The Applicable Law to International Commercial Contracts and the Status of Lex Mercatoria—
With a Special Emphasis on Choice of Law Rules in the European Community

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1. INTRODUCTION

International commercial contracts in the context of increasing globalization of the national markets have posed some of the most difficult questions of the legal theory as developed since the emergence of nation states; those are, whether it is possible or desirable to allow international commercial contracts to be governed by the law merchant or, in its medieval name, lex mercatoria, a body of rules which has not been derived from the will of sovereign states, but mainly from transnational trade usages and practices, and to what extent those rules should govern transnational transactions. The traditional approach of legal positivism to the questions maintains that law governing contracts containing a foreign element should be a national law which will be determined according to choice of law rules. However, the particularities of cross border trade yield unsatisfactory results when the rules essentially designed for the settlement of domestic disputes or national laws pertaining to international economic relations, but developed under the influence of a certain legal tradition, are tried to be applied. New solutions are needed to overcome the special problems of international trade between merchants from different legal systems.

In that regard, while the international commercial arbitration which has been freed from the constraints of the domestic laws is an important step, the courts generally applying the principle of party autonomy which allows parties to designate the law that will apply to their transactions have proved insufficient due to the positivistic influence on the conflict of laws rules of most countries which has limited parties’ choice of law to the national substantive laws. The problems created by those inconsistencies and divergences have been felt more strongly in the European Community which constitutes an internal market by integrating the national markets of Member States into a single one. The present paper is an attempt to search for answers to those questions with a special emphasis on the situation in the European Community on the basis of the idea that law as a servant of social need must take account of the far reaching and dramatic socio-economic changes.

First of all, the idea of law as a body of rules solely emanating from the power of a sovereign is contradictory to historical evidence. Therefore, the first part of this paper is devoted to the examination of the roots of those non national rules and their
evolution from the position as the applicable law to international commercial contracts into the marginalization of them by the notion of sovereignty and the emergence of nation states in the course of history. Moreover, the relationship between those rules and other laws, authorities and the conflict of laws theories will be analyzed during the historical discussion.

Given the fact that modern lex mercatoria differs from its historical counterparts in respect of character and sources, but contains inherent similarities at the same time, the second part of the paper will try to present the elements of modern law merchant following a brief discussion on its autonomous and imperfect nature. Indeed, the comparative and substantial approach to international commercial contracts utilized mainly by legal doctrine and arbitral tribunals has immensely contributed to the augmentation and coherence of modern law merchant as a whole along with the emergence of new elements such as non binding codifications of general principles or trade usages and publication of arbitral awards. Then again, the traditional underpinnings of lex mercatoria continue to be reflected in the contractual nature of the modern law merchant which has shown that the legitimacy of each element emanates from its adoption by international mercantile community through business practice.

In the last part, while searching for the place where modern lex mercatoria stands, the paper aims to focus on the law applicable to cross border commercial contracts in the domestic courts within the European Community which has become more susceptible to the problems associated with those transactions due to the increased commercial activities between merchants from different Member States. In order to enable a comparative approach, before starting with the analysis of the rules in the European Community, a brief overview of the situation in the United States and Latin America as well as the presentation of the arbitral experience with modern lex mercatoria will take place. With the discussion on the recent developments in the European Community with regard to modernization of choice of law rules and, to a lesser extent, European contract law codification, the paper will reach to the conclusion and suggest its position to the triad of relations between the choice of law rules, substantive rules and modern lex mercatoria.
2. HISTORICAL AND THEORETICAL DEVELOPMENT OF THE LAW GOVERNING INTERNATIONAL COMMERCIAL CONTRACTS AND THE STATUS OF NON NATIONAL RULES

2.1. Historical Foundations and Origins Prior to Modernism

Employing the historical approach to international commercial contracts promptly reveals the fact that long before the rise of national state and legal positivism with respect to the sources of law, there were rules and institutions which basically did not emanate from a sovereign and these rules governed commercial intercourses more or less until the national codifications.

Those non-national rules governing commercial activities can be traced back to the fourth century B.C. when the Greeks came to rely upon a transcendental law designed to deal with the “international” transactions. Greek’s substantial law approach to economic relations between merchants from different and politically independent city-states was aimed to meet the needs of cross-border trade of that time. Thus, the Greek law, applicable to trading between city-states, was based upon commercial customs and practices developed in antiquity.¹

The Romans followed the same way of solution with a search for better equipped set of rules and institutions to provide the appropriate environment for trade to thrive given Rome’s location at the centre of a global trading system of that time. The Roman private law was largely developed by jurists from the classical period who were in reality private individuals and, through their writings and opinions, they created rules and principles which are so influential that underlying philosophy can still be found embedded in the modern common law and civil systems.² Romans also developed a separate tribunal, named the praetor peregrinus, to adjudicate the legal relationship with and between non-Romans by applying a law of universal scope.

which was called “ius gentium.”\textsuperscript{3} The ius gentium, emanating from the legal creativity of praetor, Greek legal doctrines and the notion of good faith\textsuperscript{4}, was, therefore, more flexible and functional than the ius civile that governed relations between roman citizens.\textsuperscript{5}

After the fall of Western Roman Empire in the fifth century, Europe was drawn into a state of danger and insecurity due to the unstable political situation which would have lasted for more or less five centuries. During this period, which was also called Dark Ages, lack of political authority created a large number of different legal systems which were determined according to personal rather than territorial criteria and enforced by local courts presided by either feudal landlords or bishops. In such an unsafe environment and uncertain legal context, commercial transactions were rare and composed of individual activities of itinerant merchants traveling with goods, mostly luxury goods that would cover high costs and risks, and concluding random transactions. Therefore, transactions that were concluded and performed simultaneously in the presence of both parties prevailed during that era and avoided such disputes over the date of payment or the conditions of delivery which could be exceedingly hard to settle under such circumstances; however, that also precluded the emergence of the rules governing commercial transactions similar to the ones used in Ancient Greek or Roman laws.\textsuperscript{6} On the other hand, the fact that merchants were independent of feudal landlords and free of any formal control on their activities contributed to the revival of trade at the close of the Dark Ages.\textsuperscript{7}

In the eleventh century, Europe managed to cope with the chaotic legal and social environment of Dark Ages and experienced “the first western renaissance” during the following two centuries in which the separation of the state and the church and rediscovery of Roman law brought about the emergence of law both as a profession


\textsuperscript{5} Borchers, supra note 1, at 424


\textsuperscript{7} Ibid. at 437
and a subject of study in newly developed universities. Thus, Common law in England and ius commune of the continental Europe, a supranational law based on Roman law that became a continental European law, started to evolve in this period.

With the concurrent upswing in trade, free merchants formed communities, called “elder mercantile guilds,” in order to travel together in safety with the intention of benefiting from the revival of commercial activities. In addition to security, guilds provided their members with the possibility of making transactions other than ones concluded and performed by parties present simultaneously which had become the regular practice during Dark Ages; and, new “non-simultaneous transactions” paved the way for the development of substantive rules needed to govern these more complex relations. Each guild established some special set of rules which were derived from customs that were common to them and differed from traditional law. These rules were applied to the disputes between members within the same guild regardless of whether they were at home or abroad, and enforced by the guild itself which the merchant belonged to by means of sanctions, ranging from a fine to the exclusion from the community, in which reputation played a very important role.

The authority of the rules were strengthened by occasional privileges or immunities granted by medieval rulers, both feudal and ecclesiastical, which exempted certain related issues from normal jurisdiction. Besides, medieval rulers never intended to institute substantive rules governing the transactions between merchants; rather, their interests in luxury items provided and taxes paid by merchants simply limited their intervention in commercial matters to the recognition of merchant’s freedom of movement and contract or granting of immunities and other privileges. All these rights, privileges and immunities granted to merchants, called ius mercatorium, were

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9 Common law is the foundation of private law for England, Wales and Ireland, forty-nine U.S. states, nine Canadian provinces and most countries which first received that law as colonies of the British Empire and which, in many case, have preserved it as independent States of the British Commonwealth. In addition, some legal systems were converted to the common law tradition: Guyana, the Panama Canal Zone, Florida, California, New Mexico, Arizona, Texas and other former Spanish possessions. See; Tetley, W. Q.C., *Mixed Jurisdictions: Common Law vs. Civil Law (Codified and Uncodified)*, Louisiana Law Review, 60 (2000), at 685
10 See McDougal III, supra 4, at 522
11 Volckart and Mangels, supra note 6, at 437
12 Ibid. at 440
13 Ibid. at 438
14 Ibid. at 442
15 Ibid. at 443
considered as a single body of rights and entitlements devoted to the easiness of commercial activities.

However, there were still difficulties for merchants as to the enforcement of institutions governing non-simultaneous transactions between them and members of other guilds or non-merchants. The transformation of medieval towns from feudal and ecclesiastic administrative centers into autonomous political organizations in the late eleventh and early twelfth centuries provided the missing enforcement mechanisms for those kinds of transactions by supplementing those of the elder guilds. Indeed, the autonomy of towns led to the emergence of urban laws differing according to the influence of guild-specific rules gained on them. In this period, merchant guilds continued to be efficient in the regulation of cross-border commerce by disciplining members and imposing trade embargoes against political authorities which happened to be in conflict with merchants’ interests, so almost all of the urban laws had detrimental effects on foreign merchants due to the one-sided privileges provided for domestic merchants. Therefore, the first study of conflict of laws began as a discipline in Upper Italy in the twelfth century when the scholars invented unilateral, multilateral and substantive approaches in order to find a solution to problems involving connections with more than one jurisdiction and one urban law. Multilateral approach was the widespread one with regard to the competent court which the guiding principle was *forum contractus*, the place where a contract is considered as the place of jurisdiction. However, there were difficulties in the determination of substantive law that would govern the legal relationship since urban laws proved to be inadequate to rule the complicated affairs of cross-border merchandise. In order to provide equitable solutions, these commercial affairs were needed to be “regulated by a law of their own, called the law merchant or lex

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16 Ibid. at 442
17 Cutler, A. C., *Globalization, the Rule of Law, and the Modern Law Merchant: Medieval or Late Capitalist Associations?*. Constellations 8 (4), (2001), at 486
18 Volckart and Mangels, supra note 6, at 444
19 Borchers, supra note 1, at 424 et seq. In this era, multilateral approach was headed by Bartolus de Saxoferrato from Bologna who argued the applicability of local or foreign rules in conflicts of laws by saying that, for example, the validity of contracts is governed by the place of making, a rule adopted in the First Restatement of Conflict of Laws in United States; and substantive law approach was argued by Magister Aldricus, the Italian glossator, who was in favor of application of “better and more useful law”, an idea that was re-asserted 800 years later by some modernist authors of American Conflict of Laws, including Professor Leflar arguing that courts should search for objectively defined “better law”. See; McDougal III, supra note 4, at 531
20 Volckart and Mangels, supra note 6, at 446
mercatoria”, an acknowledged commercial law that was composed of customary law, customs and trade usages.\textsuperscript{21} Hence, even though merchants of this period had a variety of means available for settlement of disputes arising from their commercial activities, namely royal courts, ecclesiastical courts and common law courts, the most utilized mechanism was the merchant court where merchants themselves sat as juries and applied lex mercatoria thereby providing speed, informality, efficiency and justice for settling of disputes.\textsuperscript{22}

Medieval lex mercatoria was not an organized body of rules which had the quality of an autonomous legal system.\textsuperscript{23} The merchant courts decided in cases before them according to the interests of parties and the economic values involved and the rules of equity\textsuperscript{24}, so the content of law was constantly changing along with the mercantile customs applied to the case. Particularly, in the Common Law tradition, the more apparent link between the evolution of lex mercatoria as applied by commercial courts and the Court of Admiralty and the development of principles of equity in the Court of Chancery\textsuperscript{25} revealed the conflict between the lex mercatoria and law of equity, which eventually caused lex mercatoria to be deficient in universally-accepted set of principles.\textsuperscript{26} Nevertheless, there were attempts to consolidate mercantile customs in more or less authoritative compilations, though, most of which focused heavily on lex maritima, a branch of lex mercatoria, that comprised rules, customs and usages relating to navigation and maritime commerce.\textsuperscript{27} The maritime codifications of the Middle Ages\textsuperscript{28} had rather regional scopes and contained detailed and technical rules instead of broad principles or sweeps of policy.\textsuperscript{29}

\begin{itemize}
\item \textsuperscript{22} Cutler, supra note 17, at 485
\item \textsuperscript{24} Berger, supra note 21, at 61
\item \textsuperscript{25} Glenn, supra note 8, at 255 et seq.
\item \textsuperscript{26} De Zylva, M. O. And Harrison, R. (eds.), \textit{International Commercial Arbitration: Developing Rules for the New Millennium}, Jordans, Bristol, 2000, at 122
\item \textsuperscript{27} Tetley, W. Q.C., \textit{The General Maritime Law - The Lex Maritima (with a brief reference to the ius commune in arbitration law and the conflict of laws)}, Syracuse Journal of International Law and Commerce, 20, 1994, at 108
\item \textsuperscript{28} Ibid. at 110 et seq. The most influential codifications were the Laws of Oleron, used in northern and western Europe from the Atlantic coast of Spain to Scandinavia in the end of the twelfth century; the Consulate of Sea, applied to the maritime affairs in the Mediterranean Sea starting from the late thirteenth century; and the Laws of Wisby, based on the Laws of Oleron and printed in sixteenth century to govern trade in the Baltic Sea,
\item \textsuperscript{29} Goode, supra note 23, at 17
\end{itemize}
Even so, until the end of the sixteenth century in Europe, there was considerable homogeneity in maritime law which emanated from common underlying problems addressed by those codified rules and which, in consequence, removed the need for theories of conflict of laws; and this was also partly true for the lex mercatoria in general since although lex mercatoria lacked that kind of strict homogeneity in itself, merchant courts did not have to choose between different systems of substantive law when dealing with a commercial dispute that had links to more than one jurisdiction. Above all, the medieval law merchant managed to form a substantive legal order that was composed of trading practices of merchants and the dictates of equity, and coexisted successfully with other forms of political and legal regulation in such a context where “the local political authorities shared authority with other political and religious authorities in a system mediated by customary laws and historic entitlements.”

2.2. The Concept of State Sovereignty

After the fourteenth century, the theory of sovereignty emerged in Europe mainly in the writings of Machiavelli (1469-1527), Jean Bodin (1530-1596) and Thomas Hobbes (1588-1679). In the sixteenth century, theory came to reality in Spain and, later in the transition to the seventeenth century, also in France and, further, continued to shape the political structures of other countries in Europe. These primitive forms of modern state were characterized by the importance they attached to the notion of sovereignty which became apparent from their centralized use of force depending on a standing army and efficient bureaucracy. The emergence of internal sovereignty in the early modern period led states to engage in the regulation of economic and social spheres, including the cross-border commercial activities which medieval lex mercatoria had ruled until that time. These incidents transformed the relationship between domestic legal systems as well so that supranational norms were about to come out. In 1648, the Treaty of Westphalia brought about a new political order

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30 Tetley, supra note 27, at 113
31 Cutler, A. C., supra note 17, at 481 and 486
33 Ibid. at 3
between sovereigns of Europe which, *inter alia*, led to the recognition of each other’s legislative supremacy within their respective territorial borders.\(^{34}\)

In that way, sovereignty in the meaning that the exclusive right to domination over a territory rather than people replaced the principle of personality, whereby law was applied according to personal criteria, which was the dominant principle during the Middle Ages due to the fragmented and overlapping spheres of authority in feudal societies, with the principle of territorial jurisdiction.\(^{35}\) In addition, the detachment of substantive law from feudal patterns and the arguments of natural law theory about individual rights and limitations on governments in the same period\(^{36}\) were followed by the progressive removal of traditional restrictions based on the social status or position of individuals with regard to the participation in economic life by granting them universal rights to own property, to enter into contracts and to sell their labor power with the aim of enabling markets to function.\(^{37}\) Thus, trade continued to thrive and grow out of those territorial confines and the disappearance of a common law merchant created conflicts between sovereign laws competing for being the law by which the cross-border commercial transaction was to be governed since the laws of a sovereign applied only within that sovereign’s territory but did not apply in the territories of other sovereigns. That brought about the increasing study of conflict of laws doctrines on this subject with the influence of French scholarship in sixteenth century and Dutch scholarship in the seventeenth century.\(^{38}\) While, on the one hand, party autonomy in contracts whereby the parties concerned may designate a law to govern their issues, a concept that was able to weaken the foundations of the principle that state sovereignty is the exclusive basis of conflicts of law, was introduced into the study of conflict of laws under French influence by jurists such as Charles Dumoulin (1500-1566) to whom the concept of party autonomy is customarily attributed\(^{39}\); on the other hand, the more restrictive ideas like territoriality and sovereignty also formed important parts in the theories, such as that of Ulrich Huber (1633-1694), a

\(^{34}\) Edgeworth, B., *Law, Modernity, Postmodernity: Legal Change in the Contracting State*, Ashgate, Aldershot, 2003, at 69

\(^{35}\) Drahos and Braithwaite, *supra* note 2, at 109


\(^{37}\) Edgeworth, *supra* note 34, at 71

\(^{38}\) Borchers, *supra* note 1, at 425

\(^{39}\) Yntema, H. E., "*Autonomy* in Choice of Law", The American Journal of Comparative Law, 1952, at 342
Dutch jurist immensely influential on later developments of conflict of laws doctrines in the United States and England, who argued that laws had no force and effect beyond the limits of territory where they were enacted, but bound all persons within that territory and the application of foreign law was done simply by the tacit consent of the other sovereign\textsuperscript{40} under a duty out of comity between states on the basis of courtesy.\textsuperscript{41} Although, the general theoretical discussions in these centuries excluded the consideration of non national law as governing international commercial contracts due to the impact of the notion of sovereignty, the common law of England and the ius commune in the continent was still influential and supplementing the laws of sovereigns and providing respective uniformity in rules governing these contracts to some extent.\textsuperscript{42}

2.3. The Emergence of Nation States

In the period between seventeenth century and nineteenth century, the first signals of a centrally directed and national law emerged on the continental Europe with the rise of nation states unifying small principalities, republics and city states to have larger population and economy for exploitation of the opportunities of the new industrializing “capitalist-nationalist era.”\textsuperscript{43} The distinguishing feature of the law in these newly developed national states was that its enactment in the form of positive law became the most prevalent method of producing legality and authority by turning law into an object of human creation through the agency of a unitary sovereign state thereby separating law from society with the exclusion of traditional or customary law.\textsuperscript{44} The only criterion used for assessing the validity of law was simply whether a legal rule was backed by the sanctions of sovereigns or not. The idea of law as sovereign’s command, devised by John Austin for the first time in mid-nineteenth century, was the first abstract formulation of the legal positivism which, eventually, became the object of profound and considerable development in both common and

\textsuperscript{42} Glenn, supra note 8, at 233
\textsuperscript{44} Edgeworth, supra note 34, at 70
civil law traditions. As a result, the legality came to be determined by its source, namely the will or commands of a sovereign, instead of its substantive merits, an idea of which undermined and, ultimately, terminated the authority of rules not generated by a sovereign will, such as medieval law merchant governing international commercial transactions.

Codifications of private laws in the continental Europe entailed those theoretical underpinnings so as to fortify national identities and concentrate sovereignty in the unified states. In 1804, the codification of private law in France was the world’s first codified national law. Gradually, all Europe, including Eastern Europe and Russia had their own codes. Thus, in the nineteenth century, the intense effect of ius commune on the laws of sovereigns ceased to exist and choice of law rules displaced the substantive solutions based on common principles for resolving disputes in cross-border commercial disputes. On the common law side, the same tendency to have a nationalized identity appeared, most evidently in the United States of America and, the rapid increase in commercial intercourse between England on the one hand, and the continental Europe and British colonies in overseas countries on the other necessitated the development of conflict of laws rules in England as well. Since the appearance of contemporary “private international law” as developed by Friedrich Carl von Savigny and Joseph Story, American jurist who coined the term itself, the interests of parties in an international commercial contract were only taken into account to the extent that the abstract relation between the case and the applicable “national” law so availed regardless of the quality of substantive law.

Indeed, according to the “seat of the relationship test” of Savigny, the applicable law could be determined by searching the law “with which the legal relationship has the closest connection due to its inherent nature.” Savigny, as a major proponent of the Historical School, argued that legal institutions originate in the spirit of the people

45 Glenn, supra note 8, at 151
46 Patterson, supra note 36, at 244
47 Glenn, supra note 8, at 134 and 135
48 McDougal III, supra note 4, at 522
49 Glenn, supra note 8, at 248
50 McClean, supra note 40, at 7
51 Michaels, supra note 41, at 5
52 Berger, supra note 21, at 11 and 19
53 Ibid. at 11
(Volksgeist), so opposed to the idea of codification in the private field which he considered as apolitical and pure law, and distinguished from public law.\textsuperscript{54} Constitutional law, criminal law, procedural law and other areas as parts of public law were found irrelevant for modern legal doctrine and neglected by Historical School due to their political and unscientific nature.\textsuperscript{55} Thus, he criticized the notion of codification of German private law as unnecessary, unscientific, arbitrary, hostile and contrary to tradition and the notion that law develops gradually and organically in the spirit of people;\textsuperscript{56} though, German Civil Code was adopted in 1900. In effect, by seeking for the “seat” of legal relationship to determine the applicable law in case of conflict of laws, Savigny came to attach a territorial quality to the case, which, naturally, would culminate in the application of a codified private law of a sovereign state to international commercial or social intercourses in view of the increasing popularity of the idea of codification among nation states.\textsuperscript{57} In such a context, the nation state would be both the enforcer and the creator of the law applicable to those transactions in the choice of law process.\textsuperscript{58}

In a similar vein, the substantive quality of the governing law was irrelevant to the determination process and the law was necessarily national in the work of Story on conflict of laws which was an influential U.S. treatise on the subject, created in 1834 as such never treated by the scholars from the common law tradition until that time.\textsuperscript{59} In his treatise, Story’s method was to borrow and utilize civilian conceptions of conflict of laws to the extent that they agreed with common law doctrine. His aim was to find common ground in order to obtain decisional harmony for protecting interests of the parties in cross border transactions.\textsuperscript{60} According to Story, the validity of a contract would be determined by the law of the place where it was made, but, where contract was to be performed in any other place, the matters of the performance of the contract would be governed by the place of the performance in line with the presumed

\textsuperscript{54} Michaels, \textit{supra} note 41, at 11
\textsuperscript{56} Ibid. at 15 and 17
\textsuperscript{57} Michaels, \textit{supra} note 41, at 15 and 17
\textsuperscript{58} Ibid. at 12
\textsuperscript{59} Borchers, \textit{supra} note 1, at 425 and 426
\textsuperscript{60} Ibid. at 427
intention of the parties in choosing a different place for performance.\textsuperscript{61} By so doing, with regard to the matters of performance, Story introduced the idea of lex loci solutionis, i.e. the law of the place of performance of the contract, instead of the aged civilian principle of lex loci contractus, i.e. the law of the place of conclusion of the contract, which had origins in the conflicts scholarship of twelfth century in Italy, but he did not wish for the cessation of latter principle and complete replacement by the former. In order to obtain decisional harmony in those matters, he devised a pragmatic approach based on doctrine of comity arising from mutual interest and utility between states and argued that “any state which should refuse to acknowledge the common principles, would soon find its whole commercial intercourse reduced to a state.”\textsuperscript{62}

Additionally, the principle of party autonomy, namely law governing a contract should be determined in accordance with the expectations of the parties, can be found in the discussions of both Savigny and Story. Savigny pointed out that the determination of the law applicable to contracts faced the fundamental difficulties when the reference was either to the law of the place of conclusion of the contract or the law of the place of performance of the contract since an abstract legal relationship involving two or more persons had no perceptible location in space, and, in many contracts, the obligations of the parties were reciprocal.\textsuperscript{63} Hence, Savigny argued that, except in the area of coercive legislation, the law of contracts should be based on the autonomy of the parties. In fact, the principle was espoused in the continental Europe as early as seventeenth century by Dumoulin, and the principle was finally given statutory recognition in Germany, France and Italy in the nineteenth century.\textsuperscript{64} With his approach to lex loci contractus, Story also came to espouse the principle of party autonomy by adopting lex loci contractus insofar as the presumed intention of parties, understood from the legal relationship between them explicitly or implicitly, requires some other place for performance.\textsuperscript{65} However, Story’s treatment of the subject was far from complete and lacked clarity as to the extent of the principle of party autonomy, and, in United States, the absence of clear statutory recognition and rejection of the principle by some part of the doctrine seeing the principle as the parties’ power to

\textsuperscript{62} Borchers, \textit{supra} note 1, at 427 also see; McClean, \textit{supra} note 40, at 534
\textsuperscript{63} Yntema, \textit{supra} note 39, at 341
\textsuperscript{64} Ibid. at 342
\textsuperscript{65} Borchers, \textit{supra} note 1, at 428
legislate\textsuperscript{66} caused the law of the place of contracting to become the prevailing doctrine until the twentieth century.\textsuperscript{67}

In the law of England, the nineteenth-century judges adopted a different approach by developing the idea of “the proper law of the contract” since they refused the adoption of the two other principles, lex loci contractus and lex loci solutionis, which were deemed to have “conclusive, rigid or arbitrary criteria.”\textsuperscript{68} According to that approach, the intention of parties would be discovered in each case by judges who would consider the terms of the contract, the situation of the parties and all other relevant circumstances and, accordingly, determine the applicable law, which would be a national law for sure.\textsuperscript{69} As a result, the principle of party autonomy in England was established through the proper law doctrine in a series of cases starting from 1865.\textsuperscript{70}

Since the emergence of nation states, classical choice of law readily rejected or rather disregarded the normative authority of non-national commercial rules and legal pluralism due to the legal positivism inherent in the notion of sovereignty, so the national codifications of commercial law seized the power to rule the international commercial activities by means of classical choice of law rules. Nevertheless, there were attempts in the legal doctrine to show the inadequacies of national laws, which were designed to govern domestic commercial activities, in dealing with cross-border transactions. As appeared at the very start of codifications in Europe, the Dutch scholar Josephus Jitta maintained a desire for an overarching lex mercatoria which could fulfill the expectations of parties to a transnational contract rather than national legislation which only created ambiguities.\textsuperscript{71} Later, Ernst Rabel, the outstanding German comparativist who lived between years 1874 and 1955, argued for an autonomous qualification technique in private international law based on the general principles of private law since Rabel thought that a common or best solution could be achieved in the case where the legal characterizations of the law of the forum were

\textsuperscript{67} Yntema, \textit{supra} note 39, at 349 also see; McClean, \textit{supra} note 40, at 320
\textsuperscript{68} McClean, \textit{supra} note 40, at 320 and 321
\textsuperscript{69} Ibid. at 320
\textsuperscript{70} Yntema, \textit{supra} note 39, at 348 and 349
\textsuperscript{71} Juenger, \textit{supra} note 3, at 491
replaced by autonomous notions and principles derived by means of comparative research of different legal systems.\textsuperscript{72}

However, initially, the effect of those theories appeared rather insignificant and the conflict of law rules of sovereign states remained as it was, but things started to change with the globalization of markets and the transformation of modern state into “postmodern contracting state” which becomes smaller in size, capacity and reach and increasingly manages its internal functions by a strategy of governance through contract, privatization and deregulation.\textsuperscript{73} In the new context, the revitalization of the notion of transnational commercial law has brought about alterations in the content of non national rules governing international contracts, led to their widespread use in the international arbitration which has acquired more liberty than domestic courts in functioning with regard to the substantive and procedural law applied to dispute and, finally, affected the relations between conflict of laws doctrine and non national rules.

\textsuperscript{72} Patterson, \textit{supra} note 36, at 187 also see; Berger, \textit{supra} note 21, at 87
\textsuperscript{73} Edgeworth, \textit{supra} note 34, at 143
3. THE NATURE AND ELEMENTS OF THE REVITALIZED LEX MERCATORIA

3.1. Lex Mercatoria as an Autonomous and Imperfect Legal System

The revitalization of the law merchant raises an ongoing debate as to the independent existence of lex mercatoria which is a non national source of law not exactly fit into the traditional categories of sources of law in general, and private international law in particular. The objections raised against the existence of modern lex mercatoria shares the same basic mentality. The idea of lex mercatoria as an autonomous legal system is against the prevalent positivist tradition in legal thought, which requires the authority of a sovereign state for the creation of valid legal norms and rejects any other entity’s ability to create law in view of possible deficiencies in guaranteeing justice.74 According to the positivist perception, this mentality is duly reflected in the traditional realms of law, namely in national law and in public international law, as a body of rules covering the relations between states and international organizations, legitimacy of which emanates from the will of the sovereign states.75 In contrast, law merchant in its ancient meaning evolved from the needs of merchants, developed according to their views and obtained jurisdictional and normative autonomy. The modern lex mercatoria as well is mainly based on the activities of international community of merchants and created for the better satisfaction of their business interests.76

However, their interests in achieving commercial benefits through cross border trade do not suffice to justify the law making power of the international community of merchants. There must be a mandatory element which provides merchants’ compliance with the rules created by them. Otherwise, law merchant would always be standing for the favor of its creators thereby terminating its own validity in the eyes of addressees who have infinite possibilities to change or construe the rules according to their interests. Similar to the sanctions of guilds in the Middle Ages, the modern community of merchants has developed means, such as ‘black lists’, withdrawal of membership rights, forfeiture of bonds and similar dangers to the commercial

74 Berger, supra note 21, at 102
76 Berger, supra note 21, at 105
reputation, to guarantee the validity of trade usages, customs, contract practices and similar rules. The distinguishing feature of this mandatory element from that of medieval law merchant is the consensual aspect of modern international trade which has roots in an idea from the seventeenth-century natural law arguing that the keeping of one’s word is in harmony with the social nature of men and principle of good faith. Thus, the contract becomes the inherent source of law, from which other components of law merchants are derived, in modern business relationships, yet modern lex mercatoria is not acknowledged as a third legal system next to national and international law by the traditional doctrine.

Nonetheless, the academic interest in the subject has increased rapidly since the Rabel’s thoughts on private international law and the influential article of Berthold Goldman, published in 1956, with regard to the nationality of the Suez Canal Company which he considered as ‘essentially international’ due to its particular capital structure, organization and activities. The notion of transnational commercial law has come under intense theoretical discussions. The functional comparative approach that was employed in those studies aimed at the harmonization and unification of substantive law to overcome the problems that are posed by dissimilarities of national laws with regard to international commerce and greatly influenced the development of international regulations and commercial arbitration.

Thus, the arsenal of sources of lex mercatoria has augmented with the inclusion of general principles of law, public international law, arbitral awards as precedents and the rules of international organizations into the ones existing since medieval times, which the creators are the merchants themselves, such as trade usages, customs and contract practices. In that way, modern lex mercatoria has accumulated de facto autonomy by means of the coherence of its components and their exercise in international commercial arbitration, but one has to admit that it will never reach the level of the organization of static national legal systems. Therefore, although an overwhelming majority of the countries has not granted legal recognition to lex

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77 Ibid. at 106
79 Berger, supra note 21, at 108
80 Jemielniak, supra note 75, at 180
81 Patterson, supra note 36, at 187 also see; Berger, supra note 21, at 44
82 Jemielniak, supra note 75, at 180
mercatoria in terms of allowing parties to choose non national rules as the law
governing their international commercial contracts in national courts, increasingly lex
mercatoria is applied to those contracts by the arbitral tribunals with the competence
they obtain from the trend of legal approximation in the field of international
commercial arbitration which freed international arbitrators form the constraints of
domestic substantive laws.\textsuperscript{83}

3.2. The Elements of Lex Mercatoria

Danish Professor Ole Lando, the president of the Commission on European Contract
Law, provided a non exhaustive list containing seven elements that forms the body of
lex mercatoria in his widely cited article published in 1985.\textsuperscript{84} The use of term
“element” is very important in that the term “source” may imply a traditional
approach which looks for rules originating in a sovereign will. Also, since some of the
items in the list only declare and prove the existing law and some are only sources of
rights, but not the rules, the term “element” captures the character of the components
of lex mercatoria more appropriately.\textsuperscript{85}

According to the article of Professor Lando, the elements of lex mercatoria are public
international law, uniform laws, general principles of law, the rules of international
organizations, customs and usages, standard form contracts and reporting of arbitral
awards.\textsuperscript{86} In the list, only the item “uniform laws”, namely conventions, model laws
and other international instruments which require an action from states, such as
adoption or ratification of the instrument, for their legitimacy, can be regarded as
outside the ambit of lex mercatoria due to the lack of non national qualities peculiar to
lex mercatoria.\textsuperscript{87} Nevertheless, uniform laws can be influential with their contents, to
the extent that they reflect the common general principles of law or trade customs and
usages, on the development of lex mercatoria in a supplementary status or can be
regarded as a source of a wider concept, i.e. “transnational commercial law”.\textsuperscript{88}

\textsuperscript{83} Berger, \textit{supra} note 21, at 79
\textsuperscript{84} Lando, O., \textit{The Lex Mercatoria in International Commercial Arbitration}, International and
Comparative Law Quarterly, Vol. 34, 1985, at 748
\textsuperscript{85} Goode, \textit{supra} note 23, at 4
\textsuperscript{86} Lando, \textit{supra} note 92, at 748-752
\textsuperscript{87} Ibid. at 749
\textsuperscript{88} Goode, \textit{supra} note 23, at 2
3.2.1. Public International Law

As the “post modern contracting state” increasingly chooses the contractual means to maintain its internal affairs, the disciplinary distinction of public and private law becomes blurred since private law assumes some part of the public law’s function of regulating the relations between the state and the people who compose it. In return, this incident, coupled with the globalization and the revitalization of lex mercatoria, has affected the nature of public international law by strengthening the influence of private concerns, private actors and private procedures on the discourse of public international law. Thus, the rules of public international law, which were first deemed to cover solely the relations between sovereign states, have come to be applied to contracts between a government enterprise and a private party.

Indeed, the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID) aims to promote the increased flow of international capital into developing countries through the establishment an international center for the settlement of disputes between naturally unequal parties, namely foreign investors and host countries. Article 42(1) of the Convention explicitly provides that in the absence of any express choice of law by the parties, the Arbitration Tribunal shall apply “such rules of international law as may be applicable”, in addition to the law of

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89 Edgeworth, *supra* note 34, at 143
91 Ibid. at 520
92 Lando, *supra* note 84, at 749
the contracting state party to the dispute. Moreover, the wording of the provision expresses an obligation to resort to such rules for arbitral tribunal.

Another public international law approach to choice of law questions in transnational commerce was provided by Article V of the Claims Settlement Declaration of the Iran-United States Claims Tribunal which was established in 1981 in order to resolve disputes, arising out of contractual agreements, between nationals of the United States and Iran, between Iranian nationals and the United States or between the two governments. Article V required the Tribunal to “decide all cases on the basis of respect for law, applying such choice of law rules and principles of commercial and international law as the Tribunal determines to be applicable, taking into account relevant usages of the trade, contract provisions and changed circumstances.” On this basis and in view of claims involving alleged expropriations or other public acts, the Tribunal often interpreted and applied treaties, customary international law, general principles of law and national laws together.

In effect, the biggest advantage to see public international law as an element of lex mercatoria may be the fact that comparative method which is employed successfully

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94 For the extent of the role that international law plays under Article 42(1), see; Autopista Concesionada de Venezuela, C.A. ("Aucoven") v. Bolivarian Republic of Venezuela ("Venezuela") ICSID Case No. ARB/00/5, [published in Volume 16, No. 2 issue of ICSID Review—Foreign Investment Law Journal (2001)] para. 102; “The role of international law in ICSID practice is not entirely clear. It is certainly well settled that international law may fill lacunae when national law lacks rules on certain issues (so called complementary function). It is also established that it may correct the result of the application of national law when the latter violates international law (corrective function) (Christoph Schreuer, The ICSID Convention: A Commentary, Cambridge 2001, Nr. 131 ad Art. 42, p. 623 with ref.). Does the role of international law extend beyond these functions? The recent decision of the ICSID Ad hoc Committee in Wena Hotels Ltd. V. Arab Republic of Egypt accepts the possibility of a broad approach to the role of international law, and that the arbitral tribunal has “a certain margin and power of interpretation” (ICSID Case Nr. ARB/98/4, 41 I.L.M. 933 (2002), Nr. 39 p. 941) …”


96 Hanessian, G., General Principles of Law in the Iran-U.S. Claims Tribunal, Columbia Journal of Transnational Law, Vol. 27, 1989, at 310

97 Ibid. at 313 also see; Jemielniak, supra note 75, at 194; cited a series of decisions of the Tribunal: Partial Award in Cases Nos. 74 76 81 150 (311--74/76/81/150-3) of 14 July 1987: “In the absence of contract provisions, the Tribunal must decide what choice of law is applicable by taking into consideration all circumstances that it deems relevant. In view of the international character of the SPA [Sales and Purchase agreement], concluded between a State, a State agency and a number of major foreign companies, of the magnitude of the interests involved, of the complex set of rights and obligations which it established, and of the link created between this Agreement and the sharing of oil industry benefits throughout the Persian Gulf Countries, the Tribunal does not consider it appropriate that such an Agreement be governed by the law of one Party. ( . . . ) Accordingly, the Tribunal determines that the law applicable to the Agreement is Iranian law for interpretative issues, and the general principles of commercial and international law for all other issues.”
for the development of sources of public international law from private law institutions can serve as a model basis for the next element of lex mercatoria, namely the general principles of law.98

3.2.2. The General Principles of Law

The general principles of law constitute an integral part of any sophisticated legal order which has the open quality and character to provide the necessary flexibility for the ‘law in action’.99 Thus, the general principles of law recognized by the commercial nations are an important element of the lex mercatoria.100

A functional legal comparison of legal systems, which is problem-oriented with topical approach rather than general, will tell the judge or arbitrator whether the rules of various legal systems produce the same result even if their formulations are radically different. In this effort, the judge or arbitrator will tend to confine his or her investigation to the legal systems related to the subject matter of the dispute.101 After the selection of the related legal systems which requires considerable endeavor to determine whether differences contained in these legal systems are of an accidental or fundamental nature, judge or arbitrator will formulate the general rules and principles which are regarded as part of the lex mercatoria.102 Some of those general principles, such as the notion of good faith and pacta sunt servanda, Latin for "pacts must be respected," belong to the common core of the legal systems of the most of the national laws in the world.103

98 Berger, supra note 21, at 50
99 Ibid. at 99 and 133
100 Ad Hoc Arbitral Award; Texaco Overseas Petroleum Co. & California Asiatic Oil Co. v. The Government of the Libyan Arab Republic, 53 ILR 389 (Preliminary Award 27 November 1975; Award on the Merits 19 January 1977) at 461; “The municipal law of the contracting State itself includes principles of international law: every municipal law is a vehicle for the general principles of law as provided for under Article 38 of the Statute of the International Court of Justice. Under the generic name of general principles of law, reference is made in fact to certain principles common to the legal systems of the various States of the world. They constitute a source of international law which originates in the various municipal laws: therefore, the application of municipal law does not exclude the application of the general principles of law which themselves are part and parcel of the principles of international law.”
101 Lando, supra note 84, at 750
102 Berger, supra note 21, at 48 and 49
103 Ibid. at 166