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Ross Cranston*

Abstract: Although now forgotten, organized markets in commodities like grain, cotton, sugar, coffee and spices became firmly established in London and Liverpool in the nineteenth century. These markets were stimulated by the rising volume of international trade, as Britain became the first industrial nation, a major importer of these commodities and a centre for organising their distribution elsewhere, especially in Europe. The story of these markets, and the role of law in their operation, is fascinating

melting like snow in the sun…'.[2] Then followed the Piacenza fair, mainly run by Genoese *banchierei di conto*: without merchandise and little cash, masses of bills of exchange were liquidated, representing the entire wealth of Europe.[3] Markets were no longer simply places to trade goods but where contractual claims could be settled.

The setting for this study is not Italy in the fourteenth century but, rather the commodity markets in London and Liverpool in England in the nineteenth and early twentieth centuries. Despite considerable gaps there is a rich seam of business archives which have hardly ever been exploited by lawyers.[4] The story of these markets, and the role of law in their operation, is fascinating in itself. However, it also enables us to test some ideas about markets against the reality of what were, for a time, some of the leading physical and futures markets in commodities in the world. The first part of this article outlines key features in the organisation and operation of these markets; the second part concentrates on the central, if uncelebrated, functions of clearing and settling transactions in these markets; and finally there is a discussion of market integrity and the role of law in curbing abuse. The crucial feature of dispute resolution through arbitration is left for another day.

MARKETS, BROKERS AND FUTURES

> *'They stood together, two solid middle-aged men, and together they watched the long line of masts and funnels in the Royal Albert Dock go sliding away. They were still in London, and no great distance from the buses and trams, the teashops and the pubs, yet all that London seemed to have*

did they facilitate distribution through space with spot transactions for immediate delivery but as well distribution through time with forward and futures dealings.[6] Futures transactions enabled the ultimate producers of commodities in various parts of the world, and the manufacturers using them in Britain, the Continent and further afield, to obtain greater protection from risks through hedging. Although not universally popular, speculation in futures worked to level out prices on each market and between markets.[7]

ORGANISATION, MEMBERSHIP AND RULES

The London and Liverpool commodities markets started as informal gatherings of merchants interested in particular commodities and subsequently transformed themselves into formal associations. Thus the Baltic Exchange, an important venue for international dealings in commodities such as grain, tallow and linseed, began life as one of the London coffee houses. It remained as an unincorporated association, although a Baltic Company Ltd was incorporated in 1857 under the Joint Stock Companies Act 1856 to buy new premises where dealings could take place. Its rules related to little other than membership. From the second part of the nineteenth century the organisational framework for commodities trading was provided by the relevant trade associations and by the bodies they spawned like the London Produce Clearing House. Other trade associations were responsible for other markets. These took corporate form from the 1880s. This was both the fashion of the times but also had distinct advantages when the common law of associations was underdeveloped. Incorporation offered a pattern of organisation both internally (e.g. control over membership) and externally (e.g. the ownership of property; the ability to sue).[8]

Conditions for membership formed an important component of the rules of these associations. The rules and regulations drawn up in 1823 for 'The Baltic

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[6] J.G. Smith, *Organised Produce Markets* (London: Longmans, Green and co , 1922). See also S.S. Hoebner, 'The Functions of Produce Exchanges', *Annals of the Amer Acad of Pol and Soc Sci*, [hereafter *Annals*] Vol. 38, No.2, Sept. 1911, 319.

[7] The main markets examined are, in broad outline:

Commodity	**Trade Association**	**Venue**
(a) London		
grain	London Corn Trade Association	Baltic Exchange
sugar	Sugar Association of London	London Commercial Sale Rooms/ Plantation House/ London Commodity Exchange
coffee	Coffee Trade Association	as above
rubber	Rubber Association of London	as above

Coffee-House' limited membership to three hundred with no more than six members from the Stock Exchange (associated, it was said, with undue speculation). New members were to be admitted only on the recommendation of six other members and approved by the committee.[9] Prospective members had to be proposed and seconded by members to whom they were personally known, their names had to be publicised to other members and then there was a ballot by the committee. Once elected, however, there was nothing in the way of formal rules for behaviour. Informal conventions operated. A member's word, it was said on the Baltic, was his bond but this in a narrow sense meant simply that as soon as members made an agreement verbally they could not resile from it.[10] One had to look to the trade associations such as the London Corn Trade Association for any formal rules governing the behaviour of those trading on the Baltic.

Expulsion was the other side of the coin to admission. While typically there was a wide discretion in the rules as to admission, decisions on expulsion were

of expulsion. Other trade associations also adopted disciplinary action short of expulsion. The relevant clearing-house might restrict a party's trading either by limiting the number of contracts it could register, or refusing it the right to register contracts altogether.

Prompted by an agreement with the Bremen Cotton Association, the

States practice where the rules for commodity exchanges spelt out a range of specific and more general prohibitions on behaviour.

BROKERS, RULES AND THIRD PARTIES

The emergence of organised commodity markets was accompanied by the growth of a class of specialised brokers. The law insisted on some rigid distinctions. One such distinction was between brokers and factors, the former middlemen making contracts between buyer and seller, the latter always entrusted with the possession of the property they dealt with.[19] Another distinction was in the role of the broker, that he was strictly 'a middleman, an intermediate negotiator between other parties' and was not authorised to buy or sell in his own name.[20] A modern economic historian has deprecated the 'verbose attempts' of nineteenth century lawyers to make such firm distinctions about brokers where they seldom existed and noted the 'entrepreneur's silent determination to pursue profit wherever it beckoned'.[21] Certainly some commodities brokers trading in markets on their own account became more remunerative than relying on the brokerage earned by acting for others.[22]

The law provided a backdrop to brokers' this commercial activity. One aspect concerned the rights and liabilities of brokers vis-à-vis other brokers (and these other brokers' principals); another aspect, the relationship between brokers and their clients. Market practice offered the starting point for the first. Until the second part of the nineteenth century, when commodity markets began adopting formal rules, the law relied largely on trade usage to define the rights and liabilities of brokers between themselves. Trade usage was the course of dealing in particular markets which had attained such notoriety that brokers could be said to be bound by it if it was reasonable and not inconsistent with any contract. It was invoked in relation to various commodity markets to define a broker's rights and duties.

rules'.[24] Signature made unequivocal the commitment of the member to abide by the rules and the authority the clearing house had over him.[25]

It became the standard practice for brokers on commodity markets to make contracts in their own name. There was evidence of that in the coffee trade in the early nineteenth century,[26] the London grain market of the early 1840s, at least with foreign principals,[27] and Pulling asserted it to be accepted 'in the West India and other trades'.[28] In the absence of formal rules, his conclusion that 'in such cases, the broker is personally answerable for its fulfilment…' could have only been as a matter of trade usage on those markets since the common law lacked a bright line rule.[29] Under the common law doctrine of undisclosed principal, even if the broker contracted in its own name, without revealing the existence of a principal, the principal could subsequently claim the benefits of the transaction for itself. The eighteenth and early nineteenth century law to this effect was applied by the House of Lords to the Liverpool cotton market in the leading case, *Cooke & Sons* v *Eshelby*.[30] That involved the sale by Liversay & Co, brokers, for an undisclosed principal, N.C. Maximos, now bankrupt. Eshelby, the trustee in bankruptcy, sued the buyers, Cooke & Sons, who contended that they could set-

could later emerge to assume the transaction as its own. Contract offered a solution. Bought and sold notes in commodity markets had a clause added that the contract of which they were a note was made between the brokers themselves and not with any other person, whether disclosed or not, on whose instructions or for whose benefit it was entered.[32] Trade associations adopted a rule that when dealing either themselves or for clients members could deal in their own name. C.W. Smith, a broker in Liverpool, recalled in evidence to the Royal Commission on Agriculture:

> [T]here was a celebrated case called Cooke v. Eshelby … I brought it before our Association, and I told them that if the thing was going on, no man dare trade under those systems. The consequence was that a committee was formed, and a new contract was made out which makes every man under that contract himself liable, do you see, as his own principal under every contract, so that there was no going behind anybody and therefore, under the settlement system every contract is wrung out compulsorily.[33]

Such a rule might add that members were then personally liable on any contract and no rights or liabilities accrued to a principal, except against his own broker.[34] The London Produce Clearing House echoed this in its rules, in some versions also conferring a discretion on itself to decide whether to permit a hitherto unidentified client from having its name substituted and, if so, subject to what conditions.

in 1818. Under these brokers had to obtain the permission of the City authorities before acting as such. Admission as a broker meant producing a certificate of competence and knowledge and then acting in accordance with certain standards.[38] Thus a broker was forbidden from dealing in his own name, had to enter every bargain into a broker's book and could not take or receive double brokerage (e.g. from both buyer and seller). Agitation that they were a restraint of

that not all fully understood the workings of futures markets. Most notably Viscount Finlay was taken in by the argument that the purchases were a resale to the broker, emphatically not the case with futures transactions which under the contract were not referable to particular cotton.[44]

Brokers, then, were under certain duties to the client. What of the broker's rights against the client? *Christoforides* v *Terry* began as a claim for indemnity, perhaps the most important common law right which an agent had against the client. At the outset of any claim against the client, however, it was necessary to determine whether the broker was, in fact, an agent; brokers might be acting as principal for their own account. In the commodity markets the capacity in which brokers were acting was usually evident from the bought or sold notes they gave clients. 'Sold for AB', 'bought for CD' or 'sold from AB to CD' all indicated agency. But, as the standard treatises pointed out, the form 'sold to you by me' meant the broker was assuming the obligation of principal.[45] In practice the rights which a broker might wish to assert against his client derived in large part from the rules and practices of the market. As we have seen brokers themselves were bound by these rules and practices. To what extent were clients? The law struggled with, and never satisfactorily resolved, the issue of the relationship between third parties and markets. On the surface contract law was of no assistance, especially when the doctrine of privity of contract became entrenched. Not being a party to the rules of a market, clients were not bound by them nor were they in a contractual relationship with the market or related institutions like the clearing-house. Their contact was with their broker, acting on their behalf.

Initially weight was put on agency law to address the problem of the third party. It was established early in relation to a stock exchange that a client employing a broker impliedly gave him authority to act in accordance with its rules although the client himself was ignorant of them.[46] This use of agency law was subsequently extended to other markets and beyond market rules to customs and practices. 'A person who deals in a particular market must be taken to deal according to the custom of that market…'[47] The matter came to a head in a case involving a transaction on the Baltic Exchange. In *Robinson* v *Mollett*[48] Robinson was a Liverpool merchant. As on several previous occasions, he had instructed brokers, Mollett & Co, to buy tallow in this case in April for June delivery. As we have seen, tallow as an object of speculation on the Baltic and subject to significant fluctuations in price. There can be little doubt that Robinson was speculating, a point which Mollett's counsel, J.P. Benjamin QC made, but without

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subject to the rules and bye-laws of the relevant trade association.[60] Once trade associations began issuing standard form contracts these may set out key rules in the small print or incorporated them by reference through a term of the contract.

ARRIVALS AND FUTURES MARKETS

What firstly we see as the basis of futures contracts is the emergence of arrivals markets in commodities from abroad. From the early nineteenth century the

for such a declaration be made sometime after the contract.[66] In the 1860s, reflecting the greater predictability of voyage times, arrival contracts began to be used which named a one or two month period when the cotton would arrive. More importantly, the form of contract used might not provide for delivery of specific cotton tied to a particular ship, named or to be named, but of cotton of a particular description.[67] This clearly presages the futures contracts of a decade later.

There was no difficulty for these arrival contracts from English sales law. From early in the nineteenth century the courts upheld contracts for the sale of goods to be delivered later. Thus it was held that the sale of a growing crop of hops did not constitute the old offence of forestalling.[68] Brewers had used such contracts for future delivery for many years to secure their supplies of malt. The principle applied as well to commodities to be made by processing.[69] So the validity of a contract to sell what was to be delivered in future was settled law. Subsequently, the courts upheld contracts when the seller did not have the commodity at the time of sale but was to acquire it. and deliver it after making the contract.[70]

A second development germane to the emergence of futures contracts was the growth of speculation in commodities markets. There had always been speculation in the physical markets, for example, the purchase of grain and storing it in expectation of a rise in price. While this type of speculation continued there was also speculation in the arrivals markets. Speculation in tallow in the first part of the nineteenth century on the Baltic Exchange included 'delivery' transactions, said by one commentator to be 'the description of contract that would allow of a rise or fall in price, it usually embracing a period of two or three months forward…'.[71] With cotton, speculation was most likely with spot transactions because its variability in quality meant there were risks in buying it without the opportunity to inspect. Speculation in relation to arrival contracts in cotton became common in the 1850s as a result of the improvement in communications.[72] It was the attraction of enormous profits which stimulated speculation in arrival contracts during the American Civil War. Specified amounts of particular types of cotton were re-sold, sometimes many times, so that on settlement documents and payment had to pass along the chain.[73] Many of those

[66] See rule 2 set out in *Thorburn* v *Barnes* (1867) 16 LT (NS) 10, 12.
[67]

engaged in buying and selling the cotton had no interest in taking delivery and

in coffee and sugar. Sugar was especially conducive to futures dealings since, unlike other products like tea and wool, it was easily graded. Later the London Produce Clearing House cleared futures transactions in wheat, maize, pepper, rubber, raw silk, silver, indigo and, for a while at the turn of the twentieth century, tea. It published separate rules for each commodity which, with some exceptions noted below, followed a very similar pattern.[85]

Eventually, the project of the London Corn Trade Association for its own clearing house was achieved in 1921. As far as London was concerned futures dealings in grain never prospered, even after they were provided for in 1929. Those transacting grain futures preferred Liverpool. Rather the work of the London clearing house concentrated on clearing documents in string transactions. A clause was inserted in LCTA standard form contracts under which either party could register a contract at the clearing house so that, once registered, it would be subject to the clearing house rules.[91]

While clearing houses for commodities focused on futures transactions it is important not to overlook their contribution, as with these cif string contracts in grain sales, to documentary clearing. Two clearing systems devoted solely to documentary clearing bear closer attention. The first is the Tea Clearing House, an association formed in 1888 by dock companies and warehouse keepers, having dealers carrying on the wholesale trade in tea as subscribers. Among the aims of the association was to facilitate the rapid and efficient lodgement and transmission from a central office of warrants, delivery orders, carding, cording and other orders to the various docks and warehouses.[92] A sophisticated system developed for documentary clearing for sugar transactions. Formed in 1882 the Beetroot Sugar Association (from 1905 called the Sugar Association of London) devised a system for the use and clearing of filières. Filières represented sugar arrived at port in Britain or on the continent.[93] Filières passed from hand to hand, successive holders filling in the date, price and time of delivery. Clearing was on a daily basis and the manager of the clearing would, on receipt of tenders, endeavour to liquidate contracts by passing a filière from sellers to buyers until the filière arrived at a buyer who could not pass it on (called in the rules the 'stopper').[94] The first seller would then pass the bill of lading or dock or warehouse warrant to the stopper, who paid a price based on its weight and analysis. Upon the manager receiving notice that the documents had passed or liquidation had been otherwise effected, he

> shall receive from the middlemen or pay them the difference between their buying and selling prices and receive from or pay the issuer and stopper the difference between their contract prices and the filière price.[95]

[91] e.g. LCTA, London La Plata Maize Contract. Steamer or Power Vessel. Parcels. Rye Terms. 1938. Conditions and Rules, §11.

[92] *Chamberlain's Whary. a0 14R1. a0 14R1. a0 14R1. aaned, he ho cc6(7( )]TJETEMC Spa(r786 Tw T6BT2[TEnt)52)TjrTw -15.406 -1.23*

margin payments entitled the clearing house to close out the party's contracts and to sell any deposited securities without obtaining prior approval.[102] The securities were thus deposited by way of security, although the rules did not state this expressly.[103]

Settlement occurred in commodity markets in three main ways.[104] Direct settlement was the most straightforward through the bilateral reconciliation of contractual claims and liabilities. Direct settlement faced no objection at law. If a seller agreed to set off the price of goods supplied against items admitted to be due to him by the buyer, Lord Campbell explained that both would be paid because it was as if the parties had met 'and one of them actually paid the other in coin, and the other handed back the same identical coin in payment of the cross debt.'[105] Once the price was payable under the contracts the set-off was effective as to both delivery and payment obligations unless there was a difference in price, whereupon one party would have to pay that to the other. In a leading American futures case Holmes J put it pithily: 'Set-off has all the effect of delivery'.[106] That was the position in English law as well. In one of the few English cases concerning the commodity markets, in 1925, the judges in the Court of Appeal simply accepted the effectiveness of this contractual provision in the Liverpool cotton rules. [107]

Although effective in law the problem of direct settlement was that, as the volume of trading increased, especially for hedging and speculative purposes, it became impractical without the intervention of a clearing house.[108] How a clearing house could facilitate direct settlement was demonstrated by the method used in the London Produce Clearing House in relation to coffee futures.[109] The settlement process was initiated, as typically for clearing houses, by the registration of contracts after the payment of a required deposit.[110] Following this the clearing house issued to each party a non-endorsable 'certificate of guarantee' in which it declared that it was responsible to both buyer and seller for the fulfilment of the

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[102] r.13. For an example: London Grain Futures, Minute Book No.1, GH MS 23 205/1, 24 Aug 1939. See also *E. Bailey & Co. Ltd.* v *Balholm Securities Ltd.* [1973] 2 Lloyds Rep. 404, 406-7, 415.
[103] Cf. the Liverpool grain trade rules, n 99 above, r.41.
[104] J. Moser, *Origins of the Modern Exchange Clearinghouse: A History of Some Early Clearing and Settlement Methods at Futures Exchanges*, Working Papers Series, Issues in Financial Regulation, Research Department, Federal Reserve Bank of Chicago, WP-94-3, April 1994, 7-15.
[105] *Livingstone* v *Whiting* (1850), 15 QB 722, 723; 117 ER 632, 632. See J.P. Benjamin, *y85tF*

contract.[111] Under rule 14 of the rules settlement occurred by a contracting party handing the clearing house two certificates of guarantee for the same delivery, in one of which it was named as buyer and the other seller. Absent any default the clearing house was then 'bound… to make up accounts at once and to pay or place to the credit of the contracting party, any balance due'. That balance was made up of the margins, which needed to be repaid, and brokerage, but with a discount if payment was prior to the delivery date.[112] If a contracting party was unable to enter an off-setting transaction to settle in this way it needed to accept tender of the coffee (unless it could subsequently re-sell.[113]) Settlement then involved passing of the dock or wharf warrants, representing the goods.

After direct settlement a second method used on the commodity markets was ring settlement. Its advantage was to increase the number of potential counterparties available to settle. Where A sold to B, B to C and C to A the same amount of a commodity for delivery on the same date, bringing A, B and C together in a ring meant that the different sales would cancel each other out and all that was needed was for the parties to pay the price differences. The ring could involve many more parties than three and price differences could be netted so that payments were reduced. Netting of price differences was facilitated by striking a settlement price, representative of prices in the market, and parties then needed to pay only the difference between that and the price of their trades. Ring settlement did not need an organised clearing house. In some markets there is evidence of traders meeting after a market closed to trace contracts back so as to form rings and outdoor clerks being sent around to different offices to close up a series of trades.[114] The London Metal Exchange did not have a clearing house and seemed to use a form of ring settlement, devised in 1909 by a member of its committee.

clearing contracts in the London and Liverpool grain markets. Their clearing houses would match up trades to form rings as best they could.[117]

The third, and typical method of settlement when the London and Liverpool commodity markets matured, was settlement by novation. At its simplest if a party had bought and sold equal amounts of a commodity for delivery in the same period, it could drop out if its buyer and seller were brought together, and it paid anything owing on the two transactions. Novation as a legal technique was familiar to lawyers from partnership law.[118] New partners undertook, and retired partners relinquished, contractual obligations with the acknowledgement of third parties dealing with the firm. There were also instances of the assignment of the business of one insurance company to another, with the policy holders assenting to the transfer of their policies. [119] By the time the London and Liverpool clearing houses were being established, novation was being recognised by the highest of authorities.[120] Initially, however, clearing house rules did not specifically mention novation and there may have been some doubts about contracting for it in advance in this way. Although Pollock had proferred the view in his *Principles of Contract* that apart from novation in the proper sense the creditor might bind himself once and for all in the original contract to accept a substituted liability at the debtor's option, other writers were not as bold.[121] When United States courts considered the substitution of parties to settle commodities contracts they upheld its legality on the basis of market practice in the Chicago Board of Trade rather than novation.[122] It was not until 1915 that an English court approved novation in the context of commodities markets..[123]

Novation was mentioned expressly in the rules of the London Produce Clearing House, once it adopted novation as a technique rather than direct settlement through presentation by a party of equivalent buy and sell certificates of guarantee. Thus rule 1 of the 1928 regulations for settling futures transactions in cocoa provided that in consideration of the registration of a contract, and the guarantee the clearing house gave both buyer and seller as to its fulfilment, both parties respectively agreed with each other and the clearing house to accept 'by way of novation' such other sellers and buyers as the clearing house might appoint for the sale or purchase of the commodity mentioned in the contract.[124] Rule 13

[117] e.g. Bye-Laws of the Liverpool Corn Trade Association Ltd, n 97 above, r.18 provided: 'The Secretary shall have power to vary the arrangements of the contacts on a string whenever all or any number of them are capable of being formed into a ring'.

[118] e.g. *Wilson* v *Lloyd* (1873) LR 16 Eq 60.

[119] e.g. *Re International Life Assurance Society & Hercules Insurance Co ex p. Blood* (1870) LR 9 Eq 316; *Re European Assurance Society, Miller's Case* (1876) 3 Ch.D. 391.

[120] *Scarf* v *Jardine* (1882) 7 App.Cas. 345, 351.

[121] F. Pollock, *Principles of Contract* (London: Stevens, 2nd ed., 1878) 190. S.M. Leake, *An Elementary Digest of the Law of Contracts* (London: Stevens and sons, 1878) 791 could have been read as supportive but Chitty did not acknowledge novation until the 12th edition in 1890 (at 862).

[122] *Oldershaw* v *Knowles*, 6 Ill App 325 (1880), aff'd 101 Ill 117 (1881). See also *Wolcott* v *Reeme*, 44 Ill App 196 (1892).

[123] *Jager* v *Tolme and Runge and the London Produce Clearing House Ltd.* [1916] 1 KB 939.

[124] London Produce Clearing House Ltd, *Regulations for Future Delivery Business in Cocoa*, April 1928. To the same effect see novation for rubber sales in the contract set out in S.W. Dowling, *The Exchanges of London* (London: Butterworth, 1929) 117-8.

of the regulations then provided that if a party ('the middle party') requested a settlement of contracts in which it was on the one hand a buyer, and on the other a seller, for the same amount of cocoa for the same month of delivery, it ceased to be under any liability to receive or deliver that commodity and its seller and buyer were deemed to contract with each other.

The operation of novation in this way was still in the rules of the London Produce Clearing House in the early 1970s. [125] What had fallen by the wayside, although it was to be revived as the norm once the (renamed) London Clearing House began to clear financial futures in the 1980s, was novation whereby the clearing house itself was substituted for each of the parties (called 'complete clearing' in the United States). Under this arrangement a seller-buyer contract was transformed into two contracts, a seller-clearing house contract and a clearing house-buyer contract. An advantage of substitution of the clearing house in this way was that it, not the parties, carried the credit risk. Sellers and buyers were now bound to the clearing house, which had taken the place of their original counterparty. If either party failed the clearing house would bear the loss directly.

One example of its early use was in sugar clearing just prior to World War I. The 1913 version of the LPCH rules for clearing futures business in beetroot sugar provided for substitution of the clearing house once settlement occurred by a party handing in buy and sell certificates of guarantee for the same delivery date.

> Such settlement shall have the effect that all rights and liabilities of the contracting party – as regards the respective contracts – shall devolve upon the [Clearing House] and that the liability of the contracting party to the [Clearing House] or to any client thereof shall terminate. Buyers and sellers (as the case may be) of the oldest open contracts, in the numerical order of the [Clearing House's] Register shall then take the place of the counterparty so liquidated…

The Court of Appeal averted to these arrangements in 1916 although it did not refer to the clearing house rule.[126] Rather it relied on the contract of the Sugar Association of London, for sale of beetroot sugar 88º, which was cleared under LPCH rules and which contained a clause along the same lines. The Court of Appeal accepted that this meant that the position was the same as if the plaintiff had made a contract with the clearing house and the liability of the original sellers to the plaintiff was at an end.

[125] London Produce Clearing House Ltd., *General Regulations for Future Delivery Business and Byelaws for Options*, 1972, r.13. See *E. Bailey & Co. Ltd.* v *Balholm Securities Ltd.* [1973] 2 Lloyd's Rep 404, 407-8.

[126] *Jager* v *Tolme & Runge and the London Produce Clearing House* [1916] 1 KB 939. See also *Smith, Coney & Barrett* v *Becker, Gray & Co* [1916] 2 Ch.86.

but although satisfied of a fraud they decided against prosecution because of uncertainty about getting a conviction.[155]

conducted business in the City for many years. His co-conspirator was John Howeson, chairman of the London Tin Corporation, Initially pepper was acquired from early 1933, it seems, by Bishirgian on behalf of William Henry & Co, which he and Howeson were able to control. To further the scheme they acquired the commodity brokers, James and Shakespeare Ltd. which they then took public in August 1934, ostensibly to raise funds for general expansion but in fact to continue the cornering operation.[161] The corner failed because the ring had underestimated the stocks of pepper they needed to corner the market and because of a large inflow of pepper to London.

The crisis came to a head in January 1935. James and Shakespeare was in financial difficulty – the General Produce Brokers' Association declared it to be in default on 8 February – and a number of other commodity brokers hovered precariously. Some of the banks were also exposed, in particular the Midland Bank (now part of HSBC) having advanced something like one million pounds to James and Shakespeare. The General Produce Brokers Association, and then an ad hoc committee of commodity brokers, appealed to the clearing banks to accommodate the firms threatened to avert widespread failures in the market. Under pressure from the Bank of England the banks agreed.[162] Trading was suspended for a week to break the jam. A pepper pool, the London Pepper Sales Control Committee, was formed to dispose of the pepper over the following years. A few commodity brokers still went under.[163]

When a criminal prosecution ensued it was not for any offence of trying to corner the market for in English law there was none. Nor was it for conspiracy. Rather the prospectus which the principals had caused James and Shakespeare Ltd to issue for the acquisition of Williams Henry & Co and Bishirgian & Co was alleged to have been false and therefore in breach of section 84 of the Larceny Act 1861. Perhaps it is not surprising that the prosecution should look to that, rather than conspiracy, since the section had grounded the successful prosecution of Lord Kylsant a few years earlier.[164] The jury convicted and the defendants were imprisoned. An appeal was unsuccessful.[165] Never one to mince his words, the Lord Chief Justice, Lord Hewart, said that morally and legally the transaction did not differ, other than in dimensions, from 'the office boy who takes a half-crown from the till because he has a good thing for the Grand National'.[166] The purpose for which the money was wanted here, and to which it was applied, 'was the bolstering up of a very ambitious scheme – which failed – to control the pepper supply of the world'. The upshot of the scandal was that, under pressure from the Bank of England, a futures marked was inaugurated for pepper in 1937, with

[161] 'James and Shakespeare Ltd. Liquidation Meetings', *The Times*, 5 Ap. 1935, 4; 'Liquidation of James and Shakespeare Ltd. Senior Official Receiver's Report', *The Times*, 10 July, 1935, 4.

[162] R.S. Sayers, *The Bank of England 1891-1944* (Cambridge: Cambridge University Press, 1976) 544-5; D. Kynaston, *The City of London* vol 3 (London: Chatto & Windus, 2000) 425-9.

[163] 'City Pepper Crisis', *The Times*, 9 Feb, 1935, 12; J.F. Adair and Co. Ltd. 'Senior Official Receiver's Report', *The Times*, 16 July 1935, 5.

[164] *R.* v *Kylsant* [1932] 1 KB 442.

[165] *R.* v *Bishirgian* [1936] 1 All ER 586.

[166] *ibid* 594.

put it, in a case involving the sale of shares, *Hibblewhite* v *M'Morine,*[173]although commodities are referred to throughout, and the headnote is formulated in terms of a rule for the sale of goods, not shares. To Baron Parke Lord Tenterden's views were contrary to law and influenced by the 1825 depression. There was no injury to the public: '[i]ndeed, the fewer the restraints imposed upon contracts the better'.[174] Alderson B was blunt: the Tenterden view would 'put an end to half the contacts made in the course of trade'.[175] As for Maule B, he had often heard the Tenderden approach spoken of with great suspicion by lawyers as against principle and by mercantile men as against commercial convenience.

So at common law such transactions were in the clear. But futures trading was not out of the legal woods yet. Unless carefully structured there remained a threat well into the twentieth century that it would constitute breach of the Gaming Act in 1845.[176] The Act was not directed at commercial activity but at evils like common gaming houses.[177] However, the Act had a general prohibition, section 18 under which all contracts or agreements by way of gaming or wagering were null and void, and no legal action could be brought to recover any money or thing allegedly won or staked in relation to any wager. When the issue came before the Court of Common Pleas in 1852, in *Grizewood* v *Blane*, Serjeant Best cited *Hibblewhite* v *M'Morine* and argued that the transaction was not within section 18, any more than if it related to wheat or any other article of commerce or manufacture.[178] However, the judges upheld the direction to the jury that it was a wager and void if the parties did not really intend at the time of the transaction to purchase or sell the shares in question.

The legal solution to *Grizewood* v *Blane* seemed to be to cast contracts in such a Blane way that ostensibly at least there was always an intention to 3 Tmp003 Tmaru4 412eu4 4.d4 Td2H

that only differences would be paid, and that was wagering.[181] This conflict between the formal and subjective intention in the stock market cases was never satisfactorily resolved.

When in the 1920s the English Court of Appeal finally examined the validity of futures dealings on commodities markets it was not as a result of a direct attack but in the context of a tax appeal.[182] The taxpayer was employed by a cotton broker in Liverpool. The issue was how profits he made from private futures dealings on the Liverpool, New York and New Orleans cotton exchanges ought to be assessed for tax purposes.[183] The special commissioners for income tax had found as a fact that they were gaming transactions and were entered by him with no intention of taking actual delivery of cotton or using them as hedges. Notwithstanding this Pollock MR adopted a robust approach. These were real transactions, with real parties, which the dealer or broker could have implemented at any moment, and gambling only in a loose or colloquial sense. Most importantly Pollock MR rejected the subjective approach in some of the cases involving stocks and shares: '[T]he purpose for which he made them did not alter the character or nature of the contracts that he did make…'.[184] Warrington and Atkin LJJ were more circumspect given the commissioners' findings, but still regarded them as real transactions for, whatever the intention of the taxpayer, there was no evidence that his counterparties did not intend to take delivery of cotton.

A month later McCardie J adopted an equally robust approach in a case involving a direct attack on futures dealings on the London Metal Exchange.[185] In formulating a test McCardie J erected a very high hurdle for challengers: transactions would only be unenforceable if the parties intended that there should be no legal bargain and no right to demand payment of differences, except as a moral right. As long as the parties intended to enter into a legal contract, which gave legal rights and imposed legal obligations, it was enforceable, despite being of a speculative character. In 1936 Hilbery J considered transactions on the Liverpool Cotton Exchange impugnable on either objective or subjective grounds. A member of the public (albeit a businessman) was invited by someone employed on a half commission basis by the plaintiff firm, members of the exchange, to have a gamble in cotton futures for which the firm would (and did) provide credit. Yet here the difference with American law came into play, the effect of the Gaming Act being to make transactions void, not illegal. As Hilbery J put it, once he was satisfied that the firm entered the transactions as brokers, then their claim was for an indemnity from their principal. The firm might have enabled the defendant to gamble but as agents were not directly themselves a party to a contract where it was intended only differences would be paid.[186] The upshot of all this was that by World War II futures dealings on the commodities exchanges were legally safe.

[181] e.g. *Universal Stock Exchange Ltd.* v *Strachan* [1896] AC 166; *Re Grieve* [1899] 1 QB 794.
[182] *Cooper (Inspector of Taxes)* v *Stubbs* [1925] 2 KB 753.
[183] Arbitraging between the three exchanges was no doubt an aspect of his dealings.
[184] n 182 above, 763.
[185] *Barnett* v *Sanker* (1925) 41 TLR 660.
[186] *Woodward* v *Wolfe* [1936] 3 All ER 529, 533-4.

The shadow cast by the Gaming Act could be avoided in the drafting of exchange rules and hence of the standard form contracts between members and those dealing through them on the exchanges.

CONCLUSION

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litigation washing into United States courts. So the chances for untoward decisions were fewer. Partly that is explicable by healthy systems of arbitration, partly by the limited category of speculators on the London and Liverpool commodity markets who were potential litigants if deals went wrong for them. Perhaps most importantly doctrinal obstacles were rarely insuperable: the response to *Cooke & Sons* v *Eshelby*, quoted above, is just one of a number of examples of how they could be avoided in the drafting of standard form contracts and rules. The law proved a rare barrier to the pursuit of profit in their preferred way by the practical men working the London and Liverpool commodity markets.