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The Roots of the „New Law Merchant“: How the international standardization of contracts and clauses changed business law¹

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I. Introduction

The term „law merchant,“ or *lex mercatoria*, first appeared in medieval and early modern publications on commercial law.² Synonymously used, they referred to an autonomous body of legal customs which had emerged in supraregional commerce and which had become law by consent and by continuous use. Its main fields of application were maritime and banking law, besides the more general commercial strand. The core of the *lex mercatoria* consisted at the time of a number of legal principles, such as *bona fides* and *rebus sic stantibus*.³ They were formulated in a very general way which made them adaptable to changing political and economic circumstances.⁴

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1 This article is based on the author’s research at the Max Planck Institute for the History of European Law in Frankfurt am Main . His dissertation about the evolution of transnational law in the world economy, „Rechtsbildung im wirtschaftlichen ‚Weltverkehr‘“, will be published in 2006 (V. Klostermann publishers, Frankfurt/Main). Many thanks to Noah Dauber, Cambridge, Mass., for his comments and amendments to the text.

2 The term „*lex mercatoria*“ is to be found from the late 13th century on, U Stein, *Lex mercatoria. Realität und Theorie*, Frankfurt/Main 1995 p. 3 (Fn 14). Some of the most influential early modern monographs were G de Malynes, *Consuetudo, vel Lex Mercatoria / Or the Ancient Law-Merchant*, London 1622 (3rd ed. 1686); J Marquart, *Tractatus politico-iuridicus de iure mercatorum et commerciorum singulari*, 2 vols., Frankfurt/Main 1662. W Beawes, *Lex mercatoria rediviva, or, The merchant’s guide to all men in business*, London 1752 (5th ed. by Ths. Mortimer, 1792). Cf. H Pohlmann, *Die Quellen des Handelsrechts*, in H Coing (ed.), *Handbuch der Quellen und Literatur der neueren europäischen Privatrechtsgeschichte* vol. 1, Mittelalter (1100-1500) (1973) pp. 801-832; KO Scherner, *Die Wissenschaft des Handelsrechts*, in H Coing op cit, vol. 2.1, Neuere Zeit (1500-1800): Wissenschaft (1979) pp. 797-997.

3 R Meyer, *Bona fides und lex mercatoria in der europäischen Rechtstradition*, pp. 15, 69.

4 The discussion on the structure of the historical *lex mercatoria* has been revived by eminent authors who claim that the idea of a coherent and international body of law is a myth. See N Foster, *Foundation Myth as Legal Formant: The Medieval Law Merchant and the New Lex Mercatoria* (2005), www.forhistiur.de/zitat/0503foster.htm; A Cordes, *The Search for a Medieval Lex Mercatoria*, 5 Oxford University Comparative Law Forum (2003); and E Kadens, *Order within Law*,

Around 1800, the terms *lex mercatoria* and „law merchant” disappeared from the contemporary legal discourse.⁵ A century later, they reappeared in the writings of authors like the German professor of commercial law, Levin Goldschmidt. But they were not used any longer to describe contemporary phenomena. By Goldschmidt’s time, they had become *termini technici* of legal history.⁶ 2

The *lex mercatoria* reappeared as a topos of legal theory as late as the second half of the 20th century.⁷ European and North American jurists who were studying the impact on the law of the globalization of the western economies and the emergence of the European single market discovered a „new law merchant”. However, the meaning of this notion had changed fundamentally. Besides some general principles and legal institutions⁸, internationally accepted standard contracts and clauses were now seen as parts of the phenomenon.⁹ Many authors interpreted them as substantive sources of law.¹⁰ 3

This study is concerned with the period between the disappearance of the „old” and the reappearance of the „new” law merchant. Of course, it would be a mistake to conclude that there had not been any international business law before World War I solely from the terminological history. Rather, it is for other reasons that most legal historians believe this to be the case.¹¹ The existence of an autonomously created, transnational business law in the 19th and the early 20th centuries can at first sight barely be imagined. The convoluted 4

Variety and Custom: The Character of the Medieval Merchant Law, 5 *Chicago Journal of International Law* (2004), pp. 39-66.

5 At least in continental Europe. In British jurisprudence, they were still to be found.

6 E.g. L Goldschmidt, *Handelsrecht. Geschichtliche Entwicklung* (1892), in *Vermischte Schriften II*, Berlin 1901 pp. 29 foll.

7 CM Schmitthoff, *International Business Law: A New Law Merchant*, in *Current Law and Social Problems* vol. 2 (1961) pp. 129-142. A Goldstajn, *The New Law Merchant*, in *Journal of Business Law* 1961 pp. 12-17. B Goldman, *Frontières du droit et „lex mercatoria“*, in *Archives de la philosophie et du droit* 1964 pp. 177-192.

8 See F Osman, *Les principes généraux de la lex mercatoria. Contribution à l’étude d’un ordre anational*, Paris 1992; KP Berger, *Formalisierte oder „schleichende“ Kodifizierung des transnationalen Wirtschaftsrechts. Zu den methodischen und praktischen Grundlagen der lex mercatoria*, Berlin 1996; J-P Béraudo, *UNIDROIT principles for international contracts: a new lex mercatoria?*, Paris 1997.

9 A clear sign of the great importance of standardised contract clauses is the existence of the so-called INCOTERMS (International Commercial Terms) agreement of 1936, which issued uniform interpretations of certain clauses. It was designed to avoid misunderstandings owing to different national legal and commercial traditions. The latest INCOTERMS amendment came into force in 2000.

10 Selected contemporary literature: F de Ly, *De lex mercatoria*, Antwerpen 1989. F Dasser, *Internationale Schiedsgerichte und Lex mercatoria*, Zürich 1989. P-F Weise, *Lex mercatoria: Materielles Recht vor der internationalen Handelsschiedsgerichtsbarkeit*, Frankfurt/Main 1990. A Kappus, *„Lex mercatoria“ in Europa und Wiener UN-Kaufrechtskonvention von 1980*, Frankfurt/Main 1990. U Stein, *Lex mercatoria. Realität und Theorie*, Frankfurt/Main 1995. TE Carbonneau (ed.), *Lex mercatoria and arbitration. A discussion of the new law merchant*, New York 1997.

11 E.g. F Wieacker, *Historische Bedingungen und Paradigmen supranationaler Rechtsordnungen*, in H. Bernstein et al. (ed.), *Festschrift für K Zweigert*, Tübingen 1981 p. 589.

regulations of the national states of this period fenced in the sphere of business activity. Especially, in many countries, new commercial and civil codes came into force. Also, international private law was gradually formed by international agreements and could be seen as a useful instrument for international conflicts. Looking back, it seems that decade by decade, the space for the development of non-state law and for autonomous mechanisms of conflict resolution were shrinking.

But is this account correct?

II. Companies „colonizing” private law

Severe legal problems arose with the entry of regional and national economies into the process of industrialization. Under the dynamics of rapid, fundamental changes, national law and economic necessities drifted apart. The notion of „cultural lag”¹² coined by the American legal theorist William Ogburn, precisely describes the situation. Neither the legislators, the administrators, nor the jurists showed themselves capable of following the economic evolution. On the international level, the situation was even worse. Negotiations on conventions for the facilitation of border-crossing business traffic, or for the setting up of common tribunals of arbitration, dragged on slowly. A good example is railway transportation. At state borders, it was not only the change in gauges which hindered the traffic of goods, but also the change in the transportation laws. Where this resulted in delays and impaired delivery, it frequently caused legal complications. This is why in 1875, the Swiss lawyers de Seigneux and Christ began promoting the idea of an international unification of the transportation laws as applied to the contracts (*„Transportreglements”*). But an international agreement was not reached before 1890, and its complete implementation took another decade.¹³

Since the legal and governmental actors were not adapting the law and legal institutions to the economic realities quickly enough, the businessmen themselves brought their contract law up to date. A central instrument which they used were the so-called general conditions of contract, derogating great parts of national law.¹⁴ The first to begin systematically developing their own rules of contract were the insurance and the transport industries.¹⁵ By as early as the beginning of the 19th century, these two industries organized their mass

12 WF Ogburn, Cultural lag as theory, in *On Culture and Social Change* (1964) pp. 86 foll. Ogburn employs the notion of cultural lag principally in his studies of the relation between technology and law. He defines it as follows (p. 86): „A cultural lag occurs when one of the two parts of culture which are correlated changes before or in greater degree than the other part does, thereby causing less adjustment between the two parts than existed previously.“

13 See G Eger, *Internationales Übereinkommen über den Eisenbahnfrachtverkehr* (1906-1908), Berlin 1909 p. 499; W Hausteine, *Das internationale öffentliche Eisenbahnrecht*, Frankfurt/Main 1953 p. 13.

14 S Lammel, *Rechtsbildung durch Verträge und Vertragsbedingungen*, in KO Scherner (ed.), *Modernisierung des Handelsrechts im 19. Jahrhundert*, Heidelberg 1993 p. 95.

15 The insurance industry traditionally called their contract forms „policies“. Other industries used a variety of different terms.

contact with customers using contract forms. These contract forms were similar to the forms we use now when renting a car or filling out an application for an insurance policy. During the next decades, many others followed their example: wholesalers¹⁶ and banks¹⁷, shipping companies and warehouses, hotel owners, landlords, employers¹⁸ and so on.¹⁹ The contract forms were an adequate substitute for national and international regulation, because they were flexible and could be changed whenever needed.

It seems that this „colonization” of contract law by businessmen and companies was accepted in all societies on the road to industrialization. The influential bourgeois classes trusted the self-organizing forces of society, the invisible hand, as it were, at least as long as their own class was responsible for the organization. Naturally, this outlook corresponded with the thinking of the classical economic theories.²⁰ In civil law, it was mirrored in the principle of private autonomy.²¹ How widely the legislators and judges gave space for autonomy of contract is well known.²²

On the level of individual states, the expansion of general conditions of contract continued almost without pause until far into the 20th century. The most important period in the emergence of transnational legal structures begins in the 1870s when the pace of economic internationalization quickened. The question then is whether or not the tendency towards the standardization of contracts in this period tracked the level of the emerging world economy? And if so, whether the autonomous mechanisms of legal regulation which came into existence resembled the law merchant of the early modern era or the international business law of the post-war 20th century?

A careful answer to these questions may already be given here. Some business branches did indeed try to withdraw their cross-border commercial activities from state regulation. As a substitute, they formed their own transnational legal structures. However, before the beginning of World War I, most of them did not proceed further than to a harmonisation of their contract bases.

16 German terms were *Zahlungsbedingungen* and *Lieferungsbedingungen*.

17 German terms were *Bankreglements* and, after ca. 1880, *Allgemeine Geschäftsbedingungen*.

18 Typical German terms were *Fabrikordnungen*, *Arbeitsordnungen*, *Musterarbeitsverträge*, and *Engagementsformulare*.

19 See L Raiser, *Das Recht der Allgemeinen Geschäftsbedingungen* (1935), Bad Homburg 1961 [reprint] and U Michel, *Die allgemeinen Geschäftsbedingungen als Vertragsbestandteil in der Rechtsprechung*, Tübingen 1932, both with many further citations.

20 S Lammel, *Rechtsbildung durch Verträge und Vertragsbedingungen*, in K O Scherner (ed.), *Modernisierung des Handelsrechts im 19. Jahrhundert*, Heidelberg 1993 p. 96.

21 This process started as early as ca. 1770 in England. There, the move towards the liberty of contract is closely associated with the judge Lord Mansfield and the economist Adam Smith. See P S Atiyah, *The Rise and Fall of the Liberty of Contract* (1979) pp. 120 foll., 194 foll.

22 See S Hofer, *Freiheit ohne Grenzen?*, Tübingen 2001; PS Atiyah, *The Rise and Fall of the Liberty of Contract*, Oxford 1979; and HN Scheiber (ed.), *The State and the Freedom of Contract*, Stanford 1998.

Early beginners were again parts of the transport and insurance industries. The performances offered by wholesale companies, marine insurers and re-insurance companies were typically border-crossing.²³ As a result, these industries became experienced in dealing with all the legal difficulties which arose due to the international exchange of goods and services. Since the legislators believed that the businessmen involved in these branches did not need any specific protection, state regulations of the related contract law were almost nonexistent. Thus, as I have noted above, the absence of regulation meant that there was room for transnational legal structures to develop, which soon thereafter took place. From the middle of the 19th century on, diverse conditions on contracts in the transport and insurance industries were put into place.²⁴ The formation of cartels like the *Internationaler Transportversicherungs-Verband* (International Transport Insurance Association, founded in 1871) intensified this development. The companies also shifted the mechanisms of conflict resolution away from the state, by agreeing to the formation of non-state arbitral tribunals.²⁵ It seems that many of them were deeply distrustful of the ordinary jurisdiction.²⁶

10

In the following table I have sketched a brief timeline of the standardization of contract conditions which spread from the middle of the nineteenth century to right before World War I.

11

International Standardization of contract conditions (selected examples):

12

after 1853	Adaptation of the <i>Allgemeiner Plan Hamburgischer Seeversicherungen</i> (Hamburg Standard Form of Marine Insurance Policies) in Denmark, Sweden, Norway
1860s	International standard contract forms („ <i>Charters</i> “) of steam-boat transportation
1875	A new <i>Bremer Seeversicherungs-Police</i> (Marine Insurance Policy of Bremen) was developed in cooperation with the <i>Internationaler Transportversicherungs-Verband</i> (ITVV, International Transport Insurance Association) and steam-boat transportation clauses of the ITVV contracts were standardised
1878	Negotiations on the World Post Congress in Paris on common policy conditions for consignment insurance
1878	Agreement on a standard clause for transport insurance contracts concerning the exclusion of liability for perishables

23 KO Scherner, Rechtsvereinheitlichung für grenzüberschreitende Leistungen: Eisenbahnen, Banken, Versicherungen, in C Starck (ed.), Rechtsvereinheitlichung durch Gesetze, Göttingen 1992 p. 43.

24 See V Labraque-Bordenave, *Traité des assurances maritimes en France et à l'étranger. Polices internationales comparées, unité, reformes*, Paris 1876.

25 In some industries like the re-insurance business, almost every contract contained arbitration clauses.

26 R Neugebauer, *Versicherungsrecht vor dem Versicherungsvertragsgesetz*, Frankfurt/Main pp. 142 foll.

1880s	Plans made by the ITVV for the adoption of standard policies for railway transport insurance contracts
1881	Adoption of a River Transportation Policy by the Rotterdam Stock Exchange
1890	Standard Freight Transportation Conditions adopted by the Rhine shipping companies
1892	Foundation of the <i>Internationaler Verband zur Transportversicherung von Post- und Eisenbahnsendungen</i> (International Post and Railway Transportation Insurance Association), and harmonisation of members' contract conditions
1893	Common Insurance Conditions offered by a group of insurance companies based in Belgium, Germany, the Netherlands, Austria, and Switzerland to travelers to the World Exhibition in Chicago (the so-called „ <i>Weltpolize</i> “)
1895	Formation of the <i>Mitteleuropäischer Seereise-Unfallversicherungs-Verband</i> (MSUV, Central European Sea Voyage Accident Insurance Association), and agreement on standard contract conditions
after 1895	ITVV policies for the insurance of river transports on Rhine river, and on the East German rivers
1897	Standard insurance conditions of the MSUV for voyages to the Orient and to Northern Europe ²⁷
1899/1900	Efforts made by the <i>Comité international maritime</i> (International Maritime Committee) to introduce standard liability rules for shipping companies
around 1900	Efforts made by the International Law Association to harmonize of maritime law through the international use of standard contract conditions
1900	Agreement on the Harter Act clause for marine insurance contracts
1911	General ITVV conditions for river transportation insurance contracts
1911	Standard La-Plata-Clause for marine insurance contracts
around 1912	Introduction of standard war clauses for transportation insurance contracts, initiative of ITTV

27 Untitled article in 3 Zeitschrift für Versicherungs-Recht und -Wissenschaft, Leipzig 1897 p. 889.

It is striking that this kind of cooperation rarely reached beyond certain geographical limits. Agreements on standard contract conditions and clauses were found mostly on the European continent or within North America.²⁸ And the same holds for the legal standardization of other industries which were not international *per se*, such as the accident, life, and fire insurance industries.²⁹ 13

III. The example of the „earthquake clause”

The possibilities and limits of private legal standardization are perhaps most easily observed in the example of the so-called earthquake clause in the contracts of fire insurance companies. 14

On April 18th, 1906, an earthquake and the fire which followed it destroyed the young metropolis of San Francisco. The fire raged for three days, destroying large tracts of the city.³⁰ No incident before had ever caused comparable damages. On the basis of the existing fire insurance contracts, the international insurance business was obliged to pay damages in the amount of 330 million dollars. A global discussion ensued in the following weeks, concerning the development of a legally flawless exclusion clause of the earthquake hazard from fire insurance contracts. It was pressed ahead by re-insurers who tried, in close cooperation with each other, to promote this idea.³¹ In fact, it was a very small number of insurance managers who reached out to a virtually global network and tried to influence more than five hundred fire insurance companies worldwide as well as cartels, legislators, and the public. Their aim was a globally uniform solution to the problem of the earthquake hazard in fire insurance contracts. In their view, this risk had to be excluded for two major reasons. First, seismology was not yet able to provide sound analyses of the causes of earthquakes, making any prediction impossible. Thus, many considered inclusion of the earthquake hazard in fire insurance coverage to be tantamount to gambling. Second, it seemed likely to them that another disaster like the earthquake and fire of San Francisco would be sufficient to put many insurance companies out of business. 15

For these reasons, the re-insurance managers developed a „perfect“ contract clause called the „earthquake clause”.³² This clause was translated into all the important commercial languages of the time and was then circulated worldwide. 16

28 In this sense, lawyer CF Reatz spoke of the emergence of a *European* marine insurance law. Reatz, *Die Seeverversicherung*, in W Endemann (ed.), *Handbuch des deutschen Handels-, See- und Wechselrechts*, vol. 4/1, Leipzig 1884 p. 322.

29 H Coing, *Europäisches Privatrecht*, vol. II: 19. Jahrhundert, München 1989 p. 563.

30 An impressive description of the disaster appears in: J London, „The Story of an Eyewitness“, in *Collier’s Weekly*, May 5th, 1906.

31 „Zur Katastrophe in San Francisco“ [Position of 20 European Re-insurance companies, Frankfurt/Main April 4th, 1906], in *Masius’ Rundschau* 1906 p. 227.

32 Facts based on studies in the archives of (re-)insurance companies, esp. the Swiss Re (Zurich).

Meanwhile, the issue was being discussed wherever fire insurance was commonly in use. The reactions to the re-insurers' demand were varied.

A number of countries, especially in Europe, agreed to the call for an exclusion of the earthquake hazard from all fire insurance contracts. Cartels adopted standard earthquake clauses into their contract conditions, and in some countries even the legislators supported the move, arguing that their laws provided for the exclusion of that risk from any insurance contract.³³ The acceptance of the „earthquake clause“ was not solely based on the experience of the enormous financial loss in San Francisco. For only months after „San Francisco“, similar events occurred in Valparaiso (Chile), Kingston (Jamaica) and Messina (Italy). Also famous earthquakes of the past like those of Basel (1356) and Lisbon (1755) were recalled. It was argued that such events would ruin the insurance industry without providing any benefit to the victims who would barely be compensated due to the general lack of reserves.

17

Overseas, the question was discussed differently - especially in California and the rest of the United States. After the loss of San Francisco, California was dominated by conflicts between the insurers and the insured whose property had been damaged by the earthquake and resulting fire. The courts judged in favour of the insured. Consequently, some companies tightened their exclusion clauses. But the traumatized public reacted with fierce opposition. On August 1st, 1909, the Californian Senate enacted the California Standard Form of Fire Insurance Policy. It required that all fire insurers from then on had to use identical policies, word for word. Of course, the stipulated contract did not contain the earthquake-clause. It was clear that the insurers would still be responsible for paying out compensation in the case of fires caused by earthquakes. Here, the attempt at standardization begun by the insurance industry was stopped by standardization on the part of the state. Other earthquake-prone areas followed suit.

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The case of the earthquake clause shows in detail how the economic internationalisation of one industry (fire insurance) could result in the standardization of a contract clause. However, similar developments were rare, presumably due to the great efforts which any international standardization required. Still, in this case study at any rate, we can speak of a true harmonisation of fire insurance law in Europe. What is remarkable is that several states actively supported this process by enacting coordinated insurance legislation.³⁴ Furthermore, efforts on the part of some European insurance regulators to establish common rules for the control of the insurance industry³⁵ fit into this picture. All in all one can see that the development of a world economy led to changes in national laws on many different levels – from private contracts between an insurance company and its client to public legislation about the insurance industry as a whole.

19

33 E.g. in Germany.

34 The author's dissertation (see fn 1) examines many examples related to the introduction of the earthquake clause. Besides this specific problem in fire insurance law, legislators from Germany, Austria, Switzerland, France, and further states tried to coordinate their insurance legislation in the

IV. Conclusions

Regarding the regulations of the different branches of industry from 1871 to 1914 as a whole, three parallels with the earlier and the later law merchant become evident. First, the law of the border-crossing industries became more and more international. This is most obvious in the cases of shipping and oversea trade, marine insurance and re-insurance industries. The example of the earthquake clause shows that standard clauses also spread in other industries which were not *per se* international. In both cases, businessmen replaced legislators. Second, the substantive law was subject to permanent changes. Third, non-state institutions for conflict resolution came into existence. In part, one can even speak of an autonomous regulatory mechanism of societal groups organizing their legal affairs more and more on their own.³⁶ 20

But theories which claim that there is an unbroken connection between the old *lex mercatoria* and the new transnational business law of the 20th century³⁷ must be contested.³⁸ Perhaps the principal objection lies in the differences between the legal sources. The early modern *lex mercatoria* was clearly different from state law. Its basis was not much more than a number of legal principles. It did not contain detailed regulation of the diverse subjects that it was applied to. In contrast, we find detailed clauses and contract forms besides legal principles by the late 19th century which later come to resemble in their form the manner of state regulations.³⁹ 21

The question introduced at the start of this essay can finally be answered: The legal structures which emerged in the world economy before World War I through the standardization of contract clauses were principally new. They formed the roots of the transnational law which has been such an important topic of observation and discussion since the 1960s. 22

early 20th century more generally. See the comparative study by the Swiss law professor H Roelli, *Der schweizerische und der deutsche Entwurf zur Kodifikation des privaten Binnenversicherungsrechtes*, in 3 *Zeitschrift für die gesamte Versicherungswissenschaft*, Berlin 1903 pp. 328-370.

35 German, Austrian, and Swiss insurance regulators began negotiations in 1906. A Manes, *Politik*, in Manes, *Versicherungswörterbuch*, Tübingen 1909, Sp. 888.

36 Cf. R Meyer, *Bona fides und lex mercatoria in der europäischen Rechtstradition*, 1994, pp. 15 foll.

37 LE Trakman, *The Evolution of Law Merchant: Our forgotten heritage*, part 1: *Ancient and Medieval Law Merchant*, in 12 *Journal of Maritime Law and Commerce* (1980/81) pp. 1-24; part 2: *The Modern Law Merchant*, as cited pp. 509-529.

38 O Volckart / A Mangels, *Are the roots of the modern lex mercatoria really medieval?*, in *Southern Economic Journal* 65/3 (1999) pp. 427-450.

39 This reflects its contemporary designation as *leges contractus*.