note 18, at 297.

82. *Italian Debt Service*, THE ECONOMIST, Jan. 31, 1948, at 198.

83. *Id.*

84. *Suspected Leakage of Italian Debt News*, THE FINANCIAL TIMES, Jan. 30, 1948, Edition 18, 332, column 3, at 1.

85. *Italian Bond Dealings: Some Bargains Canceled*, THE FINANCIAL TIMES, Feb. 3, 1948, Edition 18, 335, column 2, at 4.

86. RULES AND REGULATIONS OF THE STOCK EXCHANGE 43 (A.L.F. Green ed., 1938).

87. *Italian Bond Dealings: Some Bargains Canceled*, *supra* note 85, column 2, at 4.

they think fit, they are satisfied that the circumstances in which the bargain was made were such as in their judgment would justify its annulment.”<sup>88</sup>

A competing proposal more directly targeted dealing in confidential information: “The Council may in their absolute discretion annul a bargain either on the ground of material mistake or if in their opinion there is evidence of fraud or improper use of information which should have been regarded as confidential or secret.”<sup>89</sup>

The Sub-Committee repeatedly sought guidance from solicitors on these proposals, including on whether it was possible to bind non-members.<sup>90</sup> One early meeting was attended by Sam W. Brown, of Linklaters & Paines. Brown asserted that it would “be a pity” to alter LSE rules recognizing the “sanctity of bargains,” but he had also submitted a letter advising that the LSE had ample freedom of action.<sup>91</sup> The letter recounted a meeting with another solicitor, W. Gordon Brown, with whom Sam Brown had discussed the matter. With regard to the first option—giving the LSE nearly unfettered annulment authority—the letter expressed the practical concern that the change might prompt “a possible flood of applications for annulment.”<sup>92</sup> But whichever path the LSE took, the letter left no doubt that non-members would be bound by the rule: “[P]urchases or sales of securities by members of the public, through the medium of the Stock Exchange, are subject to the Rules and Regulations of the Stock Exchange.”<sup>93</sup>

Minutes from this early meeting of the Sub-Committee reveal debate about the wisdom of a rule change. The matter was considered important enough that the Sub-Committee requested a formal opinion letter from W. Gordon Brown.<sup>94</sup> This letter, ultimately signed by W. Gordon Brown and Cyril Radcliffe, provided starkly different advice. The solicitors advised that, under English law, an LSE rule or custom bound non-members only if it (i) was intended to have this effect and (ii) was either reasonable or known to the customer at the time of the transaction.<sup>95</sup> In their view, Rule 74 as written was not intended to bind non-members and therefore gave the LSE no power whatsoever to annul bargains in a way that affected a non-member’s rights.<sup>96</sup> Moreover, they advised that even if Rule 74 were revised to expressly bind non-members, “the case would fall within the principle of ‘unreasonable’ customs in markets, since so wide a power to

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88. Guildhall Library, MS 14612/9/36 (Mar. 17, 1948).

89. *Id.*

90. Other questions included whether the proposals risked expanding the potential grounds for libel or slander lawsuits against the LSE.

91. Guildhall Library, MS 14612/9/37 (Mar. 17, 1948).

92. *Id.* at 36.

93. *Id.* The only qualification expressed was that the annulment would have to occur before the bargain “was completed,” that is, before a contract came into existence between the ultimate buyer and seller.

94. *Id.* at 37–38.

95. Guildhall Library, MS 14612/9/40-41 (Aug. 29, 1947). The question was in some doubt after the 1903 decision in *Benjamin v. Barnett*. See *infra* notes 160–78.

96. Guildhall Library, MS 14612/9/41 (June 2, 1948).

annul contracts otherwise than on legal grounds would, in [their] opinion, be unreasonable.”<sup>97</sup> In consequence, an amended rule—here, the solicitors did not distinguish between the two proposals—would bind only those non-members who knew of the rule at the time of the transaction.

W. Gordon Brown and Cyril Radcliffe were extremely prominent solicitors and perhaps accustomed to having clients defer to their opinions.<sup>98</sup> But it is notable that they dismissed both proposed revisions as “unreasonable” without any further explanation and without referring to a single English legal authority that supported this view.<sup>99</sup> The omission cannot readily be attributed to legal custom in the writing of opinion letters. Other parts of the letter include extensive references to English case law, yet the authors apparently felt no need to offer such authority to justify the core of their advice. I am in no position to dispute their intuition, and I have found no cases that squarely address the topic. However, English law did permit contracting parties to specify grounds for termination of the contract.<sup>100</sup> It is true that the situations the law had confronted bore little resemblance to what the LSE had in mind.<sup>101</sup> And perhaps English courts would have been deeply skeptical of the first proposal, which gave the CfGP unfettered discretion to annul bargains. But the second proposed amendment only modestly expanded the LSE’s annulment authority to include cases in which a party made “improper use” of confidential information.<sup>102</sup>

Nevertheless, the letter seems to have satisfied the Sub-Committee, which recommended no change to LSE rules. The Council adopted the recommendation. The uproar over the Italian debt settlement had faded, and perhaps this tempered the push to expand the LSE’s annulment powers. But the episode illustrates another way in which English law constrained the reach of the LSE’s private legal system. More particularly, it reveals two noteworthy tendencies in LSE’s reliance on lawyers. First, the LSE deferred greatly to its solicitors’ advice about whether a rule change might provoke conflict with the English courts. Second, the solicitors gave quite conservative advice, in which the desire to avoid legal scrutiny effectively trumped the desire to maximize the LSE’s power to make and enforce rules. As we will see, these tendencies recur throughout the period covered by this Article.

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97. *Id.*

98. Most famously, or infamously, Radcliffe was responsible for the map partitioning India and Pakistan.

99. Guildhall Library, MS 14612/9/41 (June 2, 1948).

100. *See, e.g.*, SIR WILLIAM R. ANSON, PRINCIPLES OF THE ENGLISH LAW OF CONTRACT AND OF AGENCY IN ITS RELATION TO CONTRACT 411–22 (16th ed. 1923).

101. Anson’s tome discusses, among other things, force majeure and similar clauses. *See id.*

102. There were other reasons, perhaps sufficient in their own right, to reject the proposed amendment. For example, as the solicitors noted, the proposal would have necessitated changes to a number of other rules. It might also have created greater risk of litigation alleging libel or slander.



## B. Managing the Relationship with English Courts

Thus far, we have seen that English law operated both as a set of default rules and as a constraint on the LSE's ability to adopt tailored rules. Of course, the LSE retained a great deal of freedom to adopt specialized rules, especially to govern members, for whom the threat of exclusion encouraged compliance. But English law and courts also constrained the use of extralegal sanctions. The constraint was magnified by the LSE's general reluctance to have English courts interpret its rules or rule on the legality of disciplinary decisions. At times, this reluctance led the CfGP to let significant rule violations go unpunished.

### 1. Punishing Members for Filing Prohibited Lawsuits: Judicial Scrutiny as a Check on Extralegal Sanctions

In one notable episode in 1915–1916, a member, Halfhead, filed a lawsuit seeking the appointment of a receiver to wind up his partnership with another member. The lawsuit violated the spirit if not the letter of at least two rules. Rule 71 required “all disputes between Members” to be arbitrated or resolved by the CfGP, and Rule 72 forbade members to “attempt to enforce by law against another Member a claim arising out of a Stock Exchange transaction . . . .”<sup>103</sup> These rules were at the core of the LSE's private legal system, and it took violations seriously. Nevertheless, after being instructed by the CfGP to immediately discontinue his lawsuit, Halfhead cheekily replied that “he regretted that he must go on.”<sup>104</sup> Continued disobedience prompted the CfGP to suspend Halfhead indefinitely, but it held this decision in abeyance after receiving a threatening letter from Halfhead's lawyer. Instead, the CfGP referred the matter to its solicitors.<sup>105</sup>

The solicitors recommended against suspending Halfhead.<sup>106</sup> In their view, Rule 72's prohibition on lawsuits “arising out of a Stock Exchange transaction” applied only to disputes over “some specific bargain made on the Stock Exchange . . . .”<sup>107</sup> Moreover, Rule 71 could not possibly mean what it appeared to say:

“[A]ll disputes between members” must clearly receive some limitation; private quarrels which have nothing to do with the Stock Exchange cannot be included, or the rule would be *ultra vires* the Committee. In our opinion, the Rule only applies to disputes between members arising out of Stock Exchange transactions, and does not extend the jurisdiction of the Committee any further than Rule 72.<sup>108</sup>

The interpretation is plausible but not especially compelling. We may concede that English courts would not enforce an arbitration requirement for

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103. RULES AND REGULATIONS OF THE STOCK EXCHANGE 30–31 (Edward Satterthwaite ed., 1911).

104. Guildhall Library, MS 14600/98/41–42 (Oct. 11, 1915).

105. *See generally* Guildhall Library, MS 14600/98/41–201 (Oct. 11–Dec. 13, 1915).

106. Guildhall Library, MS 14612/3/86–88 (Jan. 27–Feb. 3, 1916).

107. *Id.* at 86.

108. *Id.* at 87. An earlier draft of the letter appears at Guildhall Library, MS 14600/98/263–64 (Jan. 3, 1916).

disputes having “nothing to do with the Stock Exchange.”<sup>109</sup> *This* dispute, however, was between two LSE members and concerned the winding up of a partnership that existed to buy and sell securities on the Exchange.<sup>110</sup> Certainly the text of Rule 71 encompassed such disputes. And even if that rule was read narrowly to encompass only disputes arising “out of a Stock Exchange transaction,” *this* dispute plausibly satisfied that standard. The partners’ disagreement concerned how to respond to widespread defaults by partnership clients on transactions that did not settle due to a halt in trading prompted by the onset of the First World War. The partnership was left holding the securities, and the partners disputed whether to sell the securities or to keep them in the hope of a rise in price.<sup>111</sup> It is hardly a stretch to argue that such a dispute arises out of Stock Exchange transactions.

The point is not that the lawyers were wrong; they may well have been right. Certainly two senior English solicitors were better able to predict the outcome of litigation than a U.S.-trained lawyer writing a century after the fact. The episode is another example, however, of how the LSE sought to avoid going to court to defend its interpretation of the rules or its imposition of extralegal sanctions. Although the initial resolution suspending Halfhead had passed unanimously,<sup>112</sup> the CfGP reversed course, with nineteen of the twenty-six members present voting not to confirm the resolution.<sup>113</sup> Rather than push the issue against Halfhead, the CfGP revised the rules to ensure that future partnership disputes were subject to the arbitration requirement.<sup>114</sup> Thus, the LSE avoided litigation and strengthened its private dispute resolution system, although at the cost of tolerating a member’s significant rule violation and very public defiance of its authority.<sup>115</sup>

## 2. Litigation Involving Non-Members: Defending the LSE’s Reputation and Right to Self-Governance

Some disputes could not be kept out of the courts. The problem, as always, concerned litigation involving non-members. Much of the LSE’s work consisted of monitoring and responding to these developments. Perhaps the most

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109. English law traditionally viewed arbitration agreements with skepticism, although this tendency waned over the course of the nineteenth century. *See infra* notes 188–90 and accompanying text.

110. LSE rules required that all partners be members of the LSE. RULES AND REGULATIONS OF THE STOCK EXCHANGE, *supra* note 103, at 24–25.

111. Guildhall Library, MS 14600/98/199–200 (Dec. 13, 1915).

112. Guildhall Library, MS 14600/98/190 (Dec. 8, 1915).

113. Guildhall Library, MS 14600/98/264 (Jan. 3, 1916).

114. The revision drafted by the Sub-Committee, which the CfGP ultimately approved, consolidated Rules 71 and 72 into one rule and expanded the arbitration requirement to include “[a]ll disputes . . . connected with Stock Exchange business and including partnership disputes.” Guildhall Library, MS 14612/3/55–62 (Apr. 22–June 9, 1913) & 86–99 (Jan. 17, 1916).

115. In an 1894 memorandum, the Secretary of the CfGP described how the LSE’s rules concerning the expulsion of members had evolved. A copy of the memorandum is included in the minutes of the Nov. 7, 1894 meeting of the Sub-Committee on Rules and Regulations. *See* Guildhall Library, MS 14612/2/4–6.

important aspect of this work involved defending the principle that LSE rules bound non-members, at least when the rule was reasonable or known to the non-member at the time of the transaction.<sup>116</sup> This was a well-established rule of law, but English judges occasionally made comments that seemed to call the rule into doubt or to undermine the credibility of the LSE.

The case of *Tomkins v. Saffery*<sup>117</sup> is an example.<sup>118</sup> A member, Cooke, could not fulfill his Exchange obligations and was declared a defaulter. Although its rules did not purport to displace the bankruptcy laws,<sup>119</sup> the LSE established an Official Assignee empowered to wind up the defaulter's estate in cases where all creditors were LSE members. After Cooke represented that he had no creditors outside the LSE, the Official Assignees accepted a transfer of the bulk of Cooke's assets, consisting of five thousand pounds, and distributed them among Cooke's LSE creditors.<sup>120</sup> In fact, Cooke's father-in-law, who was not a member, was a creditor and filed a petition in bankruptcy against Cooke.<sup>121</sup>

The bankruptcy trustee sought to recover the five thousand pounds from the Official Assignees. Although the bankruptcy judge refused to grant this relief, the Court of Appeals reversed, reasoning that Cooke's transfer of the funds was a voluntary surrender—*cessio bonorum*—of his estate and thus in itself an act of bankruptcy. The court therefore required the Official Assignees to return the money and to pay the costs of the appeal.<sup>122</sup> The legal reasoning underlying the judgment did not necessarily imply criticism of the LSE. Nevertheless, the LSE was deeply concerned by certain aspects of the judgment, delivered by Lord Justice James. In the reporter's account, the Lord Justice characterized Cooke's transfer of funds, and the Official Assignees' acceptance of the money, as "a plain and palpable fraud on the bankruptcy laws—a plain and palpable fraud upon the creditors."<sup>123</sup> His description of the Official Assignees' argument was especially unflattering:

An insolvent on the eve of bankruptcy takes some of his creditors' money to provide himself with a comfortable resting place after his bankruptcy, and the body of his Stock Exchange creditors say to him: "Cheat your other creditors for our benefit, and we will re-admit you as a proper and worthy member of our fraternity." If anything were wanting, this supplies it. It shows how improper and utterly illegal the whole of the transaction was.<sup>124</sup>

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116. See MELSHEIMER & GARDNER, *supra* note 45, at 34 (discussing the relationship between brokers and their principals); *Id.* at 118 (discussing the contract formed between the ultimate buyer and seller).

117. *Tomkins v. Saffery* [1877] 3 HL 138 (appeal taken from App. Ct. in Bankruptcy).

118. NATHANIEL C. MOAK, REPORTS OF CASES DECIDED BY THE ENGLISH COURTS 161 (24th ed. 1880).

119. On the evolution of which, see Jérôme Sgard, *Courts at Work: Bankruptcy Statutes, Majority Rule, and Contracting in England (17th–18th Century)*, J. OF COMPARATIVE ECON., at 3–4 (forthcoming).

120. MOAK, *supra* note 118, at 140.

121. *Id.*

122. *Ex parte Saffery–In re Cooke* (1876) 4 Ch. D 555 at 555 (Eng.).

123. THE ACCOUNTANT 9 (5th ed. 1879).

124. JUSTICE OF THE PEACE AND LOCAL GOVERNMENT REVIEW REPORTS 2157 (143rd ed. 1979).

The Lord Justice concluded: “[T]he Stock Exchange is not an Alsatia; the Queen’s laws are paramount there, and the Queen’s writ runs even into the sacred precincts of Capel-court.”<sup>125</sup>

The LSE funded an appeal to the House of Lords. The goal was not to change the outcome, which would have been “hopeless.”<sup>126</sup> The Court of Appeals had gotten it right; LSE rules could not alter the distribution a non-member was entitled to receive in a debtor’s bankruptcy. Lord Justice James’s remarks, however, “were considered to contain an aspersion upon the whole body and its customs,” and the appeal sought to correct these seemingly “grave misapprehensions” about the LSE and its practices.<sup>127</sup>

On that score, the appeal was a resounding success. The House of Lords affirmed the decision of the Court of Appeals, but each of the Law Lords took pains to portray the LSE and its rules in complimentary terms.<sup>128</sup> The LSE’s procedures for allocating a defaulter’s assets were “very wise and expedient,”<sup>129</sup> and there was “nothing in the case which impeaches the integrity, in purpose or in action, of the Stock Exchange.”<sup>130</sup> The case was watched closely by the press, which likewise interpreted the decision by the House of Lords to have “fully exonerated the Committee of the Stock Exchange from the imputation that their rules were framed with the view of securing a fraudulent preference in favour of members of their own body as against the general creditors of a defaulting member.”<sup>131</sup> Indeed, Lord Justice James later expressed surprise “to hear it had been supposed that he had meant to make injurious reflections upon the conduct of the Stock Exchange.”<sup>132</sup>

### 3. Responding to Misinterpretation of LSE Rules and Other Legal Shocks

As discussed earlier, many LSE rules were intended to bind non-members and had this effect so long as reasonable or known to the non-member.<sup>133</sup> For example, in determining whether a broker acted within the scope of his authority, courts would interpret a customer’s order in light of LSE custom.<sup>134</sup> Of course, this assumed the judge could identify the relevant rule and interpret it as the LSE had intended, and this could not be guaranteed. A judge might also interpret English law in unexpected ways, with disruptive consequences for LSE practices.

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125. *Saffery*, 4 Ch D at 561.

126. MELSHEIMER & GARDNER, *supra* note 45, at 105.

127. *Id.*

128. *Tomkins v. Saffery* [1877] 3 HL 138 (appeal taken from App. Ct. in Bankruptcy).

129. *Id.* at 161 (Lord Gordon).

130. *Id.* at 152 (Lord Blackburn).

131. *Law Report: Tomkins and Another v. Saffery*, THE TIMES, Nov. 16, 1877, at 10.

132. *Law Report: Supreme Court of Judicature: Tomkins v. Saffery*, THE TIMES, Nov. 23, 1877, at 11.

133. *See supra* Part IV.B.2.

134. *See, e.g., Mitchell v. Newhall* (1846) 153 Eng. Rep. 867, 867 (interpreting customer’s order for “shares” in a corporation to allow broker to purchase an allotment of to-be-issued shares).

One example, from 1871, implicated LSE rules governing deeds of transfer, which were used for transactions in registered securities.<sup>135</sup> A common problem involved allocating liabilities resulting from delay. The seller could not prepare the deed until it learned the buyer's identity, which was supplied by ticket during settlement. If the seller did not receive this ticket within the period set by the rules, it could resell the securities and seek compensation for any loss. Likewise, a buyer who did not receive the securities within the allowed window after settlement could cover by purchasing the securities elsewhere, seeking compensation for any increase in price.<sup>136</sup> Tickets often passed through the hands of many intermediate buyers and sellers, making it hard to allocate responsibility for delay. Consider a scenario in which a buyer did not receive the securities in time, covered, and sought compensation for the difference between the cover price and the contract price. Which party in the chain of ticket-holders was responsible? LSE's complex rules on the subject included both technical requirements—for example, record-keeping obligations—and soft standards—for example, allowing the ultimate seller to escape liability if an LSE member caused "undue delay."<sup>137</sup>

These and other LSE rules constituted a set of standardized terms created to govern contracts between members and, to the extent possible, transactions involving non-members. LSE rules effectively determined the parties' rights and obligations even if not expressly incorporated into the contract. With respect to contracts between members, LSE rules were not mere gap-fillers; they were mandatory terms imposed as a matter of course in the LSE's private dispute resolution system.<sup>138</sup> With respect to contracts between brokers (as agents) and customers (as principals), English courts presumed that customers intended for orders to be carried out in accordance with the usual practice on the LSE.<sup>139</sup> As for the contract that eventually resulted between the ultimate buyer and seller—neither an LSE member—courts likewise treated the parties as if they had implicitly agreed to be bound by LSE rules.<sup>140</sup> To be sure, few if any of these contracts expressly referenced or incorporated the rules. Nor were most transactions documented through standard-form contracts promulgated by the

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135. Upon receipt of the deed from the seller, the buyer would sign and deliver it to the registrar of the shares, which could then record the new owner's identity.

136. For background on these and other problems in transactions in registered securities, see generally MELSHEIMER & LAURENCE, *supra* note 8, at 58–59, 93–99.

137. *Id.* at 59. Lawsuits could implicate these rules. For example, consider a suit by an LSE member who had paid compensation to the buyer, seeking reimbursement from the original owner of the shares—in LSE-parlance, the ultimate seller.

138. RULES AND REGULATIONS OF THE STOCK EXCHANGE, *supra* note 103, at 30 (stating that bargains between members "must be fulfilled according to the Rules, Regulations and usages of The Stock Exchange").

139. MELSHEIMER & GARDNER, *supra* note 45, at 34. The conclusion of a bargain between broker and jobber created a contract between the jobber and the broker's principal, which was likewise interpreted in accordance with LSE Rules. *Id.* at 106–07.

140. *Id.* at 118.

LSE itself.<sup>141</sup> As noted, most bargains between members were oral. But given the LSE's sway over its members and the general tendency of English courts to defer to its rules, there was little need for such formalities.<sup>142</sup>

In some contexts, a court's misinterpretation of standardized contract language can have enduring negative consequences. In theory, the misinterpretation need not affect future transactions, for the form's drafter can revise the relevant clause to clarify its meaning. In practice, inertia often prevails. Parties may continue to use the same formulation of a clause long after legal developments have made that formulation problematic.<sup>143</sup> Put differently, standardized forms offer benefits but can also be "sticky."

Trade associations and other organized merchant groups can help produce and maintain the integrity of standardized contracts.<sup>144</sup> The LSE proved adept at such work. In July 1871, the Sub-Committee on Rules and Regulations noted that recent decisions by English courts had highlighted "certain ambiguities" in the rules governing securities delivered by deed of transfer.<sup>145</sup> The Sub-Committee prepared, and the CfGP approved, revisions "so as to render [the rules] more clear in arrangement, and more precise in expression."<sup>146</sup> Work of this nature was a routine part of Exchange governance. The meeting minutes of the CfGP and the Sub-Committee on Rules and Regulations reveal nearly constant consideration of rule changes, often in response to developments in the English courts and frequently based on extensive advice from solicitors.

A second example, from 1917, involved a disruptive legal event that wreaked havoc on the LSE's method for administering defaulters' estates. The event was an unexpected interpretation of English law in the case of *In re Halstead*.<sup>147</sup> As noted, LSE rules empowered an Official Assignee to collect and distribute a defaulter's assets when there were no creditors outside the LSE. If a member became the subject of bankruptcy proceedings, however, the bankruptcy invalidated any transfer of assets to the Official Assignee—at least when the transfer occurred within three months of the bankruptcy.<sup>148</sup> (As in *Tomkins v.*

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141. There were some exceptions. For instance, the LSE created a standard-form submission agreement for cases in which a non-member voluntarily submitted to the LSE's private dispute resolution system.

142. Conceivably, English courts might have relaxed the rule that non-members were bound only by "reasonable" LSE rules if the LSE had insisted that members and their customers use written contracts that expressly referenced the rules. As noted *infra* at note 159, however, English law generally presumed that customers knew the rules, and the LSE's solicitors advised that only reasonable rules would be enforced against non-members.

143. MITU GULATI & ROBERT E. SCOTT, *THE THREE AND A HALF MINUTE TRANSACTION: BOILERPLATE AND THE LIMITS OF CONTRACT DESIGN* 9–12 (2013).

144. See Kevin E. Davis, *The Role of Nonprofits in the Production of Boilerplate*, 104 MICH. L. REV. 1075 (2006); Sgard, *supra* note 66.

145. Guildhall Library, MS 14600/35/225 (July 18, 1871)

146. *Id.*

147. *In re Halstead—Ex Parte Richardson* (1916) 22 TLR 718, 718 (Eng.).

148. For background, see generally *International Law*, 52 CAN. L.J. 329, 340–41 (1916).

*Saffery*, the assets belonged to the bankruptcy estate for distribution in accordance with English law.<sup>149</sup>)

This was all viewed as settled law. In the *Halstead* case, a bankruptcy judge unexpectedly ruled that, because of recently-enacted legislation, LSE procedures for administering defaulters' estates had to comply with the statute governing deeds of arrangement. These instruments memorialized a debtor's voluntary assignment of assets to creditors outside of bankruptcy, and the statute required that the deed be registered.<sup>150</sup> This was entirely contrary to LSE practice, which treated the administration of defaulters' estates as a matter of purely internal concern.

The LSE's solicitors interpreted the *Halstead* ruling to forbid the Official Assignee to administer estates, and to block the CfGP from resolving related disputes, until a deed of arrangement had been prepared and registered in accordance with the statute.<sup>151</sup> The CfGP funded an appeal to the Court of Appeals, which affirmed the bankruptcy judge's ruling.<sup>152</sup> There followed extensive deliberations over whether to continue the appeal to the House of Lords or to revise LSE rules to bring them in compliance with the statute governing deeds of arrangement. As its solicitors noted, the latter course raised numerous difficult questions—such as whether and how to make rule changes retroactive to “the cases of defaults and liquidations which have taken place” since the legislation amending the deed of arrangements statute.<sup>153</sup> Despite these difficulties, the CfGP elected to bring LSE rules into compliance with the statute.<sup>154</sup>

#### 4. Constraints on the Ability to Respond to Unexpected Developments in the English Courts

The *Halstead* case was an extreme example of how developments in the English courts could disrupt practices on the LSE. In a more common scenario, a judge would adopt an unexpected interpretation of LSE rules. As we have seen, one response was for the LSE to revise its rules to clarify the meaning. The LSE made such amendments frequently, but they were not costless. The amendment process consumed committee time, might require money for solicitors, and could be blocked by internal divisions among members. Moreover, the LSE shied away

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149. See *supra* note 126 and accompanying text.

150. Before it was amended, the statute applied only to compositions between the debtor and all creditors. See *International Law*, *supra* note 148, at 341. As a technical matter, the statute might have applied to proceedings before the Official Assignee. But even if so, it did not matter when all creditors were LSE members; English courts did not hear these cases.

151. See Guildhall Library, MS 14612/3/164–67 (May 10, 1917); MS 14612/3/196–200 (Aug. 23, 1917).

152. See Guildhall Library, MS 14600/101/101–02 (Feb. 5, 1917).

153. Guildhall Library, MS 14600/101/102 (Feb. 5, 1917).

154. See *generally* Guildhall Library, MS 14600/101.

from rule changes that might invite judicial scrutiny, as illustrated by the abandoned effort to expand the CfGP's annulment authority.<sup>155</sup>

Another response to a problematic judicial decision was for the CfGP to fund an appeal. We have seen that the LSE sometimes did this to great effect—for example, in *Tomkins v. Saffery*.<sup>156</sup> But appeal was no panacea. The separation between owners and members, paired with the owners' control over the purse strings, limited the funds available for appeal. There was also a broader, structural limit on the utility of the appellate process. The likelihood of a successful appeal is partly a function of choices made during trial, and the CfGP did not control these choices. The LSE itself was not a party to lawsuits affecting its interests.<sup>157</sup> At times, the CfGP did not even know about relevant litigation until after the trial court's ruling. By then, it might be too late.

Consider the 1903 case of *Benjamin v. Barnett*.<sup>158</sup> The case would prove problematic for decades. For instance, it arguably created a separate legal test for determining whether a non-member was bound by LSE custom, as opposed to a written rule.<sup>159</sup> But the most immediate problem was not that the case introduced doctrinal uncertainty. The problem was that the judge had misapplied LSE rules and called into question their ability to bind members and non-members alike.<sup>160</sup>

The underlying transaction involved the purchase of seventy shares in the Transvaal Exploration Company. Benjamin, a broker, agreed to buy the shares from a firm of jobbers on the instructions of his non-member customer, Barnett.<sup>161</sup> The company initially refused to certify fifty of the shares, causing a delay in delivery.<sup>162</sup> Thus, Benjamin attempted to deliver only twenty shares, and even these he tendered to Barnett after the time period contemplated by LSE

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155. See Guildhall Library, MS 14612/7/21, (Sep. 14, 1933) (noting that it would be “difficult to make a rule which superceded the authority of the Courts”).

156. See *supra* note 126 and accompanying text.

157. The rules purported to give the CfGP power to intervene in lawsuits, but no one thought this gave the CfGP the right to become a party. See *infra* note 183 and accompanying text.

158. *Benjamin v. Barnett* (1903) 19 TLR 564, 564 (KB).

159. Expressed in modern terms, the distinction seems to have been that non-members presumptively had knowledge of written rules. Therefore, the rules were binding, whether reasonable or not. But the presumption was reversed for informal customs. Without proof of a member's actual knowledge, the court would enforce the custom only if reasonable. As late as 1948, the LSE's solicitors were disputing that the law in fact recognized this distinction. See Guildhall Library MS 14612/9/40 (June 2, 1948) (stating that even though many cases of the Court of Appeal did not refer to a “distinction between a rule and a custom” this did not “justify the distinction drawn by Kennedy J in” *Benjamin v. Barnett*).

160. See *Benjamin*, 19 TLR at 565 (stating that the rule in question “was not binding on the defendant” or even the plaintiff).

161. *Id.* at 564.

162. *Id.* The certificate affirmed that the transferor was in fact registered as the owner of the shares. See MELSHIMER & LAURENCE, *supra* note 45, at 98.



rules.<sup>163</sup> Barnett refused to accept any of the shares.<sup>164</sup> Subsequently, the CfGP ordered Benjamin to pay for the remaining fifty shares when delivered by the jobbers.<sup>165</sup> Benjamin did as instructed and sued Barnett to recover his costs.<sup>166</sup>

The court found Barnett liable for the twenty shares but ruled that he had no obligation to indemnify Benjamin for the remaining fifty.<sup>167</sup> This was so notwithstanding the fact that the CfGP had required Benjamin—on pain of expulsion from the LSE<sup>168</sup>—to honor his contract with the jobbers.<sup>169</sup> In the view of Justice Kennedy, the presiding judge, the remaining fifty shares had been tendered beyond the period allowed by LSE rules.<sup>170</sup> Justice Kennedy “did not see how, by passing a resolution, the [CfGP] could make valid a contract which had been broken.”<sup>171</sup> In his view, the CfGP had no power to pass a resolution binding Barnett and, indeed, did not even have the power to bind Benjamin, the member.<sup>172</sup>

Benjamin petitioned the CfGP for funds to pursue an appeal, arguing that the effect of Justice Kennedy’s ruling “was greatly to impair the indemnity which it had always been considered a Broker had, in respect of dealings for a client.”<sup>173</sup> The CfGP was concerned enough to ask the owners for funds to cover the appeal, and it referred the matter to the Sub-Committee on Rules and Regulations to consider whether to make clarifying rule changes.<sup>174</sup> The Sub-Committee replied that no change was necessary, but the seven to two vote reflected intense disagreement. According to the dissenting members:

[C]onsidering the fundamental importance of the principle involved in Mr. Justice Kennedy’s Judgment in *Benjamin v. Barnett*, against which the Committee is supporting the plaintiff’s appeal, and considering the danger to the general interests of the House of allowing that principle to remain even temporarily in doubt, it is desirable that without waiting the result of its Appeal, a Rule should be passed as speedily as possible explicitly stating the principle in question.<sup>175</sup>

As it often did, the CfGP sought legal advice. The reply from the solicitor, Rufas D. Isaacs, ended any debate about the merit of supporting an appeal.

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163. It was not clear that the rules authorized the buyer to cancel the transaction. Instead, they gave the seller ten days from settlement to deliver the shares and, if this did not happen, authorized the buyer “buy in” and demand compensation for any loss. MELSHEIMER & GARDNER, *supra* note 45, at 189. Barnett had not exercised the right to buy in.

164. *Benjamin*, 19 TLR at 564.

165. *Id.*

166. *Id.*

167. *Id.* at 565.

168. MELSHEIMER & LAURENCE, *supra* note 8, at 127–28 (the CfGP could expel any member for not obeying its order).

169. *Benjamin*, 19 TLR at 564.

170. *Id.* at 565.

171. *Id.*

172. *Id.* The report of the case indicates that Justice Kennedy believed Benjamin had voluntarily assumed the obligation to pay for the remaining fifty shares during the hearing before the CfGP.

173. Guildhall Library, MS 14600/74/316.

174. Guildhall Library, MS 14600/74/317.

175. Guildhall Library, MS 14612/2/129 (July 7, 1903).

According to Isaacs, an appeal had “no reasonable prospect” of success, largely because Benjamin had failed during trial to introduce any evidence of a relevant LSE custom.<sup>176</sup> To be sure, there was “no doubt an argument to be based upon the Rules and Regulations, but it is wholly unsatisfactory in the absence of evidence as to practice or custom.”<sup>177</sup> And, although Justice Kennedy’s disparaging comments about the CfGP’s authority were unfortunate, Isaacs dismissed these as unnecessary to the resolution of the case. After reviewing the letter, the CfGP withdrew its request for funds to pursue the appeal, deciding that it would be “better to wait until a case arose where the custom had been fully proved in evidence . . . .”<sup>178</sup>

##### 5. The Proposed Ban on Non-Member Claims Not Recognized by the LSE

Thus, although the LSE could and did protect its interests when implicated by litigation, it could not guarantee that English judges would correctly apply LSE rules. And although it frequently amended the rules, there remained a broader risk, emphasized by Justice Kennedy’s comment in *Benjamin v. Barnett*, that the CfGP could not “make valid a contract which had been broken.”<sup>179</sup> The risk was that English courts might allow non-members to assert rights that the LSE did not recognize.

On at least one occasion, in 1933, the LSE consulted its solicitors to see if this risk could be eliminated. Recall that LSE rules allowed the CfGP to “intervene in cases where the principal of a member shall attempt to enforce by law a claim which is not in accordance with the rules, regulations, and usages of the Stock Exchange.”<sup>180</sup> The meaning of this rule—at the time, Rule 76—was not clear. The word “intervene” implied the right to participate as a litigant in the non-member’s lawsuit, but it was understood that LSE rules could not create such a right out of thin air.<sup>181</sup> The Sub-Committee on Rules and Regulations asked the solicitor to clarify the meaning of this rule. It also sought advice on several potential revisions, the most important of which would have forbidden non-members to “enforce at law a claim against a member which is not enforceable under the Rules.”<sup>182</sup>

On the first question, the solicitor confirmed that the CfGP could not formally intervene in a non-member’s lawsuit. At most, it could “support and contribute to the cost of the defence of a Stock Exchange defendant.”<sup>183</sup> This interpretation highlighted the structural problem, noted earlier, that kept the LSE from

176. Guildhall Library, MS 14600/74/437-39 (Sept. 14, 1903).

177. *Id.* at 438.

178. *Id.* at 14600/74/439 (Sept. 14, 1903).

179. *Benjamin*, 19 TLR at 565.

180. See MELSHEIMER & LAURENCE, *supra* note 8, at 134.

181. *Id.* at 73 (“If an action is brought by the principal against the jobber, the Committee would certainly have no locus standi to intervene in a technical sense. . .”).

182. Guildhall Library, MS 14612/7/7 (July 13, 1933).

183. *Id.* Although he did not see “a great deal of virtue in the Rule,” the solicitor advised retaining it, to avoid giving the impression that the LSE had conceded the point. *Id.*

effectively protecting its interests in litigation.<sup>184</sup> Because it could not make itself a party, and in any event often learned about lawsuits too late, the CfGP could not control what happened during the most important phase of any lawsuit that proceeded to judgment: the trial.<sup>185</sup>

The solicitor's advice on the proposed revision was more complicated. He conceded that, under English law, non-members were bound by written rules and that this principle would apply equally to a rule that limited non-members to claims recognized by the LSE.<sup>186</sup> Nevertheless, he predicted that English courts would not enforce such a limitation:

[I]f you alter Rule 76 so as to provide that a non-member shall not attempt to enforce at law a claim against a member which is not enforceable under the Rules, this will be binding on a non-member plaintiff and enable a Stock Exchange defendant to get a stay of any proceedings instituted in contravention of the Rule. This however amounts to ousting the jurisdiction of the Courts and would meet with such zealous opposition from that quarter that I am sure they would find some excuse for saying the Rule was not

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The solicitor seems to have based this opinion on the so-called ouster doctrine. For much of the nineteenth century, English law allowed contract parties to revoke their assent to arbitrate future disputes. This rule was often attributed—though without much evidence—to judicial hostility to agreements that ousted the courts of jurisdiction.<sup>188</sup> By 1933, however, it is not clear that the law justified such a definitive rejection of the proposed amendment to Rule 76. In 1889, the English Arbitration Act made most arbitration agreements irrevocable, although English courts retained authority to review questions of law raised in arbitration.<sup>189</sup> English courts had also become more willing to enforce clauses requiring parties to litigate in other jurisdictions or calling for the application of other law.<sup>190</sup> These developments were most relevant to parties

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184. See *supra* Part IV.B.4.

185. I do not know why the CfGP did not consider requiring members to inform it of any lawsuit. Frequently it did receive notice early in the case, so perhaps it thought such a rule unnecessary. Even after *Benjamin v. Barnett*, however, I found no evidence indicating that the CfGP considered this option.

186. Guildhall Library, MS 14612/7/7 (July 13, 1933). This was so, in the solicitor's view, because non-members were bound by written rules (though not informal customs) whether or not the rule was "reasonable." On the confusion about this question, introduced by *Benjamin v. Barnett*, see *supra* note 159.

187. Guildhall Library, MS 14612/7/7 (July 13, 1933).

188. On this history, see generally Bruce L. Benson, *An Exploration of the Impact of Modern Arbitration Statutes on the Development of Arbitration in the United States*, 11 J. L. ECON & ORG. 479, 483 (1995) (stating that "contracts to arbitrate were declared revocable because they 'oust courts of their jurisdiction'"); Paul L. Sayre, *Development of Commercial Arbitration Law*, 37 YALE L.J. 595, 603 (1928) (noting that many say "the courts took an unfriendly view toward arbitration, inasmuch as they upheld the revocability of submission"). See also David Horton, *Arbitration as Delegation*, 86 N.Y.U. L. REV. 437, 444–45 (2011) (identifying eighteenth century England as the origin of "unique anti-arbitration measures"); Judith Resnik, *Diffusing Disputes: The Public in the Private of Arbitration, the Private in Courts, and the Erasure of Rights*, 124 YALE L.J. 2804, 2855–56 (2014) (discussing how, in 19th century, parties to arbitration agreements "could not turn to the public system to enforce that obligation.").

189. Sayre, *supra* note 188, at 607.

190. See Ingrid M. Farquharson, *Choice of Forum Clauses – A Brief Survey of Anglo-American Law*, 8 INT'L L. 83, 88–93 (1974) (discussing English law concerning choice of forum agreements); Hessel E.

involved in international transactions, but they provided the basis for an argument that buyers and sellers of securities were entitled to resolve disputes in the forum of their choice and in accordance with their preferred rules.

There are echoes here of the Halfhead episode, where the LSE opted not to discipline a member who broke the prohibition on suing other members.<sup>191</sup> Again, the point is not that the solicitor provided the wrong advice. It is that the solicitor provided conservative advice, which was grounded in intuition rather than identifiable legal authority—*the courts would find some excuse to treat the rule as non-binding*—and which assumed the LSE would rather avoid conflict with English courts than flex its rule-making muscle. Given the LSE's general reluctance to invite judicial scrutiny, it is perhaps no surprise that the Sub-Committee readily deferred to the solicitor's views. Although in the process of making sweeping revisions to the rules, it left Rule 76 alone.<sup>192</sup>

## V

### CONCLUSION

Like other private legal systems, the LSE enforced transactions in accordance with specialized rules and through a system of extralegal sanctions. Yet self-governance also required the LSE to manage recurring frictions with state legal actors. In addition to the ever-present threat of Parliamentary legislation, English courts routinely heard disputes implicating the rules and customs of the LSE, and these decisions could impair the LSE's ability to make and enforce its preferred rules. Any group that aspires to self-governance must devote some of its resources to managing such risks. For the LSE, the work was substantial and often heavily shaped by legal considerations.

LSE rules did not simply codify merchant customs. English law was both a source of default rules and a constraint on the ability to adopt tailored rules. Having established the rules, the LSE's governing committees worked to maintain their integrity. Although it could not prevent non-members from filing lawsuits implicating its interests, the LSE actively managed the risks such litigation created. It routinely revised its rules to add clarity or to correct a judicial misinterpretation, and it proved itself capable of using the litigation process to its advantage, as in *Tomkins v. Saffery*. In all of these activities, the LSE's governing committees relied heavily on legal advice.

It is tempting to think that the LSE's freedom of action was constrained primarily by mandatory rules of English law—such as the rules governing the distribution of a debtor's assets in bankruptcy. And indeed, formal legal rules of

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Yntema, "Autonomy" in *Choice of Law*, 1 AM. J. COMP. L. 341, 348–49 (1952) (discussing English law concerning governing law clauses).

191. See *supra* Part IV.B.1.

192. See Guildhall Library, MS 14612/7/20–23 (Sept. 14, 1933). The CfGP meeting minutes include extensive discussion of the Sub-Committee report but reveal no indication that Committee members questioned this aspect of the Sub-Committee's decision. See Guildhall Library, MS 14600/129/163–211 (Sept. 18–Oct. 16, 1933).

this nature were significant constraints. But it would be a mistake to overlook the more subtle, yet still substantial, constraint that resulted from the relationship between the LSE and its solicitors. For the most part, the LSE sought to avoid legal scrutiny, even to the point of tolerating significant rule violations, as in the Halfhead episode. Perhaps aware of this tendency, the LSE's solicitors tended to give conservative advice that prioritized avoiding legal conflict over maximizing the reach of the LSE's private legal system. In this indirect way, state-created law and legal institutions—and the norms they foster in lawyers—both supported and constrained the LSE's private ordering activities.