Arbitration and Insurance Without the Common Law

Richard E. Stewart

Stewart Economics, Inc.
www.StewartEconomics.com

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In reinsurance disputes, arbitration offers valuable advantages over courts of law. The advantages, in principle, include informality, speed, expertise, economy and business practicality, all within a controlled, adversarial format.

A natural tendency is to see arbitration as an informal and expert version of a court of law. Reinforcing the tendency are the facts that insurance is deeply infused with Common Law[1] principles, with its main product a legal contract, and that most participants in the arbitral process are members of the bar. The authority of the arbitrators themselves traces to a clause in the policy contract.[2]

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[1] "Common Law" is the legal system of the United Kingdom, the Commonwealth countries and the United States. Beginning in England in the 11th century, the Common Law developed through a long accumulation of judicial decisions, bound together by a flexible requirement of following earlier decisions on the topic. Statutes are used by Common Law states, but the distinctive quality of those states is their strong reliance on cumulative judicial rulings. Hence a great Common Law judge can have an astonishing impact on the law of his country. Modern Anglo-American commercial law was largely the work of two such judges – Lord Mansfield and T. E. Scrutton. By contrast, "Civil Law" legal systems rely on detailed statutory codes as the main source of law, and judicial decisions matter much less.

[2] Hans Smit, *Proper Choice of Law and the Lex Mercatoria Arbitralis*, in Thomas Carbonneau (ed.), Lex Mercatoria and Arbitration, 100-02 (New Orleans: Juris Pub., 1998). As an illustration of how dependent upon the authority of the Common Law the arbitration tradition has become, one leading article on reinsurance arbitration cites court decisions 132 times, custom & practice once, and arbitral decisions not at all. Paul M.

Those ideas have natural tendencies of their own.[3] One is for arbitral procedure to come to resemble Common Law procedure. Another is for substantive rules in arbitrations to come to resemble, or fully to be, some jurisdiction's Common Law, with custom and practice translating into flexibility in applying it.[4]

The drift of reinsurance arbitration toward the methods and substance of the Common Law is entirely understandable. The judicial model of decision-making is a strong one; it has been worked out in detail over centuries; and deep in our culture is a habit of obeying it. Court confirmation is needed to enforce arbitral decisions. Having courts comfortable with arbitral standards is helpful. And, as a practical matter, the judicial style is hard to resist when dealing with a particular question in a particular case.[5]

Hummer, *Reinsurance Arbitrations from Start to Finish: A Practitioner's Guide*, 63 Def. Counsel J. 228 (1996).

[3] Arbitration is used in many industries. This paper concerns only reinsurance. It is a pure case for the reasoning later in the text, with insurers on both sides, the arbitration under an insurance contract, and insurance the subject-matter. The paper argues that insurance and arbitration both came from the same, distinctive source. That is not true of most other industries, so the reasoning here may or may not apply to them.

[4] This tendency is to be distinguished from the issues in international commercial arbitration (in oil, shipping, war reparations and other multinational activities) about how much national judicial review of arbitral decisions is appropriate. There it is a question of international law, trade policy, harmonizing legal systems and arbitral independence. In reinsurance arbitration it is just a matter of adopting another institution's way of doing things. William W. Park, *Control Mechanisms in the Development of a Modern Lex Mercatoria*, in Lex Mercatoria and Arbitration, above, note 2, at 143-72.

[5] The judicial style does not extend to the footnotes in this article. They are indications of source, support and illustration. But they are not rigorous. They do not distinguish

But the drift toward the judicial model of procedure and substance does not come without cost. It compromises the very advantages that arbitration offers – informality, speed, expertise, economy and business practicality.

This drift toward the judicial model is not occurring pursuant to anyone's grand plan. It is opposed by judges, legislators, arbitrators, business, labor, insurers and just about everyone else.[6] That mountain of opposition fails to stop the drift because it is abstract, whereas the drift proceeds via one specific, concrete decision after another – an extra deposition, an extra round of briefs, close evidentiary rulings, additional motion practice, fine analysis of applicable law. The drift continues that way because it is indeed a drift, not a sudden event.

But it is not an aimless drift; it is a drift toward a powerful attraction – the substance and procedures of the Common Law.

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among direct support, indirect support, contrast, comparison, etc. in the manner of law review footnotes.

[6] At first, arbitration had trouble getting accepted in American practice. Francis Kellor, *American Arbitration*, 5-14, 44-51 (Washington DC: Beard Books, 1948). But in the last 40 years, arbitration has become more attractive, and courts and legislatures have promoted it. The result has been the assignment to arbitration of bigger and tougher disputes. Today's arbitrators have to cope with antitrust, financial and reinsurance cases as complex as those before the courts. So arbitrators drift into, indeed seek out, the wisdom and methods of the one institution with unmatched experience with complexity – the Common Law.

The drift could not keep advancing without the support of arbitration practitioners. We don't want to do it, but we do it anyway, one little decision at a time. We are the drifters; the enemy is us.[7]

What if we found out that the attraction of the Common Law is not based on the history and purposes of either arbitration or insurance? Perhaps we would feel more free to resist the drift in those small, specific, concrete decisions.

This paper looks at the background and derivation of arbitration and insurance, with their relationship to the Common Law always in mind.

A Thousand Years Ago

Most businesses can be understood through observation and measurement. Manufacturing, retailing and communications can be understood that way. Insurance and reinsurance cannot.[8] They can only be understood historically or, to put it in a modern idiom, they are exceptionally path-dependent. Where we are today and how we act today are largely foreordained by where we were and what we did yesterday and many years ago.

Today an insurance policy is a Common Law contract, and one might easily suppose it is just another commercial contract – like a lease or a loan agreement – with a pinch of public policy or consumer protection

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[7] From Pogo, "We have met the enemy and he is us" (Walt Kelly, 1970, anti-pollution poster for Earth Day), from Commodore O. H. Perry, "We have met the enemy and he is ours," dispatch after the battle of Lake Erie, 1813.

[8] In this paper, the word "insurance" will be used to include reinsurance, except where the text clearly indicates otherwise. The word "reinsurance" will be used to denote reinsurance by itself.

thrown in. It is not. Neither arbitration nor insurance is a creation of the Common Law. Both began long before the Common Law had a working theory of informal, consensual contract and long before the Common Law supported commerce at all.[9] In fact, the story begins over a thousand years ago.

One of the great strengths of the Roman Empire was its uniform system of law.[10] It provided one legal system for the whole western world. Roman Law had well-developed rules of informal, consensual contract.[11]

As the Western Roman Empire collapsed after 400 A.D., Roman Law lost its hold on civic and commercial life.[12] Western Europe became a

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[9] As used here, "informal" refers to contracts that are based on agreement between the parties, that is, the way we think of contracts today. They are distinguished from "formal" contracts, common in ancient legal systems (including early Roman and early English), which get their force by the exact performance of a ritual, usually reciting a specified phrase or performing a specified act like sealing a document. Formal contracts work without regard to what the parties intend or to the purpose of the transaction.

[10] Edward Gibbon, *The History of the Decline and Fall of the Roman Empire*, vol. vii, pp. 301-88 (New York: Fred de Fau, 1907, 1st ed., 1776-88). As used here, "Roman Law" includes both the civil law, *e.g.*, for contracts between citizens (*ius civile*) and the customary law of commerce with people outside the Empire (*ius gentium*). By analogy, the English Common Law would be *ius civile* and the Law Merchant would be *ius gentium*. Harold J. Berman, *Law and Revolution: The Formation of the Western Legal Tradition*, 339-406 (Cambridge US: Harv. U. Press, 1983), hereafter "Berman, *Revolution*."

[11] H. F. Jolowicz, *Historical Introduction to the Study of Roman Law*, 294-320 (Cambridge UK: Camb. U. Press, 1954); Barry Nicholas, *An Introduction to Roman Law*, 159-207 (Oxford UK: Clarendon Press, 1962); Peter Stein, *Roman Law in European History,* 1, 20, 25-26 (Cambridge UK: Camb. U. Press, 1999).

[12] Paul Vinogradoff, *Roman Law in Medieval Europe*, 1-31 (London: Harper & Brothers, 1909, reprinted Union NJ: The Lawbook Exchange, 2001).

lawless, disorganized, and dangerous place, and it stayed that way for hundreds of years.[13]

In that vacuum new institutions grew up. Feudalism, while hardly efficient, did provide peace and protection against bandits and marauders. The King and feudal lords could extend their peace to merchants nearby or from around the world.[14]

But what about long-distance trade – spices from the East, grain from the South, metals from the North? Transporting valuable materials across many feudal jurisdictions and across broad expanses of land or sea was a good way to get killed and an absolutely certain way to get robbed, taxed and squeezed again and again. In economic terms, the post-Roman disorder loaded transaction costs onto commerce and drove up prices. The situation, as a drag on trade, again called for new institutions.

Starting in the 11th century, the new institutions for trade included the Fair and later the Staple Town as safe and reliable places to trade.[15] Those scattered locations were tied together by generally accepted rules and

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[13] Fernand Braudel, 2 *The Mediterranean and the Mediterranean World in the Age of Philip II*, 134-54 (New York: Harper & Row, 1973); Paul Vinogradoff, *Feudalism*, in 3 Cambridge Medieval History, 458 (Cambridge UK: Camb. U. Press, 1924, reprinted at http://socserv2.socsci.mcmaster.ca/~econ/ugcm/3ll3/vinogradoff/feudal).

[14] Magna Carta, ch. 41 (1215).

[15] Berman, *Revolution*, 340-41; Francis M. Burdick, *What is the Law Merchant?*, 2 Colum. L. Rev. 470, 478-82 (1902); Charles Kerr, *The Origin and Development of the Law Merchant,* 15 Va. L. Rev. 350, 356-61 (1928-29); J. E. S. Broadhurst, *The Merchants of the Staple*, in 3 Select Essays in Anglo-American Legal History 16 (Boston: Little Brown, 1909). Fairs had existed for centuries, and vestiges exist today in the annual state Fairs. But Fairs were "new" in the 11th and 12th centuries, in the sense that they were uniquely important during those years, more than before and more than after.

customs to govern commercial activity. The rules and customs were compiled from time to time, combined with the rules of the sea, and called the Law Merchant.[16]

The Law Merchant

The Law Merchant consisted of the accumulated customary rules and practices of merchants in the trading cities and countries, particularly regarding foreign and maritime commerce.[17] The rules arose out of what the merchants really did and the rules they really followed. They were remarkably uniform in Europe and other trading lands in the Late Middle Ages.[18]

Customary laws, as accumulations of custom and practice, tend to concentrate on simple central ideas, in this instance the idea of good faith. The Law Merchant was dedicated to efficient, ethical trade. Good faith was

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[16] Berman, *Revolution*, 333-56.

[17] The best single source for the Law Merchant is William S. Holdsworth, *A History of English Law*, vol. 5, pp. 60-120, 131-148; vol. 8, pp. 99-300 (London: Sweet & Maxwell, 2d ed., 1937, reprinted 1991-92), hereafter "Holdsworth, *H.E.L.*" It could be cited for much of the text, but will only be cited where especially useful. Among earlier descriptions of insurance under the Law Merchant, the best are Gerard Malynes, *Consuetudo Vel Lex Mercatoria or The Ancient Law Merchant*, 145-56 (London: Adam Islip, 1622; reprinted Amsterdam: Theatrum Orbis Terrarum, 1979); and Nicolas Magens, *An Essay on Insurances*, preface and vol. I, pp. 1-95 (London: J. Haberkorn, 1755).

[18] Malynes, above, note 17, at 3; Leon E, Trakman, *The Law Merchant: The Evolution of Commercial Law*, 7-12 (Littleton CO: Fred B. Rothman & Co., 1983); William R. Vance, *Handbook on the Law of Insurance*, 243-44 (St. Paul: West Pub. Co., 1904, 3rd ed., 1951); 1 Holdsworth, *H.E.L.*, 526-30.

its simple central idea and speed its chief technique.[19] That approach is different from the approach of other systems of law, such as the Common Law, that concentrate on delimiting rights and duties rather than on vindicating central ideas, and which, therefore, devote a lot of time and effort to getting the limits just right.[20]

The Law Merchant first of all concerned the sea, the rights and duties of ship captains and crews in port and on the coastal waters of Europe and on the Mediterranean Sea. The earliest land trade it applied to was at the medieval Fairs.

Fairs were the largest places to trade in the Late Middle Ages.[21] A sovereign or a feudal lord or the mayor of a town would declare a Fair at a designated place on designated dates. The King or lord or mayor would

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[19] Wyndam Anstis Bewes, *The Romance of the Law Merchant*, 93-107 (London: Sweet & Maxwell. 1923), hereafter "Bewes, *Romance*"; Charles Gross, *Organization and Jurisdiction of Fair Courts*, in 1 Select Cases on the Law Merchant, intro. at xxv-xxvi (London: Selden Society, 1908); Trakman, above, note 18, at 7-17. Ethical behavior and trust are also highly efficient in any business involving long distance and poor communication. That describes the sort of trade the Law Merchant governed – buying and selling over long distances with the active partner at the remote trading scene, utilizing the capital of others who stayed home. The passive investors had no way to supervise the active one. Good faith, and the expectation of good faith, were necessary for the arrangement to work at all, quite apart from higher morality. Carlo M. Cippola, *Before the Industrial Revolution*, 160-64 (3rd ed., New York: Norton, 1994).

[20] Berman, *Revolution*, 339-56. Common Law depended on written records and hence on writing and literacy. One reason customary law stuck to simple core beliefs was that it was part of an oral, not written, tradition. Marc Bloch, *Feudal Society*, 109-16 (Chicago: U. of Chicago Press, 1961).

[21] Fernand Braudel, *The Wheels of Commerce*, 81-94 (New York: Harper & Row, 1982); Thomas Edward Scrutton, *General Survey of the History of the Law Merchant*, 3 Select Essays in Anglo-American Legal History, 7 (1909), hereafter "Scrutton, *Survey*"; Bewes, *Romance*, 93-107.

extend his peace – meaning his military protection – to the Fair site on the Fair days, and to people traveling to and from the Fair. The rules to be applied to trade at the Fair were the custom and practice of trade everywhere – the Law Merchant.

Dispute Resolution under the Law Merchant

For disputes over transactions at the Fair, a resolution device was needed. The Common Law courts, and the neighboring manorial or municipal courts, were not attractive. They were slow and technical and apt to apply the law of one country to merchants from several, with home-town bias to boot.

More appealing was the Law Merchant, with its pro-business orientation, its international constituency, and its arbitrations by the merchants themselves.[22] The arbitrations, like the Law Merchant itself, were outside the judicial system of any nation, and amounted to self-regulation by the merchant class.[23]

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[22] Berman, *Revolution*, 346-48; Paul R. Teetor, *England's Earliest Treatise on the Law Merchant: The Essay on Lex Mercatoria from The Little Red Book of Bristol (circa AD 1280)*, 6 Am. J. Legal Hist. 178, 182, 188-90 (1962). Sometimes the mayor or other official who had called the Fair would preside, but the merchants made the decisions. Bewes, *Romance*, 87-88.

[23] Malynes, above, note 17, at Epistle Dedicatorie ("Lex Mercatoria…is a Customary Law…of all Kingdomes…and not a Law established by…any Prince…."); Frederic W. Maitland, *Review of "The Guild Merchant,"* Economic Review, 1891 (reprinted in Collected Papers of Frederic William Maitland, vol. II, Essays Part 3 (Cambridge UK: Camb. U. Press, 1911, reprinted http://oll.libertyfund.org/Texts/LFBooks)); Leon E. Trakman, *From the Medieval Law Merchant to E-Merchant Law*, Univ. of Toronto Law Journal, vol. 53, no. 3 (Toronto: U. of T. Press, 1993, reprinted www.utpjournals.com).

Arbitrations at Fairs were quick and informal.[24] Some panels were set up to resolve disputes between two tides, that is, in 24 hours from petition to award. The arbitrations were called "piepowder courts," because they worked so fast that participants still had dust from the fairground on their feet (pieds poudrés). Enforcement was by the merchants and administrators of the Fair, but was apparently infrequent, as awards could be secured and expulsion from the Fair was always possible.[25]

Fairs were temporary commercial centers, confined to a small area on set dates, and lasting a month or less. It would have been more efficient to have a full-time place that offered the Fair's advantages – safety, density of merchants, standard weights and measures, and reliable settlement of disputes.

The answer was the Staple Town (or "market town"), designated by the King or lord to host some or all trade with the rest of the world. The Staple Towns provided physical safety and the other advantages of Fairs, plus continuous operation, permanent residence and lower costs. They planted the Law Merchant enduringly on English soil. In the Staple Towns, the Law Merchant was a permanent resident of England, not just a visitor at

[24] Burdick, above, note 15, at 470-74. The need for speed grew out of the circumstances – a ship in port for a few days, a Fair due to close the next week.

[25] Teetor, above, note 22, at 196-201; J. H. Baker, *The Law Merchant and the Common Law before 1700*, 38 Camb. L. J. 295, 303 (1979).

Fair Time. The Fairs began to decline in the early 14th century as the Staple Towns replaced them.[26]

In both Fairs and Staple Towns, the arbitrators and market courts observed the customs and practices of the Law Merchant. Consensual contracts were to be performed, and that included informal contracts and even oral ones. Hearsay evidence was admitted. The objective was to keep commerce moving, and the contribution of the arbitrators was to make decisions that were sensible and quick.[27]

Insurance under the Law Merchant

English Common Law did not develop a reliable theory of informal, consensual contract until the 17th century.[28] Before that, the only contract actions were excruciatingly slow, formalistic and unreliable, with ancient and capricious defenses such as trial by oath-helpers.[29]

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[26] One should not conclude that Fairs had only a brief existence. They had begun long before the Late Middle Ages. See above, note 15; Bewes, *Romance,* 1-11.

[27] William S. Holdsworth, *The Early History of the Contract of Insurance*, 17 Colum. L. Rev. 65, 91 (1917), hereafter "Holdsworth, *Early History"*; J. H. Baker, *The Law Merchant and the Common Law before 1700*, 38 Camb. L. J. 295, 299-301 (1979).

[28] 3 Holdsworth, *H.E.L.*, 412-54; A. W. Brian Simpson, *A History of the Common Law of Contract*, 280-315 (Oxford UK: O. U. Press 1976, 1996); Nicholas, above, note 11, at 162.

[29] The early Common Law had curious ways of determining which party to litigation enjoyed the favor of God, which influenced the outcome more than proof of facts. One was trial by battle. Another was trial by ordeal – crushing weights, red hot stones, near-drowning, etc. If you survived, it showed God was on your side. Oath-helpers were part of "waging one's law" or "compurgation," in which the defendant swore he hadn't done what he was accused of, and residents of the area swore (without knowing) that he was telling the truth. Frederick Pollock and Frederic William Maitland, *The History of English Law before the Time of Edward I*, vol. 2, pp. 184-233, 632-39 (2nd ed.,

The Law Merchant had recognized consensual contracts as far back as 1200 A.D., and probably a century or two before that.[30] Insurance in the modern sense began around the same time. The insurance was marine. It could be on the ship or on the cargo. It could be combined with a loan on the ship or cargo (bottomry or *respondentia*), or it could be purchased separately, free-standing.[31]

Where insurance developed so early was in the trading city-states of northern Italy and Spain in the Late Middle Ages. Starting around 1200 A.D., Barcelona, Genoa, Florence and Venice dominated Mediterranean trade, and that trade brought grain, spices, metals, cloth and jewelry to Europe. The legendary merchant princes of the era made their money in the trade.[32]

The great traders needed to borrow, and modern deposit banking appeared. They needed to transfer title to goods without physical delivery and to make payment without carrying a lot of gold, and trade documents

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Cambridge UK: Camb. U. Press, 1898, reprinted 1952); Wyndham Beawes, *Lex Mercatoria Rediviva: or The Merchant's Directory*, 292 (4th ed., London: J. Rivington, 1783, reprinted Ann Arbor: UMI Books, 2001), hereafter "Beawes, *Rediviva*."

[30] 1 Holdsworth, *H.E.L.*, 570; Bewes, *Romance*, 63-69.

[31] Holdsworth, *Early History*, 88.

[32] Raymond De Roover, *The Rise and Decline of the Medici Bank*, 142-66 (Washington DC: Beard Books, 1999); David Abulafia and Christopher Allmand eds., *The New Cambridge Medieval History*, vol. v, pp. 61-70, vol. vii, pp. 150-53 (Cambridge, UK: Camb. U. Press, 1998, 1999).

such as the bill of exchange (or check) were invented. They needed to cover the physical risks of transport, and modern insurance began.[33]

It was the Law Merchant that fostered these imaginative, essential tools of emerging modern business, not English law or the law of any other state.

The Common Law as an Obstacle to Commerce

The English Common Law of the time was not supportive of commerce.[34] Land was the main form of wealth, and commerce in land meant alienating land. Preventing the alienation of land meant more of it would pass according to the mediaeval rules of tenure.[35]

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[33] Robert S. Lopez, *The Commercial Revolution of the Middle Ages, 950-1350*, pp. 103-05 (Cambridge UK: Camb. U. Press, 1976). As early as 1601, the English Parliament (probably Francis Bacon) explained the importance of insurance to commerce in words never surpassed for elegance and perception: "…by meanes of whiche Policies of Assurance it comethe to passe, upon the losse or perishinge of a Shippe there followethe not the undoing of any Man, but the losse lightethe rather easily upon many, then [than] heavily upon fewe, and rather upon them that adventure not then those that doe adventure, whereby all Merchantes, spiallie [especially] the younger sorte, are allured to venture more willinglie and more freelie …." *An Acte concerninge matters of Assurances, amongst Merchantes*, 43 Eliz. c. 12 ¶1 (1601). Statutory text in David Jenkins and Takau Yoneyama (eds.), *History of Insurance*, vol. 7, pp. 3-5 (London: Pickering & Chatto, 2000). For an impressive list of the contributions to commerce of the Law Merchant, see Berman, *Revolution*, 349-50.

[34] Frederic W. Maitland, *The Law of Real Property*, Westminster Review, 1879 (reprinted *The Collected Papers of Frederic William Maitland* (Cambridge UK: Camb. U. Press, 1911, reprinted http://oll.libertyfund.org/Texts/LFBooks)); Frederic W. Maitland, *The Forms of Action at Common Law*, 16-42 (Cambridge UK: Camb. U. Press, 1909, reprinted 1997).

[35] William Blackstone, *Commentaries on the Laws of England*, vol. 1, pp. 263-64 (Oxford UK: Clarendon Press, 1765, reprinted Birmingham AL: Legal Classics Library, 1981); 4 Holdsworth, *H.E.L.*, 446-47. In addition, land relationships were tightly intertwined with political and social relationships, for that is the definition of feudalism (a

Under the old feudal rules, the transfer of land (usually upon death) to descendents, spouses and churches, called for services and payments to be rendered to the lord of whom the land was held. So did certain events involving the tenant, such as wardship, marriage, escheat and forfeiture. These "incidents of tenure" significantly supplemented, and may eventually have exceeded in value, the annual services and payments that were owed to the lord for the right to farm the land and to live on it.[36]

The incidents of tenure were a main source of income for the land-owning classes, including the King. If land could be freely alienated outside the system of feudal incidents of tenure, that revenue would be lost.[37] One suspects that the economic interest affected the law.[38] Certainly

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contract exchanging protection and the use of land for loyalty, service and a share of crops). A great landowner was *ipso facto* a powerful political figure. That was another reason – besides revenue – for the Common Law to be set against passing land around as just another item of commerce. Frederic W. Maitland, *The Constitutional History of England*, 23-32 (Cambridge UK: Camb. U. Press, 1908); Vinogradoff, above, note 13, *passim*.

[36] A. W. Brian Simpson, *An Introduction to the History of Land Law*, 21-23, 186-88 (Oxford UK: O. U. Press, 1961); S. F. C. Milsom, *Historical Foundations of the Common Law* 88-102 (London: Butterworths, 1969).

[37] Thomas Edward Scrutton, *Land in Fetters*, 37-69, 101-07 (Cambridge UK: Camb. U. Press, 1886); Theodore F. T. Plucknett. *A Concise History of the Common Law*, 30-31 (4th ed., London: Butterworth & Co., 1948); Simpson, above, note 36, at 21-23, 48-60, 77-86, 171-75; 4 Holdsworth, *H.E.L.*, 446-47.

[38] The five-hundred-year struggle over alienability of land was part of a larger struggle over revenue, as feudalism wound down. The King was always a landowner, and the peers and others of great wealth near the top of the feudal pyramid were usually landowners (being tenants only of the King and lords of everyone below them), so both wanted to maximize collections under the incidents of tenure. Tenants, on the other hand, wanted to avoid the incidents of tenure by transferring land by their own actions – sales, wills, etc. The fee tail apparently started that way in the 12th century. It enabled the tenant to ensure future succession in the family by the terms of his own grant, so the relevant incident of tenure (inheritance) would not have to be paid for each generation.

the interest was well served by the formidable and tenacious barriers the Common Law put up against free commerce in land.

In the Late Middle Ages, commerce in goods was picking up, but the English Common Law did not provide the necessary framework for it. If the Common Law courts had tried to use the law they had – land law – as the basis for the law of commerce in goods, the natural result would have been cumbersome and obstructionist, slow and expensive.[39] The result would also have been unlikely to support, or perhaps even to permit, the emergence of a modern insurance business.

Insurance as a Law Merchant Institution

Insurance was commonplace in the Mediterranean trade, certainly from the 14th century on. It had to be accomplished, as they said back then, "at the speed of commerce."[40] So the underwriters and brokers thought up shortcuts. One was the binder. It was an ingenious way to keep up with commerce at a time when scriveners were slow and in great demand, and moveable-type printing had not yet been invented.

Joseph Biancalana, *The Fee Tail and the Common Recovery in Medieval England*, 9-20 (Cambridge UK: Camb. U. Press, 2001). Other examples of the economics of revenue driving the law of land include three of the most famous statutes of the Late Middle Ages – the Statute of Marlborough (1267), *De Donis Conditionalibus* (1285) and *Quia Emptores* (1290).

[39] Simpson, above, note 36, at 112-134; Pollock and Maitland, above, note 29, at 184-233; Maitland, above, note 34, *passim*.

[40] William R. Vance, *The Early History of Insurance Law,* 8 Colum. L. Rev. 1, 67 (1907), hereafter "Vance, *Early History.*" In practice, the speed of commerce meant the time merchant ships were in port – a few days.

The trading city-states promulgated mandatory policies, so the binder did not have to specify the policy form.[41] Most of the time, the full policy text was never written out at all.[42]

The trading states had insurance commissioners to establish rules.[43] They used arbitrators to resolve transaction-specific disputes. The arbitrators were to be from the merchant class and they were to apply the rules of mercantile custom and practice.[44]

The Law Merchant was dedicated to facilitating commerce. Insurance policies were to be construed "largely, for the benefit of trade, and for the insured."[45] That was the original reason policies were construed in favor of coverage. The Common Law concept of ambiguity came later.

But the Law Merchant had weaknesses. It was law for a class – the merchants – unlike the Common Law, which was for everyone. It did not

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[41] Magens, above, note 17, at vol. II, pp. 4-5; Warren Freedman (ed.), *Richards on Insurance*, 2074 (5th edition, New York: Baker Voorhis, 1952). Both give the full text of a standard policy from Florence in 1523.

[42] Holdsworth, *Early History,* 91; Beawes, *Rediviva*, 292. .

[43] Edwin W. Patterson, *The Insurance Commissioner in the United States*, 513-15 (Cambridge US: Harv. U. Press, 1924).

[44] 5 Holdsworth, *H.E.L.*, 81-84. While Law Merchant arbitrations were independent of the host country's law, the English central courts of Chancery and Common Law did occasionally swoop in with the King's writs to remove cases, for special reasons such as royal policy or the international status of the parties. Hubert Hall, *The Sources for Law Merchant Cases*, in 2 Select Cases on the Law Merchant, intro. at ix-xlii (London: Selden Society, 1929).

[45] James Allan Park, *A System of the Law of Marine Insurances*, 44 (London and Philadelphia: Joseph Crukshank, 1789), quoting with approval Lee, C.J. [1743], hereafter "Park, *Insurances.*"

generate precedents and records, for the arbitrators made oral awards without opinions.[46] And it had no enforcement mechanism once the Fairs and Staple Towns had dwindled. It had to rely on the host state, which meant its King and its courts.[47]

Those three weaknesses would become serious if the Law Merchant's authority were challenged. And it was challenged in England in the 17th century, as part of the struggle for supremacy between the King and the more popular branches – Parliament and the Common Law courts.

Why the Law Merchant was Absorbed by the Common Law

The 17th century was a strenuous time in English politics. Royal beheadings, riots, murders, Protestant-Catholic warfare, government overthrows, a swing from absolute monarchy to republic, then dictatorship, followed by a limited monarchy (from Holland) with parliamentary supremacy. The net effect of all of this turmoil was to shift a lot of political power from the King to Parliament and the courts of the Common Law.

The Law Merchant was, when all was said and done, a creature of royal authority. It had grown under the protection of the royal prerogative – to keep the Fair ground and ocean transit safe, to enforce arbitrators' awards, and to keep competing courts (common law, ecclesiastical and admiralty) out of the merchants' way. Those protections were withdrawn when the monarchy could no longer sustain them. A system without

[46] Beawes, *Rediviva*, 342.

[47] Vance, *Early History*, 12-14; Holdsworth, *Early History*, 99-107.

enforcement, without written records, a system for an elite class in an era of government for the common man – such a system was in deep trouble in the 17th century.

During the struggle between the crown and the legislature and courts, the leader of the courts, Chief Justice Sir Edward Coke, declared that "the Law Merchant is part of the law of this Realm."[48] It was a political statement as well as a legal one.[49]

As a legal matter, Lord Coke did not claim that the mercantile customary law had been assimilated into the Common Law. It certainly had not, and to achieve assimilation, a lot more work lay ahead.[50] Recall that the Common Law was primarily land law. The free transfer of land was far from being a goal of the Common Law. The free transfer of goods was at the heart of commerce.

Conservative as it appears, always looking back for precedent, the Common Law has repeatedly adapted its rules so as to further the progress of commerce and community. But adapting the Common Law to the needs of modern commerce was not to be easy. Not only was the Common Law set against free trading in land; it was highly detailed, formalistic and

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[48] Edward Coke, *The First Part of the Institutes of the Lawes of England, Or, A Commentarie Upon Littleton*, §182a (1628), quoted in 5 Holdsworth, *H.E.L.*, 145. Note that Coke did not say the Law Merchant was part of the *Common* Law, and he identified three elements of the law of England: statute, common, and mercantile.

[49] William S. Holdsworth, *Sir Edward Coke*, 5 Camb. L. J. 332, 334-37 (1933-35).

[50] Burdick, above, note 15, at 479.

tedious, with labyrinthine procedures that were not likely to move "at the speed of commerce."[51]

During the 16th and 17th centuries, the courts began the process of absorbing the Law Merchant into the Common Law, but their efforts were piecemeal and fell well short of full integration.[52] That required a wider view, a more comprehensive approach, and got it, from William Murray, Lord Mansfield.

Lord Mansfield and the Law Merchant

William Murray was a Scot educated in both the Common Law and in the Scottish law that had received much of Roman Law. His learning extended well beyond the Common Law, to include several European legal systems and the Law Merchant.[53]

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[51] Scrutton, above, note 37, 1-2 and *passim*; 3 Holdsworth, *H.E.L.*, 217-56; Maitland, above, note 34, *passim*.

[52] 1 Holdsworth, *H.E.L.*, 568-73. In the 16th and 17th centuries, the first shifts of insurance disputes from merchant arbitration to Common Law litigation led to a deterioration in claims practices. The eloquent Statute of 43 Elizabeth, quoted above, note 33, went on, in the next sentence, to find: "And whereas heretofore suche Assurers have used to stande so justlie and p'cisely [precisely] on their credites, as fewe or no Controv'sies have arisen thereupon, and if any have growen the same have from tyme to tyme bene ended and ordered by certaine grave and discreete Merchantes, appointed by the Lorde Mayor of the Citie of London, as men by reason of their experience fitteste to understande, and speedily to decide those Causes; until of late yeeres that divers psons [persons] have withdrawen themselves from that arbitrarie [arbitral] course, and have soughte to drawe the parties assured to seeke their moneys of everie severall Assurer, by Suites comenced in her Majesties Courtes, to their greate charges and delayes …." Jenkins and Yoneyama, above, note 33.

[53] Charles Kerr, *The Origin and Development of the Law Merchant*, 15 Va. L. Rev. 350, 362 (1928-29); William S. Holdsworth, *Some Makers of English Law* 161-62 (Cambridge UK: Camb. U. Press, 1938, reprinted 1966). Dr. Samuel Johnson, history's foremost

He became an illustrious barrister and then a Member of Parliament, Solicitor General and Attorney General of England. Looking for yet bigger things, he got himself named Lord Chief Justice of England, a post that put him at the helm of the Common Law. He took office in 1752.

Chief Justice Murray, now Lord Mansfield, took up the challenge of really integrating the Law Merchant and the Common Law. Consider what he faced. The bill of exchange, the insurance policy, the honoring of informal agreements, the theory of holder in due course, and the enforcement of honest market agreements even when they later appeared unfair – all were essential to modern commerce, and all were unimaginable under the Common Law of his time.

Yet he succeeded and is now universally regarded as the father of commercial law.[54] How he did it is significant for our inquiry.[55] For he found a way to bring into his deliberations the practical business realities.

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deprecator of all things Scottish, paid tribute to Mansfield (who had been taken to England as a youngster) thus: "Much may be done of a Scotchman if he be caught early." James Boswell, *Life of Johnson*, 568 (London: H. Baldwin & Son, 1791, reprinted Salt Lake City: Project Gutenberg, 2003, www.gutenberg.net).

[54] Could anyone else have done it? Maybe later, but not then, for two reasons. First, a less cosmopolitan and confident Common Law judge would have tried to create a new law of commerce through reform of the old Common Law of land. Given the radically different roots and objectives of the Common Law and the Law Merchant, that would have been just about impossible. The starting point had to be the Law Merchant. Second, Mansfield was not only exceptionally learned; he was exceptionally well-connected. As a former leader in the House of Commons, and as an Attorney General who kept that office for years after going on the bench, he was certainly not anybody's run-of-the-mill judge. Even Mansfield's influence was not unlimited – witness his failure to get the doctrine of consideration out of the Common Law of contract (it was not in the Law Merchant). But a lesser jurist would surely have fallen further short of the goal of fully integrating the two systems. C. H. S. Fifoot, *Lord Mansfield, 2*1-26, 36-42, 82-97, 126-144 (Oxford UK: Clarendon Press, 1936); Simpson, above, note 28, at 407, 617.

As a starting point, the Law Merchant was attractive for its furtherance of commerce, an activity that England was coming to see as central to national success. How to get it into the Common Law?

For centuries the Law Merchant had been proven in court just as any other foreign law was – as a fact for the jury. Jury verdicts left no precedents to guide merchants in the future, just as arbitration awards had left none in the past. Mansfield was trying to get Law Merchant principles into the Common Law and on the permanent, public record. He wanted to take such questions away from the jury and decide them himself, with reasoned opinions for future guidance.[56]

But he needed to learn the current customs and practices of the merchants. The Common Law reports were little help. Very few cases concerned commercial matters, as those had been resolved in arbitrations.[57] So Mansfield empanelled the businessmen themselves to give expert answers to his questions, and they came to be called "Mansfield's jurors."[58] The customs and practices they testified about were the Law Merchant. Mansfield adapted what he learned from the merchants to fit Common Law

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[55] For Mansfield's approach to commercial law, see Fifoot, above, note 54, at 82-117 (Oxford UK: Clarendon Press, 1936); Holdsworth, above, note 53, at 160-75.

[56] Park, *Insurances*, xlii-xliii; Fifoot, above, note 54, at 105-11. James Allan Park was a protégé of Mansfield, and served with him on the Court of King's Bench. Park's book was probably written at Mansfield's suggestion, and it is largely devoted to his opinions.

[57] Scrutton, *Survey,* 8.

[58] James Oldham, *The Mansfield Manuscripts*, 93-99 (Chapel Hill: U. of No. Car. Press, 1992).

requirements. Then in his opinions, he made them the Common Law of England.

As a result of Lord Mansfield's work and of his method, it is impossible to say whether the Common Law absorbed the Law Merchant or the Law Merchant dictated the substance of the Common Law. It is not a choice; both are true.[59]

The Significance for Insurance Arbitration

This historical survey tells us that neither insurance nor arbitration is a Common Law creation. Both have deeper, older roots, quite different from the roots of the Common Law.

Both insurance and arbitration came out of an ancient tradition of furthering commerce through good faith and practicality. For arbitration that meant the speedy vindication of good-faith commercial dealing, from which naturally flowed informality, low cost and reliance on custom and practice.

Those qualities of arbitration from nearly a thousand years ago echo to this day in insurance arbitration. Adherence to custom and practice is inherently conservative, and insurance is, as noted above,[60] highly

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[59] A practical illustration of the cross-assimilation of the Law Merchant and the Common Law is the standard Lloyd's marine policy from late in Mansfield's tenure, which remained the standard policy for hundreds of years. It was a Common Law contract which promised results as reliable as under the Law Merchant ("this…Policy…shall be of as much Force and Effect as the surest Writing or Policy of Assurance heretofore made in Lombard Street…." – the merchant center of London). Charles Wright and C. Ernest Fayle, *A History of Lloyd's*, 127-8, 138 (London: Macmillan, 1928).

[60] Text at note 8.

dependent for its future on the path it has taken to the present. That is surely why even now we sense that insurance and arbitration are different from parallel institutions of our time – first among them the Common Law and the courts that administer it.

Some narrower observations also flow from the historical survey.

One, the intended informality and speed of insurance arbitration can be traced to the circumstances in which Law Merchant arbitrations began – commercial settings on temporary Fair grounds and on merchant ships briefly in port.

The emphasis on good faith, speed and practicality – as the essential qualities of the Law Merchant and its commercial arbitrations – assured that commerce would be able to proceed at its ever-increasing pace, and not be held up by arguments. Those qualities may have contributed as much to the emergence of modern commerce as the substantive rules did. The emphasis on good faith, speed and practicality is compromised by the drift of reinsurance arbitration toward the Common Law decisional model.

Two, insurance and arbitration entered the Common Law from the same source – the Law Merchant. That may be a reason why some Common Law rules – such as rules of evidence – seem too confining when applied in arbitrations. It is also the likely reason for the admonition in arbitration clauses that the panel not be bound to strict law.

Three, the rules to be applied in reinsurance arbitrations were those of custom and practice in the relevant trade, just as in all the Law Merchant. To this can be traced the direction in arbitration clauses to appoint

experienced insurance people and to observe the custom and practice of the business. Such people and such customs could be expected to emphasize speed, fairness and practicality.

Four, in early arbitrations, both parties were from the same class – the merchant class – and the rules of arbitration were from the system of law reserved exclusively for that class, the Law Merchant. That may account for the feeling of many today that insurance arbitrations work best when the dispute is between two members of the same insurance-merchant class (that is, reinsurance arbitrations) rather than between parties of different classes (that is, primary disputes between insurers and lay policy-holders).

Finally, this historical survey reminds us that arbitration is not an offshoot of the Common Law trial, nor is insurance a subset of the Common Law of contract. They come from elsewhere and from another time, both of them with the purpose of promoting honorable commerce. What can look like quaint features of insurance arbitration, and of insurance itself, generally make good sense in terms of their origin and purpose, and often make good sense in today's terms as well.

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