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Reflections on the Historical Origins and Economic Structure of the Law Merchant

Richard A. Epstein*

I. IS THE LAW MERCHANT LAW?

The purpose of this short essay is to make some introductory remarks to frame the debate about the historical evolution and economic structure of the Law Merchant. For these purposes the capitalization of the phrase should not mislead, for by the Law Merchant I mean nothing more pretentious than the commercial law rules—contractual, customary, and statutory—that govern transactions among merchants. It includes the rules governing sale, credit, insurance, transportation, and, probably, partnership. In approaching so salient a topic, it comes as something of a shock to realize that the first order of business in this venerable area is the extensive debate over whether there really is a Law Merchant at all. The positions on this matter are many and subtle, and it is worthwhile to give a capsule account of the overall situation. One point of broad agreement is that a body of law largely directed to the business transactions between merchants arose sometime during the Middle Ages. Much of this law derived from the Roman law of sale, but much of it, such as the creation of bills of exchange and similar credit instruments, was created by merchants in response to the difficulties of trading at a distance. There is further agreement that this law prized freedom of choice and speed of enforcement. There is yet further agreement that it had a distinct international cast in that a large number of transactions that fell within the scope of the Law Merchant involved trade between merchants from two or more nations. Thus, one party often had to sue in a court in which he faced the risk of discrimination as a foreigner. And last, there is some agreement that the principles that were embodied in the Law

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Merchant had some relationship to the *ius gentium*, or the law of nations as it has come down to us from Roman times.

But beyond that, there is massive disagreement. In his treatise *An Exposition of the Principles of Estoppel by Misrepresentation*, John Skirving Ewart takes the strong position that there was no independent body that constituted the Law Merchant but only the collection of national and local practices that governed merchant transactions. He wrote:

The custom of financiers, as of social clubs or other organizations or coteries, is observed and enforced by the law; not because the financiers or clubs enacted or had power to enact laws, but because it is with reference to those customs that the parties have acted or contracted; and it is with reference to them, therefore, that rights and liabilities ought to be adjusted. When these or any other customs obtain general acceptance by the community they then pass into and for the first time become laws.¹

In response, Francis Burdick in 1902 defended the existence of the Law Merchant, heaping scorn on Ewart for taking so skeptical a position. Burdick's chief evidence is the constant reference in the legal literature to matters that were decided in accordance with the Law Merchant, which seemed to suppose a coherent body of law.² Ewart offered a reply that stressed that the Law Merchant had no greater claim to law than international law as a freestanding body of rules.³ That position has been defended after an exhaustive examination of the sources by J.H. Baker, who concluded that the Law Merchant was a body of principles that was only instantiated, at least in England, through common law decisions.⁴ Their appearance in the cases is somewhat delayed because in medieval times these principles were often enforced in specialized merchant courts. But once the action of assumpsit was made available, hints of the Law Merchant were found in the pleadings, in which they were often surplusage (under the liberal assumpsit pleading rules) that explained the background of the case but did not point to an extraterritorial body of law. The clear import of Baker's argument is that, as assumpsit reduced the cost of going to a common law court, the willingness to do so increased, so that any specialized law, if such there be, of the merchant courts became fully assimilated into the common law.⁵

It is something of an open question as to the extent to which the specialized courts developed principles that were, or could be understood to be, at variance with the common law rules. Baker does not pursue that topic, as he is interested

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⁵ Id at 321.
more in the provenance of the law, not its content. And similar conclusions have been reached in dealing with the continental sources.\(^6\)

The historical situation thus gives rise to the possibility that there was some supranational body of legal principles that were enforced in a coordinated fashion in the various courts in which merchants of all nations did business. It gives rise further to the possibility that this law evolved in some spontaneous fashion without the direct intervention of legislation, or even judicial pronouncement, at least before the codification movement that arose in many places toward the late middle ages. On the other hand, the Law Merchant could have a shadowy status as a set of aspirational norms that sometimes worked themselves into the positive law enforced by various sovereigns. Yet its influence was limited because it did not speak to the variation in customs across different jurisdictions or to the differences in the procedures that were used to decide the cases that were supposedly governed by its principles.

Some might think it a great historical achievement to resolve this debate on the status of the Law Merchant, once and for all, over time and across different ancient cities and fledgling nation-states. I take quite the opposite view. In part, I think that the problem here lies less with what the Law Merchant is and more with what counts as a proper definition of law. The persons who deny the independent existence of the Law Merchant are those who adopt, often implicitly, some version of the Austinian theory that marks law as a general command of the sovereign.\(^7\) Those who support it tend to take, as will become clear, a different view of law which looks at it as a set of immanent principles that is so powerful that all sovereigns feel obliged to adopt it. So framed, the debate is as much about the definition of law as it is about the historical origins and development of the Law Merchant itself. There is a deep “chicken-and-egg” problem. One side claims that the various national and local courts adopted the Law Merchant because it was law and was so regarded by the judges. Others claim that it was only law once it had been adopted and enforced by some sovereign. Yet even here, the stern Austinians have to admit that the set of customary practices that merchants developed were not simply a collection of abstract propositions written in a schoolmaster’s diary that only became law once they were recognized in some standard legal proceeding. That seems to be the import of Ewart’s last sentence; even if he cannot quite bring himself to say how a custom is generally accepted by the community unless it is ratified by

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\(^7\) See John Austin, *The Province of Jurisprudence Determined* (J. Murray 1830, reprint Hackett 1998).
statute or judicial decision, the Austinian hallmarks of law. The merchant development of distinctive instruments, like bills of exchange, covered a set of practices that mattered in the real world, even if they did not quite satisfy the Austinian definitions. When Ewart writes that these customs only became law after acceptance, he gives away at least part of the game. What were they the day before that first authoritative decision came down? And how much difference did that decision make in the life of the standard merchant?

I don’t want to try to resolve the definitional dispute here. My own instincts on this score follow the position defended by Emily Kadens, who thinks that the most accurate description of this “hybrid” system finds a place for both the transnational and local elements. So long as we know how the system operated on the ground, we can let any reader choose the definition that he or she finds most congenial. At this juncture, however, I will only say that the key to understanding the vitality of the Law Merchant lies precisely in the fact that no one can be confident whether it had a separate and autonomous existence. That question would have been resolved if law from different sources came into sharp conflict with each other. If the local commercial law of English courts, for example, contrasted sharply with the general body of mercantile principles, then we should see case after case where judges had to choose between them. At that point it would be a simple matter to figure out which prevailed so as to allow for an authoritative answer to this question. But that dog quite simply does not bark, which means in effect that any disputes over the source of law did not insinuate themselves into the substantive rules that decided concrete cases. In effect, the large agreement about outcomes made it possible for just about everyone to finesse the question of how the Law Merchant fit into local systems. The question is why did that happen.

I think that the central clue lies with the treatment of the *ius gentium* or *ius commune* in Roman law. The start of both Justinian’s Institutes, which everyone would have read, is devoted to just this distinction. Justinian puts it thus:

All peoples with laws and customs apply law which is partly theirs alone and partly shared by mankind. The law which each people makes for itself is

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8 Ewart, *An Exposition of the Principles of Estoppel* at 374 (cited in note 1) (“When these or any other customs obtain general acceptance by the community they then pass into and for the first time become laws.”).

9 See Emily Kadens, *Order within Law, Variety within Custom: A Character of Medieval Merchant Law*, 5 Chi J Ind L 39 (2004). The single sentence summary in the text does not do full justice to the nuances in her position, which stresses the interplay of multiple forces. At one level, she notes that customary norms did display similarities across large geographical areas. But at the same time, other customs were tied to particular locales or regions, or even to particular trade groups. The customary system was also buttressed by a combination of local municipal law, and guild practice, as supplemented by legislation. For her term “hybrid” is not a single dimensional concept. For my purposes, the additional complexity only conforms the futility of trying to resolve the status of the law merchant on definitional grounds.
special to its own state. It is called ‘state law’, the law peculiar to that state. But the law which natural reason makes for all mankind is applied the same everywhere. It is called ‘the law of all peoples’ because it is common to very nation.\textsuperscript{10}

Here it should be noted that the passage in question does not locate the \textit{ius gentium} in terms of any particular sovereign, but rather treats the global existence of the \textit{ius gentium} as a matter of fact, indeed as the kind of fact about which there was and could not be any real dispute. Clearly, Justinian was not thinking of Austin when he wrote this passage and was not troubled by any nagging suggestion that the \textit{ius gentium} might not count as law because it had to be “custom” given that statutes could only be enacted by a sovereign. As Barry Nicholas writes of the passage from \textit{Gaius’s Institutes} which Justinian lifted:\textsuperscript{11}

The one [\textit{ius civile}] has no intrinsic moral value and derives its validity from its adoption by the state (the rule of the road would be a modern example), while the other is universally valid, whether it is adopted or not. The one, it has been said, is right because it is law, the other is law because it is right.\textsuperscript{12}

In light of this early indifference to enforcement, the key concern was with the substantive principles that it contained. One of those principles found in Justinian is “to give everyone his due,”\textsuperscript{13} which in this context means, or at least suggests, that people should normally honor the promises that they make. Clearly this proposition is a massive overstatement of the law of virtually any society that we care to mention. But even so, it has powerful implications for the study of the Law Merchant because it strongly suggests that people should be allowed to enter into the bargains that they desire on the terms and conditions that they see fit. It was in effect a generalized statement which, whether the Law Merchant existed or not, defined the general attitude toward mercantile transactions. There is, for example, in the \textit{Digest} a clear recognition of the mutual gain that comes from the contracts of sale, whereby one party surrenders that which he has in excess in order to obtain the funds to buy something else that he lacks.\textsuperscript{14} The proposition does not quite embody all the modern terminology that stresses gains from trade, but it points unmistakably to the proposition that trade is a positive sum game for the parties which, by creating new mercantile opportunities for others, has positive externalities as well, as we moderns like to say. The constant harping on the basic theme of freedom of contract is central to Leon Trakman’s somewhat rhapsodic celebration of the medieval Law

\begin{thebibliography}{14}

\bibitem{10} \textit{Institutes} 1.2.1, in Peter Birks and Grant McLeod, trans, \textit{Justinian’s Institutes} 37 (Cornell 1987) (facing page Latin text edited by Paul Krueger).
\bibitem{11} \textit{The Institutes of Gaius} 1.1 (Clarendon 1946) (Francis De Zulueta, trans).
\bibitem{12} Barry Nicholas, \textit{An Introduction to Roman Law} 54 (Clarendon 1962).
\bibitem{13} \textit{Institutes} at 1.1.3 (cited in note 10).
\bibitem{14} \textit{Digest} 18.1.1 (Paulus), in Alan Watson, trans, 2 \textit{The Digest of Justinian} 513 (Pennsylvania 1985) (facing page Latin text edited by Theodor Mommsen and Paul Krueger).
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That point holds whether or not we accept his view that the origins of the Law Merchant lie in the autonomous, decentralized, and customary actions of the mercantile community.

There is a substantial payoff to this substantive agreement about the ideal of the *ius gentium*. In the first place, nothing in the *ius gentium* precludes the use of local customs to enforce basic rights. Quite the opposite: in line with Kadens's hybrid vision, the original formulation of the principle manifestly invites local variation on important points of detail. The Romans used stipulations as their formality for certain unilateral obligations but allowed the formation of consensual contracts, including sale and partnership for others. The *ius gentium* is not offended by these variations. It is also satisfied if writings are required as evidence in certain sales, or if partnerships are effective only if publicly recorded. From the beginning, the basic distinction between *ius civil* and *ius gentium* is that matters of formality and enforcement may well depend on the nature of the underlying obligation and the social setting and material circumstances that surround the formation of the agreement. Contracts at a distance (which precludes the question and answer form of stipulations) present greater difficulties in any conception than those which are formed between two parties in the presence of each other. The local law can adapt rules that facilitate contracts in both these settings. The two systems could be at variance with each other in their formal requirements, but neither is at variance with the *ius gentium*, which in its original formulation displays the same elusiveness later found in its offshoot, the Law Merchant. The modern private international law, with its expansive acceptance of choice of law and forum selection clauses, is a regime that seems to fall squarely within the Law Merchant position, precisely because it adopts a strong orientation toward freedom of contract.  

A. FREEDOM OF CONTRACT ON A LIMITED TERRAIN

The question then arises: why does the Law Merchant, whatever its status, show such an affection for the principle of freedom of contract? Due emphasis should be attached to the word "merchant." The legal situation would have been quite different, then and now, if our topic was the Law Farmer, the Law Employee, or the Law Consumer. In each of these settings, we instantly have the intervention of huge forms of regulation (or dispensation from regulation), which by no stretch of the imagination could be regarded as consistent with either the *ius gentium* or the Law Merchant. The Law Employee and the Law Farmer are antitheses of what the Law Merchant requires. Notwithstanding the

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obvious substantive differences between them, both bodies of law have moved in the same direction: efforts among farmers or workers to form united fronts are exempted from the operation of the general antitrust law. Further, barriers to entry by others who might wish to compete with established players are erected by the law, whether in the form of exclusive representation systems of collective bargaining or the requirements to obtain state permits to plant corn in the next growing system. And consumers of course are always protected against their own mishaps, often to their own detriment.

Without pretending to offer the slightest respectability to these deviations in the Law Farmer, Law Consumer, and Law Employee, a certain strong logic indicates that merchants are in fact the strongest candidates for a general regime of freedom of contract. These individuals are in the prime of life. They have chosen to enter a specialized market. They cannot claim special protection because of some special disability. At this point, the (universal) observation that mutually anticipated gains are the outcome of voluntary exchange seems too powerful to deny. If that is correct, the object of the system is to increase the velocity of transactions in order to wring the last vestige of gain out of all present and future exchange relationships, which accounts for the “formal” (self-contained with clear standard terms) nature of bills of exchange and other commercial documents. Since the merchants are, moreover, drawn from the same economic and social class, the frequent concerns with unconscionability, inequality of bargaining power, and exploitation of the weak and helpless does not resonate at all in the field. Which merchant would be exploiting which? Hence the usual communitarian, socialist, anti-market rhetoric is silent here.

To be sure, these writers could attack the existence of a merchant class on the ground that it rests on the dubious institution of private property. But that frontal assault has no resonance in a body of law that is intended to deal with various facets of exchange. Of course, merchants are worried about whether this seller can supply good title to his goods or that buyer is able to persuade the seller that his check is valid. But those are not first-order challenges to the system of private ownership. Quite the opposite: the claim that X has bad title to a given chattel presupposes that someone else has good title to it and thus reinforces the legitimacy of a system of private ownership by condemning claims that are inconsistent with it. Whatever doubts one has about the validity of the first possession rule, they generally have no place whatsoever in the elaboration of merchant rules. And so the Law Merchant gets a general pass from the broad assemblage of anti-market forces.

The same can be said on the pro-market side of the intellectual spectrum. Most of the transactions that involve merchants are buying, shipping, and paying. In the background looms the possibility that the merchants in any transaction are part of a particular guild. This possibility raises the kinds of competition policy issues of direct concern to free market economists from
Adam Smith forward, who do not see the workings of the beneficent invisible hand when guilds are part of the basic institutional structure. Indeed, the toughest issues in international trade revolve around just those questions. There are the hard-core trade issues of tariffs and entry restrictions, and the second-tier questions of how domestic antitrust law should respond to coordinated activities of sellers who organize outside the local jurisdiction but sell their goods within it. Yet the questions of whether various nations should sign on to the Convention on Contracts for the International Sale of Goods, which deals with the issues covered by the Law Merchant, generates much learned dispute but remains politically invisible in comparison with the high-level publicity that surrounds each round of the talks in the World Trade Organization.

There is a powerful explanation as to why the transactional issues covered by the Law Merchant do not stir the blood of those who have a deep dread of monopoly practices. Even if merchant combinations did play a role in particular cases, it is hard to see how their members could prosper by proposing or adopting norms that led to inefficient transactions. The monopolist normally wants to make cost-effective changes in his products just like anyone else. The choice of customary terms seems to be no different from any other type of innovation that he might make. Once the product is better, he can raise prices and leave himself better off as well. I am not aware of any standard term that has the power to aid any supposed monopoly position and thus think that, subject to rare exceptions, these customs should survive, even if some separate government action should (if political will existed) be used to control the guild-like (that is, monopoly) side of the business. Its narrow subject-matter focus should do something to still the fear that huge numbers of merchants and small firms in fact could collude to raise prices and lower output. The questions of guild and protection thus work at right angles to the topics covered by the Law Merchant. So the narrow focus of the Law Merchant means that it should receive a vote of confidence from the other side of the political spectrum as well.

Given the intellectual landscape, within the appointed area of the Law Merchant no one wants to depart from the norm of freedom of contract implicit in the *ius gentium*. With that concurrence as to ends, huge sources of potential disagreement just disappear from view: no one has to figure out which system of price controls is best. There might not be perfect agreement among the

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17 For one recent effort to cope with these issues, see Richard A. Epstein and Michael S. Greve, eds, *Competition Laws in Conflict: Antitrust Jurisdiction in the Global Economy* (AEI 2004).


practitioners of the art as to how the Law Merchant came about or what its ideal customs are. But this fundamental agreement on ends was universal just as the Roman writers had confidently stated. Any differences in local culture could not push anyone away from basic principles. They only influenced the second-tier questions of formality and procedure that were always thought part of local law.

At this juncture, it is worthwhile to recall what has been taken for granted in many of these papers. Why do we care about freedom of contract anyhow? What contribution does it make to human welfare? At one level there is something of a puzzle, which applies to all contracts. Before the exchange, I own a horse and you have $100. After the exchange you own the horse and I have the $100. Where is the gain if the same resources just switch places? The first order answer to this question is that gains are measured by utility and not by wealth. If each of us is willing to incur the costs of trade, then it is an implicit recognition that each has moved to a higher state of utility. I prefer $100 to a horse, and you prefer the horse over the $100. So now the trick is to increase the number of contracting opportunities.

The Law Merchant does that in line with the time-honored principle too easily forgotten, that the extent of the market determines the division of labor. Stated otherwise, before the advent of transportation and communications, individuals often were born, lived, and died within a narrow radius. Their trading communities were accordingly cramped. Any individual, therefore, who could develop a technique for the large scale production of a given commodity would have no place to sell it. Thus, to survive each person had to make the first unit (or few units) of a wide variety of commodities and could not develop any expertise or economy of scale with respect to these multiple tasks. The expansion of trade changed all of this. In some ways, it could work for the negative as Harold Demsetz noted in his treatment of the Canadian tribes that risked exhaustion of local resources when they expanded output to meet the demand created by the advent of the French traders. But that problem is not solved by limiting free trade. It is solved by imposing a system of coherent property rights that prevents the overhunting of fur-bearing animals. However, most ordinary resources are not contained in the common pool, and for them the increased demand allows for specialization so that persons can take advantage of expertise and economies of scale in the production of a small set of goods, confident that they can purchase the rest with their gains. The system of trade, therefore, offers its greatest gains to the lives of ordinary individuals, whose own standards of living it increases. The volume of international trade has increased mightily in recent years, but no one has been able to undermine the unassailable logic of the basic principle. And even if someone did, the

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21 See id at 351-53, 356.
criticism would not reflect itself in an effort to undermine the Law Merchant. Those people who think that foreign films destroy national culture are not interested in regulating the terms of trade. They prefer quotas and tariffs in an effort to block entry, and these are not any part of the *ius gentium* or the system of the Law Merchant.

II. EXECUTION OF THE LAW MERCHANT

Once its basic function is understood, the inquiry shifts. Now the question is how one deals with the execution of the basic system. In dealing with this issue, we have two problems that have to be faced, each of which has generated extensive discussion across the academic disciplines within the social sciences and law. The first of these problems is to determine just what the particular contract said. The second problem, discussed in Part III, is the question of what mechanisms should be used to insure performance of the contract once its obligations have been determined. Both of these problems go to the heart of any mercantile adventure. Exchange will cease if no one can decide what each side owes the other, and the entire system will unravel if return performance is not secure. These issues apply across time and space and present, as it were, the universal challenges to the universal system of the *ius gentium*. Let me comment briefly on how to respond to each.

A. CONTRACT INTERPRETATION

First, the question of contract interpretation offers a perpetual challenge to a legal system. At one level it is possible to deny the ability of the Law Merchant to function by refusing to attribute to language the precision and clarity that is needed for transactions to go forward. That form of learned linguistic skepticism does not sit well in commercial situations where repetitive transactions are often the norm. It is easy for individuals to make a mistake the first time that they enter into any novel transaction, but so long as people learn from their mistakes, and from the mistakes of others, the initial level of uncertainty should give way to far higher levels of clarity so that one obtains a high level of convergence between what is said and what is meant, so that no one is forced to choose between them. The cases that arise in litigation often deal with transactions that for one reason or another stray from the dominant norm. But it would be a mistake to infer that typical transactions founder on questions of contractual language or intention just because it is possible to identify disputes that arise over these interpretive matters. From the ex ante perspective it is not in the interest of either side to foster the confusion that results in litigation.

All this does not, however, detract from the need for conscientious efforts to get the hard cases right. If these are seen to go astray, then cases that should be easy will all of a sudden become more difficult. Why not roll the dice when
the odds seemed stacked against you: erratic judging may allow a longshot to come home. The importance, therefore, of litigation in marginal cases is often to make sure that black stays black and white stays white, and that neither slowly turns into various shades of gray. Yet what approach should be taken to these hard cases of interpretation? Here it is possible to remove one response to the problem from the table right off the bat. It will not do to allow the subjective reservations of one side or the private misunderstandings of one party to determine their joint obligations. However forgivable an innocent mistake may seem in the eyes of some divine power, it cannot be tolerated in any commercial environment. As between the original parties to the contract, the risk is just too great that persons who have a perfect understanding of what certain terms and conditions mean will feign ignorance when the deal goes against them. It is a game that two can play, so that both sides lose from the insecurity that is thereby created. The general rule in virtually all mercantile settings is to rule these subjective claims out as a matter of course. Oftentimes, the parol evidence rule could be read in a fashion that might conceivably allow in this collateral evidence. But the common verdict today reflects what has doubtless been a long-term contractual preference: merger clauses prohibit the introduction of this evidence into the case. The person who thinks that “horse” means “cow” will have to pay the consequences, especially in a league where only professionals are supposed to play.

The second risk with looking to the subjective intent of the parties is every bit as apparent. Contracts should not be understood solely as agreements between two parties. In most mercantile situations, goods that are acquired in one transaction are resold in another. If there is ambiguity as to whether title has passed to the first buyer, it becomes unclear whether that party can resell the goods or use them to secure credit. The defects and ambiguities that arise in one transaction can infect all those that follow. The elimination of these subjective excuses thus works to the benefit of third persons who come on the scene after the original transaction, by allowing them to make judgments on the strength of the paper record, without undertaking any collateral investigations. The ability to draw those persons into the network increases the value of the transaction to the original parties as well.

In sum, there is as best I can tell absolutely no sentiment to allow unilateral subjective intention to undermine the security of transactions. The action, therefore, comes in the choice between two other approaches, one which sticks closely to the written or spoken language of the agreement, and the other that

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purports to supplement that language with evidence of standard custom and usage within the trade or profession. The question is which of these approaches will turn out to be better in the cases where the approaches appear to give divergent results. Here the closeness of the debate suggests that there is much to be said on both sides of the issue.

The advantage of the text-bound approach is that it reduces the resources that are needed to undertake construction of any particular agreement. The collateral sources of information are removed from the setting, the parties understand that this is the rule of the game, and they structure their agreement in ways that reflect the dominant norm.

It may well be the case that we do not have complete contingent state contracts, but the contracts that we do have cover the huge majority of individual transactions so that disputes on construction are left to narrow classes of case, such as those where a street name (Main Street) could refer to one of two locations, but nothing in the document indicates what the external referent is. Rather than throw up one’s hands in despair, a court could let in evidence as to that external referent. In the individual case, this approach is bound to have a high level of error no matter what is done, so that we should expect that any merchant community will take some sensible steps to avoid the repetition of that problem. If there are two ships named Peerless that sail from Bombay, no rule of contract interpretation will allow one to decide which boat carried the cotton under a particular contract. But while names may be limited, numbers are not, so that merchants in the trade could assign numbers to each boat so as to avoid the problem of external reference in any future case, just as we use license plates for cars and ID numbers for taxpayers. It was not beyond the capacity of a merchant community to do the same. In effect, the process is that an institutional change closes off any source of systematic future error.

23 See Gillette, 5 Chi J Intl L at 157 (cited in note 19).
24 See Raffles v Wichelhaus, 159 Eng Rep 375 (Ex 1864) (England). The extent the court tried to avoid the difficulties associated with these external referents is made clear from the proposal that Holmes offered to save the objective theory of contracts in this case. “The true ground of the decision [in Raffles] was not that each party meant a different thing from the other, as is implied by the explanation [of mutual mistake] which has been mentioned, but that each said a different thing.” Oliver Wendell Holmes, The Common Law 309 (Little, Brown 1881). Holmes’s explanation requires a meaning of the word “said” without precedent in the English language. Melvin Eisenberg is therefore correct to observe that “Holmes had it precisely backward; the result in Peerless is correct, not because the parties said different things, but because they meant different things.” Melvin Aron Eisenberg, The Responsive Model of Contract Law, 36 Stan L Rev 1107, 1123 (1984). Yet Eisenberg is wrong to think that the question of a name ever involves an issue of “meaning.” Names do not have meanings. They refer to things which then become the object of discussion.
On the other hand, there are drawbacks that could attach to the plain meaning approach. The price for reducing the level of ambiguity that exists at the back end of the contract is to put greater pressure on getting the terms complete and correct at the front end. In some cases the proliferation of written or oral terms will introduce new and unintended ambiguities, not to mention internal inconsistencies within documents. Hence it is claimed that it is better to stick with simpler terms and to allow trade usage to fill in the gaps in ways that all merchants understand. This trade-off between ex ante and ex post efficiency is not one that is confined to the Law Merchant but arises in any situation where the language is used to draw metes and bounds. The extensive and inconclusive debates over the scope of the doctrine of equivalence in the patent law (which protects against infringement by inventions that are “equivalent” even if they do not fall within the literal language of the patent) turns on exactly the same considerations that are used to evaluate alternative language forms.\(^2\) Short of the doctrine of equivalents, inventors will be forced to draft their claims with great detail and precision and still run the risk that others will be able to seize on their inventions by working just outside the written parameters of the initial patent. Allowing the (unwritten) equivalent to receive the protection of the written claims in the invention has the nice feature of reducing the strain on the original drafter, while curtailing the opportunism of the second player. But once again there is no free good when the trade-offs are this close. The use of the doctrine of equivalents creates new forms of uncertainty when infringement claims are presented, and allows the first party to engage in opportunism to claim coverage over matters that were not understood when the original patent was filed. In the end some use of equivalents is allowed, but the judges then quickly seek to reign it all in by a variety of mid-level techniques, for example prosecution estoppel, of the sort which says that if you gave up some portion of the claim to secure its validity, that which was surrendered cannot be reclaimed through the doctrine of equivalents.

One important lesson here is to recognize that when the equities of a certain dispute are close, we are unlikely to reach any agreement as to what should be done. I think that this difficulty reflects itself both in the general Law Merchant and in the use of customary evidence in particular contexts. In making this point, it is important to stress at the outset that one can be a strong believer in the role of custom in the Law Merchant without taking the view that allows evidence of custom and usage to vary the written terms of an agreement. A second, and important, use of the idea of custom refers to those written and

\(^2\) See, for example, *Warner-Jenkinson Co v Hilton Davis Chemical Co*, 520 US 17 (1997), for a recent Supreme Court foray into unhappy terrain.
express terms that are customary or standard in some trade or business. These terms could be construed in accordance with strict norms of plain meaning or they could in the alternative be read to allow some limited forms of trade usage to vary their meaning. But their function is clear in either context. The use of a standard provision is better understood as a source of protection against exploitation than a tool by which to commit exploitation. The party who knows with confidence that he has received a standard term knows that he has received the benefit of the accumulated wisdom of the traders that have come before him. That non-discrimination norm offers strong protection against advantage taking. In addition, the removal of certain issues from debate reduces the number of terms over which negotiation has to take place and thereby speeds up the formation of contracts. In the same vein it allows for easier comparison between two deals, if each contains the same standard terms with respect to the full range of collateral and background matters. Finally, standard form attributes make it easier to resell (often to multiple parties) what has been received from one. Thus, customary terms are surely an essential part of any mercantile system.

But custom and usage from background norms raise somewhat different issues, and the matter is how best to resolve their usage. Here we could look to mercantile norms themselves, and ask whether particular trades do or do not allow their inclusion. I see no particular necessity for having the same rule apply across the board. In trades that have slow changes in technology, customary terms may have resulted in a stable equilibrium. But in other trades, the rule is that written agreements dominate. So here we then have the meta-question of whether to admit trade usage to decide whether trade usage is admissible, which I would not do if the agreement precluded its use, but would allow if the agreement were silent on the question. The question then arises as to which approach should be followed where silence takes place. And here I take a divided view on the question. I think that with respect to the meaning of standard terms within given contracts it should be feasible, if not preferable, to allow in expert and neutral evidence that the trade meaning is at variance with the literal meaning. I would keep out evidence solely by the parties as to the standard customs and usages of the trade.

One instructive modern (at least in this company) case to that effect is *Hurst v W. J. Lake & Co, Inc*, in which the question was whether a contract for the purchase of horse scraps, minimum 50 percent protein, allowed for the delivery of product that contained not less than 49.5 percent protein. Here is one case in which the clarity of ordinary numbers seems to preclude that possibility. But in a commercial context that need not be, and in this instance,

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28 141 Or 306, 16 P2d 627 (1932).
was not regarded as the case. One might have had some doubt if the seller in this case had claimed that the 50 percent minimum allowed the sale of horse scraps with 33 percent protein or even 49 percent. But the number 49.5 percent resonates because it is the smallest fractional number which when rounded off yields 50 percent. At this point, it seems appropriate and reasonable to take neutral testimony of experienced industry hands (both seem critical) as to whether this convention holds or not, as the court allowed. The usual risks associated with parol evidence do not look substantial in this context because it is not the efforts of an individual party to insert some transaction-specific term into an otherwise standard transaction. Far from the effort to vary the meaning of the particular term, this evidence is designed to elucidate it. If the evidence on this matter turned out to be unclear, then the court still has the option to retreat to the plain meaning. In this case, freedom of contract looks to be strengthened, not weakened, by the parol.

The situation could easily be otherwise in those cases where one party seeks to use evidence of custom to establish some waiver of a particular term. To give but one example, assume that the buyer in a series of transactions has allowed the seller to replace or otherwise correct the delivery of nonconforming goods when the contract provides that he has the absolute right to reject them. I would be loathe to read into that practice, even if common within the trade, the right of the seller to replace or correct those goods. The waiver of the right to rejection could have made sense as a prudential matter in the cases where it was done. But the very fact that the buyer in this case is not prepared to go that extra step may be proof not of caprice but of his detection about some lurking commercial danger that makes it unwise to grant the seller this second chance. Even if the custom is wrongly inferred from this past practice, the powers of correction lie near at hand so long as the principle of freedom of contract applies. The next time around the buyer can include in the agreement a clause that provides that all waivers in the event of nonconforming goods are at the sole option of the buyer, and that any previous waiver does not create the right to similar treatment in future transactions. Here I have little doubt that this clause could be drafted with sufficient clarity to satisfy the judges who accept the principle of freedom of contract in mercantile transactions. Indeed, one reason why contracting is more difficult in heavily regulated markets is that the parties now have a strong incentive to make the contract look like one thing (an independent contractor relationship, say) while being another thing (an employment relationship) precisely to escape the regulatory strictures of the Law
Employee. In those cases, the self-correction measures that make for ease of contractual interpretation are simply not there.

There is next the question as to how these terms evolve. One possibility is that terms just emerge through a practice of trial and error, where those which are successful are selected over those which are not. It is clear that this is the vision of Hayek when he speaks, a bit too rhapsodically, about spontaneous generation of terms. I am sure that many contract terms work in this fashion, but there is danger in overemphasizing the lack of coordination from centralized bodies in these markets. Here I am not referring to the prospect of state intervention, but to that of private ordering by merchant groups that consciously and systematically seek to find out the best practices on a given topic. That coordination holds out some risk of collusion, but it can be minimized (and often is) by the clearly stated understanding that standardization in terms is not the occasion to talk about standardization in price. Just that practice was followed when I worked years ago with the Insurance Services Organization in an effort to rewrite some terms of the standard coverage provision. Where the separation is kept between terms and prices, standardization allows for ease of comparison in market transactions, and for ease in resale and securitization of various goods that come with a standard set of legal attributes. The antitrust laws can, and certainly should, recognize the special role that standards organizations play. And nothing in the Law Merchant frowned on this practice. All that is needed here is a defense of freedom of contract. That defense does not have to be tied to a particular historical account, often Hayekian in nature, about the spontaneous manner in which these contract terms evolved. Any form of private ordering, including a self-conscious standard setting by merchant committees, will be consistent with the minimal (but critical) dictates of the Law Merchant.

III. ENFORCEMENT

The last of the topics that we should address is the enforcement of contracts. The importance of this topic, which is the subject of several papers here, should be apparent. In those cases in which contracts cannot be enforced, the only possible exchanges take the form of cash sales. All potential for gains from trade in the time dimension are necessarily lost. If it makes sense

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29 See, for example, Roadway Package System, Inc, 326 NLRB 842 (1998) (rejecting efforts to make employees look like independent contractors who fall outside the protections of the National Labor Relations Act).


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for the buyer to pay today and take delivery next week, it cannot be done. If it makes sense to reverse that sequence of performance and to allow for a credit sale, that cannot be done either. Clearly, the stronger the set of enforcement mechanisms, the more powerful the contractual techniques. The only debate within the field is, therefore, over how this admitted end is best achieved. In one sense all this could be cast as a debate between those who believe that private and informal mechanisms allowed for future transactions and those for whom the intervention of state force was, and is, necessary to give one side the confidence to perform before he receives the like performance of the other. It is, however, a mistake to cast this debate in the form of either/or with respect to potential sanctions. It is perfectly consistent with the *ius gentium* to any and all these systems of enforcement in any proportion and combination. And it seems clear that we do not have pure forms of private or state enforcement. State enforcement did not drive out private sanctions any more than the arrival of writing has driven out speech. Most successful enterprises rely on both.

The first step in creating a successful Law Merchant is to have some limitations on membership in the club. The greater the homogeneity in knowledge and capacity, the easier it is for any set of substantive rules to work. On this score we should recognize, as neoclassical economics sometimes does not, that individuals differ in their capacity for trust just as they differ in height and temperament. The Law Merchant will work better if it can find ways to select those individuals for inclusion within the field who display the traits that lead to merchant success and stability in the long haul. In this situation, there should be no state-imposed requirements for entry, but there are no doubt requirements that individuals could be asked to satisfy before they gain a place in any close-knit trading community. How these are imposed will vary from case to case, but one method surely is to have one person enter the business under the auspices and protection of a second who will vouch for his solvency and character. The simplest way to do this is for one person who knows both parties to introduce one to the other. There need not be any legal guarantee at all, but just an additional bit of information that makes it rational to trust a stranger. Each side knows that if it goes back on the deal, it will have to answer to the third party who brought them together, perhaps at some cost. When a new customer goes to the bakery and says that Sadie sent her, the subtext is that if you give that customer a stale slice of cheesecake, you will have to answer to two people instead of one. The whole world of references and recommendations relies on third parties to overcome the information gaps in certain markets.

In some cases, the size or circumstances of the transaction may make that informal recommendation insufficient. At that point one way to move the transaction forward is to have a system of formal guarantees. Let A purchase from B on credit, and C can promise B that he will pay the debt if A does not. That guarantee need not be gratuitous; A or B could purchase it from C. The
gains from adding in this extra step is that C is in a much better position to monitor the conduct of A than B, which in turn reduces the probability of breach. C in turn can have action against A if the breach takes place. The advantages of this system should be obvious if A and C are citizens of the same jurisdiction, because now the risks of discrimination against foreigners are reduced. Greif has written of how entire towns were asked to stand surety for the debts of particular creditors. While the historical record seems clear that such things happened, it is doubtful that these global guarantees were the dominant form of suretyship transactions, for there is nothing which allows the local town to monitor the conduct of its own merchants. It seems, therefore, highly unlikely that there are ever long-term systematic mercantile gains to a regime that induces creditors to relax their guard in the selection of trading partners because they know that they may always resort to some responsible public guarantor if the deal goes sour. The Roman law had extensive treatment of the law of private guarantees, where the close relationship between the guarantor and the principal debtor was critical to the overall success of that system. I have no doubt these private guarantees had to have had a prominent place in any system of international transactions. Not so with public guarantees.

Guarantees are, of course, not the only way in which one party can bond the obligations of a second. In the alternative, it is possible to form a small firm between parties, often related by blood or marriage, where other connections help cement the bonds of trust. Now the reputational and legal constraints of bad conduct by the new entrant are evident. Indeed, if the new entrant and established player are part of a single partnership, there is no need for any separate guarantee contract. It is quite sufficient that the partnership be liable for debts incurred by its partners and employees in the ordinary course of its business.

The use of even small firms has other great advantages. One point is that it transfers the location of dispute resolution. For one thing, it allows for the creation of an efficient two-tier structure in dealing with disputes. Avinash Dixit discusses this matter on the assumption that the creation of two-tiers in markets increases the ability to monitor even though it adds transaction costs by introducing a third person into the mix. But in fact his model helps explain a good deal of how ordinary firms work. If two junior members of different firms get into difficulty, the senior members of the firm are called upon to resolve the

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33 Greif, 5 Chi J Int'l L at 109 (cited in note 32).
34 On that issue, see id at 130-32, 135-36. The difficulty with this approach is that in looking first to communal guarantees, it does not ask how these were coordinated with the private guarantees which were common at the time. Observations of Charles Donahue and Emily Kadens, at Symposium, The Empirical and Theoretical Underpinnings of the Law Merchant, The University of Chicago Law School (Oct 16-17, 2003).
35 For a parallel exposition, see Dixit, 5 Chi J Int'l L at 139 (cited in note 32).
dispute. They have more distance on the case, can handle a bundle of disagreements at the same time, and have degrees of freedom that allow for a compromise across the board, based upon their previous working relationship. The presence of junior members within a firm also helps to ease the end-period unraveling problem, which decreases the risk of cheating on either side of the transaction. No longer must either side worry (as much) about the desire to make a killing by reneging (which exists on both sides) when one trader is near retirement. The presence of the junior member, ready for promotion, again extends the game to another period, where it can be extended yet again. If these devices do not quite work, the intervention of third parties with a foot in both commercial camps could ease strains in the relationship. The point here is that these relationships will prove stable to the extent that the future gains from trade exceed the amount that either side could hope to gain by a massive one-time defection from a former trust relationship. These various guarantee mechanisms reduce that risk.

Yet by the same token, it would be foolish to claim that they eliminate the problem. The Law Merchant never purported to be a system of self-enforcing contracts. Otherwise we could not explain the extensive business that found its way into specialized courts and courts of general jurisdiction throughout this entire period. The parties could under a regime provide, quixotically, that their undertakings were made without an intention to create legal relations, and the diligent court should turn them away if their contracts so provided. But of course the contracts rarely did so provide, even if they did frequently call for merchant arbitration. Rather, parties often sought judicial enforcement, and the constant stress on quick, reliable, and impartial adjudication is a page out of John Locke, who used it to explain why men would choose to quit the state of nature (the *ius gentium*) and take on the obligations of citizenship within the state (the *ius civile*).\(^{36}\)

At this point, we should expect the rules to take the form that they did. The great danger in any system of courts is the home-field advantage. The pledge of non-discrimination might cost some local merchants in the short run but could only improve the position of the home team in the long run, by encouraging traders from other jurisdictions to trade on credit in local courts. The faster and more reliable these systems, the more likely it is that traders will enter into what were otherwise marginal transactions. It seems clear, therefore, that the overall system is one in which private practices and legal enforcement worked in tandem toward a final end of greater contractual liability. The former were designed to reduce the frequency and severity of breach. The latter were designed to resolve those cases that slipped through the reputational net. The

better the legal system worked, the less likely the prospect of breach and the more likely that disputes could be resolved informally short of litigation. It is, therefore, not necessary to make any heroic assumptions about how the Law Merchant operated outside of all legal systems, or any equally heroic assumptions that ordinary business practices did not matter because the courts were always at the ready. Kadens’s hybrid model has it right. The truth is that both systems of enforcement were, and are, needed to make for a successful system of merchant trade. The unwillingness to forsake bold pronouncements in favor of low-key approaches is why the Law Merchant works. And work it does. For whatever doubts we have about the success of international trade today come, as noted earlier, from tariffs and trade restrictions that are exclusively governmental in origin. The slight perturbations that so exercise the Law Merchant are perturbations on a mixed system that works well. Taken alone or together, these perturbations do not amount to a hill of beans in this crazy world, as one noted non-merchant once said. Which is why so much attention has to be devoted to the pathologies of the Law Employee, the Law Farmer, and the Law Consumer—none of which can trace its origins back to the ius gentium.