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ARTICLE

Custom and law in transnational commercial contracts: A co-evolutionary perspective

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1. Introduction

This article examines the role of custom and trade usages in transnational commercial law. It distinguishes between state and communities-based rules. The validity of the former is grounded on procedural compliance, the validity of the latter on the effectiveness of the rule. It is only when the trading community applies those rules that they become binding.

This article addresses the alternative or complementary nature of custom and law, accounting for the historical perspective. But for a few exceptions, custom and law are complementary and have co-evolved over time. Co-evolution has operated through different mechanisms: cooperation and choice. Intergovernmental organisations and private institutions collaborate in various forms to coordinate the production of commercial law. A second mechanism of co-evolution is the choice by private contractual parties. Parties can individually or collectively enter and exit legal and customary regimes, making choices, and signalling their preferences to the drafters. The distinction between individual and collective opt-ins and opt-outs is introduced to suggest that differences can occur when collective opt-outs are decided by trade organisations or private institutions.

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This analysis argues that different forms of complementarity arise depending on whether the law is hard or soft. The turn towards soft transnational commercial law by intergovernmental organisations does not replace customary law but enshrines a form of complementarity where flexibility and fast adaptation to socio-economic and technological changes is necessary.

It is not only the distinction between hard and soft law that affects the co-evolution with custom, but also between default and mandatory rules. In commercial contracts, customary law contributes to the reduction of the stickiness of default rules when collective instead of individual opt-outs are in place.[1] Collective opt-outs in trade usages and customary rules reduce transaction costs and facilitate co-evolution. Co-evolution is not only the most accurate representation of both the current and the past relationship between law and custom in commercial contracts; it is also a normatively desirable framework that should be promoted by increasing the scope of institutional cooperation and establishing mechanisms of choice for contracting parties.

This article proceeds as follows. Section 2 defines the institutional framework of regulatory cooperation in transnational commercial contracts. Section 3 identifies the distinguishing features of custom and law. Section 4 examines the nature of the relationship between custom and law. Section 5 provides a brief historical account of the evolution. Section 6 analyses the contemporary pattern of co-evolution in light of the increasing role of transnational commercial soft law. Section 7 introduces the distinction between mandatory and default rules in order to analyse the mechanisms of parties' choice. Section 8 considers individual and collective entering and exiting mechanisms. Concluding remarks follow.

[1] Omri Ben-Shaar and John A. E. Pottow, 'On the stickiness of default rules' (2006) 33(3) *Florida State University Law Review*, 651-652. See also Russell Korobkin, 'The Status Quo Bias and Contract Default Rules' (1998) 83(3) *Cornell Law Review*, 608.

2. The institutional framework of international regulatory cooperation in commercial law

Transnational commercial law includes various areas from bankruptcy to investment law, from competition to intellectual property rights.[2] This contribution focuses on the role of custom in transnational commercial contracts. The analysis is premised on the changed functions of transnational commercial contract law and its evolution in the communities of States, represented in International Organisations (IOs), and in the business communities.

The conventional instruments of State regulation, essentially based on the administrative law toolkit, can only partially be used to regulate trade at transnational level. Administrative regulation requires international cooperation. When international cooperation fails, or it is missing, no effective administrative regulation can be deployed.[3] The absence of effective international regulators and the weaknesses of States' cooperation within IOs have increasingly contributed to the proliferation of transnational private regulation, whose implementation is entrusted in the use of commercial contracts within global value chains.[4] Transnational commercial contracts, unlike administrative regulation, do not need highly effective state regulatory cooperation and can implement various forms of transnational private standards to ensure consistency and effectiveness.[5] This is not to say that international regulatory cooperation does not play a role in the evolution of transnational commercial law.[6]

Transnational commercial contracts have evolved in the late 20th century. The distinction between commercial and regulatory law is still dominant at the national level,

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[2] Roy Goode, Herbert Kronke and Ewan McKendrick, *Transnational Commercial Law: Text, Cases and Materials* (Oxford: Oxford University Press 2007) 25.

[3] Bernard Hoekman and Charles F. Sabel, 'In a World of Value Chains: What Space for Regulatory Coherence and Cooperation in Trade Agreements?' in Benedict Kingsbury, David M. Malone, Paul Mertenskötter, Richard B. Stewart, Thomas Streinz and Atsushi Sunami (eds), *Megaregulation Contested. Global Economic Ordering After TPP* (Oxford: Oxford University Press 2019) 217-218.

[4] Fabrizio Cafaggi and Paola Iamiceli, 'Regulating Contracting in Global Value Chains. Institutional Alternatives and their Implications for Transnational Contract Law' (2020) 16(1) *European Review of Contract Law*, 44-45.

[5] Fabrizio Cafaggi, 'The new foundations of transnational private regulation' (2011) 38(1) *Journal of Law and Society*, 20-21.

[6] See below text and note 10.

whereas a hybridisation has taken place at a transnational level.[7] Transnational commercial contracts within global supply chains have increasingly played a regulatory function, incorporating not only quality and safety standards but also environmental and social standards and, more broadly, sustainability standards.[8]

Transnational private regulation in the field of commercial contracts complements and supplements international organisations but does not replace them.[9] There are forms of international regulatory cooperation among IOs and between IOs and private organisations aimed at increasing the implementation of transnational commercial law.[10] Institutional cooperation in transnational commercial contracts results in the production of common guidelines, in collaborative drafting of model clauses and model contracts, and in the endorsement and the recognition of the mutual relevance of each other's instruments.[11] These forms of cooperation affect the substantive relationship between law and custom at the transnational level.

The role of States in the production of international law has changed, but the importance of local legal institutions for the development of global custom remains important. The thesis developed in this article is that there exists a strong complementarity between communities' norms, based on usages and practices, and legal, local, and global institutions.[12] Such complementarity is an expression of global legal pluralism.[13]

For this analysis, it is contended that customary rules in transnational commercial contract law originate from the communities of entrepreneurs (traders) through processes

[7] Fabrizio Cafaggi, 'The Many Features of Transnational Private Rule-Making: Unexplored Relationships between Custom, Jura Mercatorum and Global Private Regulation' (2015) 36(4) *University of Pennsylvania Journal of International Law* 877, 913.
[8] Djakhongir Saidov, 'Standards and Conformity of Goods in Sales Law' (2017) 2017(1) *Lloyd's Maritime and Commercial Law Quarterly*, 65.
[9] Cafaggi (n 7) 913.
[10] OECD, 'International Regulatory Co-operation - Transforming rulemaking to meet the global challenges of the 21st century', Policy Brief, April 2020, available at https://www.oecd.org/gov/regulatory-policy/international-regulatory-cooperation-policy-brief-2020.pdf.
[11] The Legal Guide to Uniform Instruments in the Area of International Commercial Contracts jointly developed with the United Nations Commission on International Trade Law and the Hague Conference on Private International Law (2021), available at https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/tripartiteguide.pdf.
[12] Cafaggi (n 7) 913.
[13] Paolo Grossi, *L'Invenzione del Diritto* (Roma-Bari: Laterza 2017) Ch. 1.

that might either be spontaneous or organised.[14] Communities hold and exercise autonomous, rule-making power that is not conferred to them by the State.[15] The foundation of this power is in the autonomy of communities from the State.[16] Autonomy does not coincide with statelessness.[17]

Within customary commercial law are included both unwritten and codified customs, the products of organisations like the International Chamber of Commerce (ICC) whose aim is to collect, consolidate, and codify existing commercial practices. The paradigmatic examples of codified usages are the Uniform Customs and Practice for Documentary Credits (UCP 600) and the ICC Incoterms, but there is a growing number of them produced by sector-specific associations and global supply chains.[18] The majority of codified usages is meant to complement legal instruments. In some instances, however, they are designed and engineered as self-sufficient governing instruments of trade.

3. Customary rules in transnational commercial law

For a customary rule to exist there has to be the combination *of usus* and *opinio juris sive necessitatis.*[19] *Usus* is a practice encapsulating the behaviour in the customary rule. It has to represent a stable behavioural pattern within the relevant community. In addition, according to the conventional perspective, there has to be a normative belief that

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[14] Avner Greif, 'Impersonal Exchange Without Impartial Law: The Community Responsibility System' (2004) 5(1) *Chicago Journal of International Law* 109, 110.

[15] On the origins of rulemaking power and the notion of legal order see Santi Romano, *L'ordinamento giuridico*. *Studi sul concetto, le fonti e i caratteri del diritto* (Pisa: Spoerri 1918). A different perspective is developed in Friedrich A. Hayek, *Law, Legislation and Liberty*, Volume I: *Rules and Order* (London: Routledge and Kegan Paul, 1973); *Law, Legislation and Liberty*, Volume 3: *The Political Order of a Free People* (Routledge and Kegan Paul Ltd, 1979).

[16] On the autonomy of the rulemaking power in a historical perspective see Luca Mannori, 'Autonomia'. Fortuna di un lemma nel vocabulario delle libertà locali tra Francia ed Italia' (2014) 43 *Quaderni Fiorentini per la storia del pensiero giuridico moderno*, 65.

[17] On the notions of statelessness see Barak D. Richman, *Stateless Commerce: The Diamond Network and the Persistence of Relational Exchange* (Cambridge, Massachusetts: Harvard University Press 2017) 63, and on the notion of lawlessness see Avinash K. Dixit, *Lawlessness and Economics: Alternative Modes of Governance* (Princeton: Princeton University Press 2004) 5-6.

[18] See ICC Incoterms Rules, available at https://iccwbo.org/resources-for-business/incoterms-rules/ (last visited 19 August 2021).

[19] Bartolo da Sassoferrato, *Consilia, quaestiones et tractatus* (Thomas Berthelier 1547); John Gilissen, «Consuetudine», in *Digesto Sez. civ.*, III, Torino, 1988. The necessity of opinio juris as a normative requirement has been challenged. See Norberto Bobbio, *Consuetudine*, Enciclopedia del diritto, Milano, 1961, 9; Rodolfo Sacco, 'Fonti non scritte', in *Digesto discipline privatistiche* (Utet: Torino, 2012).

the behaviour by the members of the relevant community is what is expected of the parties. Namely, it is expected that members of the community will comply with that behaviour, unless they opt out.[20] The normative belief incorporates expectations – specifically, the community's expectation that its members will conform to that practice, which has a normative dimension in that it generates the mutual trust, essential to supporting trading activities.[21] But how is the pattern of behaviour formed? And how is the relevant community defined for a behaviour to become a custom?

The formation of custom is incremental, and often, but not always, spontaneous. It is not the outcome of an intentional and rational decision-making process.[22] Whether this process is spontaneous, in Hayekian terms, or driven by social institutions within the communities is debated among legal and economic historians.[23] The existence of customary rules can be inferred, and the inferential process differs depending upon whether the rule has been codified or not.[24] Cooperation among traders is required to create a community norm where mutual trust and reputation can support exchanges.[25] Specific

[20] There is a striking correspondence with recent theories of social norms developed by behavioral scientists. See Cristina Bicchieri, *Norms in the Wild: How to Diagnose, Measure and Change Social Norms* (Oxford: Oxford University Press 2017); *The Grammar of Society: The Nature and Dynamics of Social Norms* (Cambridge: Cambridge University Press 2006) 11, where she defines social norms as 'behavioral rules supported by a combination of empirical and normative expectations. Individuals have a conditional preference for obeying social norms, provided they hold the right expectations' and describes the differences between empirical and normative expectations as 'The difference between expectations of how other people will behave in specific situations (empirical expectations) and expectations about what other people think one should do in those situations (normative expectations)' (at 38). Compare with Roy Goode, 'Usage and its Reception in Transnational Commercial Law' (1997) 46(1) *International and Comparative Law Quarterly* 1, 8 where it is argued that 'Until relatively recently it has been widely accepted that for an international trade usage to have normative force it is not sufficient to establish a pattern of repetitive behaviour among merchants; it must also be shown that this pattern of behaviour is observed from a sense of legally binding obligation, not from mere courtesy, convenience or expediency'.

[21] Avner Greif, 'Institutions and the Path to the Modern Economy: Lessons from Medieval Trade' in Claude Menard and Mary M. Shirley (eds.), *Handbook of New Institutional Economics* (London: Springer 2005) 727.

[22] Sacco (n 19). See also J. H. Dalhuisen, 'Custom and Its Revival in Transnational Private Law' (2008) 18(2) *Duke Journal of Comparative & International Law* 339.

[23] Geoffrey M. Hodgson, 'On the Institutional Foundations of Law: The Insufficiency of Custom and Private Ordering' (2008) 43(1) *Journal of Economic Issues* 143.

[24] Goode (n 20) 15, where it is pointed that 'There are three principal conditions in which a court or an arbitral tribunal can be led to accept the existence of a trade usage. The first is where the usage is so well known that the tribunal can take judicial notice of it; the second, where written or oral testimony is given by expert witnesses; and the third, where the usage can be inferred from international conventions, uniform rules prepared by international organisations, standard contracts, scholarly writings, and the like.'

[25] Greif (n 21) 749.

institutions are needed to develop and consolidate customs.[26] In fact, the production of customary rules is partly and increasingly dependent upon the private institutions that codify and update them. I have argued elsewhere that customary rules need strong institutional pillars, albeit pillars which are partially different from those necessary for legal norms to develop.[27] It would be a mistake to apply the same conceptual framework to describe the origins of legal rules and those of customary norms, but it would be an even more serious mistake to believe that the rise, development, and decline of custom is independent from the existence of an institutional framework premised on legal rules.

Trade usages are part of customary rules, but they are subject to specific normative requirements when applied in transnational commercial contracts.[28] They are considered implied terms.[29] The trade usage as an implied term enters the contract subject to the occurrence of three conditions: the usage is or ought to be known, it has to be regularly observed, and it has to be reasonable.[30] Parties can opt out of this rule and explicitly adopt a different rule from the trade usage.

In some national legal systems, and in the United Nations Convention on Contracts for the International Sale of Goods 1980 (CISG), the normative belief (*opinio juris*) has disappeared from the definition of trade usages. Such definition is limited to the practice without any explicit reference to the belief.[31] According to the definition of article 9.2 of the CISG, what is required for a trade usage to be binding is a known and regularly

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[26] Clayton P. Gillette, 'The Law Merchant in the Modern Age: Institutional Design and International Usages Under the CISG' (2004) 5(1) *Chicago Journal of International Law* 157, 162.
[27] Cafaggi (n 7) 913.
[28] See Article 1.9 of the UNIDROIT Principles of International Commercial Contracts and Art. 9 of Vienna Convention on international sales.
[29] See Article 9 CISG. '(1) The parties are bound by any usage to which they have agreed and by any practices which they have established between themselves. (2) The parties are considered, unless otherwise agreed, to have impliedly made applicable to their contract or its formation a usage of which the parties knew or ought to have known and which in international trade is widely known to, and regularly observed by, parties to contracts of the type involved in the particular trade concerned.' See Clayton P Gillette and Steven D. Walt, *Sales Law: Domestic and International* (2nd edn, Foundation Press 2008) 113.
[30] Stefan Vogenauer (ed), *Commentary on the Unidroit Principles of International Commercial Contracts* (PICC) (2nd edn, Oxford: Oxford University Press 2015) 236 where it is observed that 'According to art. 1.9 (2) usages that are not agreed by the parties are only binding on them if they meet three requirements: First, the usage in question must be regularly observed in international trade by parties in the particular trade. Secondly, it must be widely known to such parties. Thirdly, the application of the usage may not be unreasonable in the particular case.'
[31] Article 9 CISG.

observed practice.[32] A similar approach is taken by art. 9.1 of the Principles of International Commercial Contracts 1994 (PICC).[33] This is the difference between trade usages and customary commercial rules. Customary rules are not regulated by transnational commercial law instruments but the same rules, designed for trade usages, apply to custom, unless otherwise specified.

Legally, parties can opt out of the customary rule, exercising their contractual freedom. There are different mechanisms for opting out of default rules: individual and collective opt-outs.[34] An individual opt-out occurs when parties to a transaction decide to modify the default rule with a term borrowed by trade usages.[35] Collective opt-out takes place when an entire industry opts out of a single default rule, or of an instrument altogether, to use a customary rule.[36] In the latter case, all the members of the trade association are committed to deploy the rules of the association (e.g. the code of conduct) rather than the default rule of the transnational instrument. A collective opt-out also occurs when a chain leader indicates in its general terms and conditions (GTCs) that a specific term is applied to the chain of contracts. Even if the change of the default rule is made unilaterally by the chain leader, the effects will involve a large number of transactions that take place within the chain. For this reason, this is a collective opt-out.

Collective opt-out may be driven by the necessity to use a different rule. This rule may already exist or may be created just prior to the opt-out. Collective opt-out may solve collective action problems. When parties trade in the same market, the use of different terms of trade may hamper exchanges, raising transaction costs. To coordinate the terms of transactions of hundreds or thousands of participants in the trade would be very costly without the intervention of a leader or an association that decides to opt out from the default

[32] Gillette and Walt (n 29) 113.
[33] Article 9.1 PICC (1) The parties are bound by any usage to which they have agreed and by any practices which they have established between themselves. (2) The parties are bound by a usage that is widely known to and regularly observed in international trade by parties in the particular trade concerned except where the application of such a usage would be unreasonable. See Vogenauer (n 30) 238, fn. 29.
[34] Lisa E. Bernstein, 'Opting out of the Legal System: Extralegal Contractual Relations in the Diamond Industry' (1992) 21(1) *Journal of Legal Studies* 115.
[35] For a theoretical framework concerning opt-out in contractual default rules see Ian Ayres, 'Regulating Opt-Out: An Economic Theory of Altering Rules' (2012) 121(8) *Yale Law Journal* 2032, 2034.
[36] Bernstein (n 34) 115.

of the transnational instrument. As we shall see, collective opt-out can also contribute to solving some problems arising from the stickiness of default rules.

Examples of GTCs that opt-out of default rules in transnational regimes to create a global supply chain regime abound. Take, for example, the area of remedies for breach of contract. The international instruments are still organised around the traditional couple of damages/specific performance. Contracting in global chains suggests that the stability of the chain and the high degree of interdependence require the use of corrective remedies.[37] This necessity has driven GTCs drafted by transnational companies to include corrective remedies and, when a term of hierarchy has been introduced to sequence the remedies, corrective remedies have been placed high in the hierarchy. Suppliers in their contracts are requested by GTCs to prioritise corrective remedies over termination and remedies like damages that do not address the causes of the breach but focus on the consequences.[38]

Opt-out can refer to trade usages rather than to the default drafted by the chain leader. When, as is currently the case for CISG and PICC, the trade usage is the implied term, parties can opt out, and decide to use a default rule or another non-common trade usage. Hence, there are exit and entry mechanisms to modify existing regimes. The issue addressed in this article is how the design of these mechanisms can influence the evolution of transnational commercial law.

The possibility that parties can opt out of the customary rules does not undermine the binding character of custom. This is certainly true for the CISG and PICC that do not require *opinio juris* for trade usages to be incorporated in the contract, but it would also be true for those regimes that still require the combination of *usus* and *opinio juris sive necessitates.* The *opinio juris sive necessitatis* requires parties' belief that the rule is binding, not that the rule is mandatory. As set out above, a dispositive rule is binding even if it is not mandatory. Therefore, parties may believe that the rule is binding as in the case of default rules, but they have the power to replace the customary rule with their own contractual terms. The existence of a customary rule is compatible with the power of opting out.

[37] Cafaggi and Iamiceli (n 4) 155.
[38] ibid, 165.

Not only is custom grounded on a solid institutional framework, but the features of customary rules may also vary according to the different institutional frameworks. Customary rules can be oral or written.[39] Within custom certainly there are written rules that constitute the products of private organisations whose main aim is to collect, consolidate, and codify them. The spontaneous or organised nature of the production of customary rules is not a distinguishing feature of custom. What is relevant to distinguish customary rules from legal rules is that they originate from a community rather than from the state.[40]

A difference might be established depending on whether the customary rule, for example a trade usage, has been codified. If the customary rule has not been codified and the *opinio juris* is based on the existence of a practice, no doubt that it is the empirical dimension related to the number and relevance of traders following the rule, that drives the normative belief. It is contended that even when the usage has been codified and it differs from the practice, the latter should prevail. If there is a divergence between *usus* and *opinio juris*, as for example, when the practice differs from the codified usage, the behaviour, commonly adopted by contractual parties (the "practice"), should prevail. In case of divergence between *usus* and *opinio juris,* the former should be given priority over the latter.[41] Actual behaviour should prevail over normative beliefs when they diverge. To argue the opposite would strongly undermine the process of legal innovation of custom and contradict the evolution embedded in the definitions of CISG and PICC.

4. Transnational commercial custom and commercial law: alternatives or complements?

Law and custom have different origins. Law, including both legislative and judicial-made law, originates from the State. Custom originates from communities. Effectiveness

[39] Gilissen (n 19) 9; Bobbio (n 19) 426.
[40] In this perspective transnational commercial law differs from international public law where clearly customary rules are practices of States. Both custom and legislation emanate from States.
[41] But see Goode (n 20) 14-15 stating that since both usus and *opinio juris* have to occur when there is divergence the custom should be what the *opinio juris* suggests and not what the practice does.

is usually not a metric of legal validity for law (state-based norms), whereas it is the validity metric for custom (community-based norms).

Both legal and customary rules can have either a mandatory or dispositive nature. Both can be binding. The binding force of a rule is not dependent upon its mandatory nature. Default rules are binding even if individual parties can deviate from them, introducing contract terms that regulate their behaviour in ways that can be totally divergent from the default. For example, the default rules on remedies within the applicable law bind the parties even if the parties can modify them and revise their hierarchy and their content.

The debate over the formation of custom outside and beyond the law has attracted the attention of historians, economists, and lawyers; the most recent accounts show that customary rules in international trade can develop independently from the States but more often flourish where legal institutions are strong and stable.[42] The discussion below addresses the distinction between independent and complementary private orders in relation to transnational commercial contracts.[43] More specifically, it considers whether transnational commercial law and custom are complementary or alternative, and how they co-evolve.[44]

As we shall see, a sharp difference exists between national and transnational domains. Certainly, the evolution of custom in transnational commercial transactions cannot be analysed as a dependent variable of legislation. The relationship is the reverse: practices influence international legislation. But even within the national domain, a distinction should be made between contracts made by merchants and other contracts.[45]

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[42] David Ibbetson, 'Custom in Medieval Law' in Amanda Perreau-Saussine and James B. Murphy (eds) *The Nature of Customary Law* (Cambridge: Cambridge University Press 2007) 153-155; Sheilagh Ogilvie, *Institutions and European Trade: Merchant Guilds, 1000–1800* (Cambridge: Cambridge University Press 2011) 160-161; Emily Kadens, 'The Myth of the Customary Law Merchant' (2012) 90(5) *Texas Law Review* 1153 (providing an account of commonly conflicting rules). See also R C Van Caenegem, *An Historical Introduction to Private Law* (Cambridge: Cambridge University Press 1992) 115-116.

[43] Richman (n 17) 37-38.

[44] See more broadly Dixit (n 17) 25-26.

[45] In continental law, commercial contracts are concluded between merchants whereas civil contracts are concluded by parties regardless of their economic status.

The State legal regulation of commercial contracts pays a significant tribute to the usages of the merchant community rule-making, even at a national level.[46]

The narratives concerning the relationship between law and custom in international commercial law are quite diverse and often divergent.[47]

The golden age of development of customary rules is usually associated with medieval times, but even during the Roman empire customary rules flourished, especially within the *jus gentium*.[48] Custom developed along the trading roads like the silk road or the Maghribi desert.[49] Fairs had their own trading rules.[50] Medieval Italy was the source of trading and banking custom and the institutional foundation of modern capitalism.[51] However, different towns had different forms of cooperation between public and private actors to devise trading rules.[52] The Hanseatic League was a powerful source of customary trading rules regulating trade between merchants operating within the territory of the League.[53] These customary rules were developed across sectors by merchants trading different commodities.[54] In other circumstances, customary rules were crafted within a community of merchants trading a single commodity, like diamonds, textiles or spices.[55]

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[46] Francesco Galgano, *Lex Mercatoria* (Bologna, Il Mulino 1976).
[47] Ralf Michaels, 'The True Lex Mercatoria: Law Beyond the State' (2007) 14(2) *Indiana Journal of Global Legal Studies* 447, 468. See also Nikitas E. Hatzimihail, 'The Many Lives—and Faces—of Lex Mercatoria: History as Genealogy in International Business Law' (2008) 71(3) *Law and Contemporary Problems* 169 (detailing the analysis of lex mercatoria's rival accounts); Gralf-Peter Calliess, *Lex Mercatoria*, Jürgen Basedow, Giesela Rühl, Franco Ferrari and Pedro de Miguel Asensio (eds), *Encyclopedia of Private International Law* (Cheltenham: Edward Elgar 2007) 1119.
[48] Gillisen (n 19) fn 38.
[49] Avner Greif, 'Contract Enforceability and Economic Institutions in Early Trade: The Maghribi Traders' Coalition' (1993) 83(3) *American Economic Review* 525, 531; Greif (n 21); Jessica L. Goldberg, *Trade and Institutions in the Medieval Mediterranean: The Geniza Merchants and their Business World* (Cambridge: Cambridge University Press 2012); Avner Greif, 'The Maghribi traders: a reappraisal?' (2012) 65(2) *Economic History Review* 445. For a critique of Greif, see Ogilvie (n 42).
[50] Paul R. Milgrom, Douglass C. North, Barry R. Weingast, 'The Role of Institutions in the Revival of Trade: The Medieval Law Merchant, Private Judges and the Champagne Fairs' (1990) 2(1) *Economics and Politics*, 1-23; Stephen E. Sachs, 'From St. Ives to Cyberspace: The Modern Distortion of the Medieval 'Law Merchant' (2006) 21(5) *American University International Law Review*, 685, 730.
[51] Paolo Grossi, *L'ordine Giuridico Medievale* (Roma-Bari: Laterza 1995).
[52] Guido Lodovico Luzzatto, 'Corporazioni' in *Enciclopedia del Diritto*, vol. X (Giuffrè, Milano 1962) 674 distinguishing between Milan, Bologna and Florence.
[53] Frédéric Mauro, 'Merchant communities, 1350-1750' in James D. Tracy (ed.), *The rise of merchant empires: long-distance trade in the early modern world 1350–1750* (Cambridge: Cambridge University Press. 1990) 255-256.
[54] Iris Origo, *Il Mercante di Prato. La vita di Francesco Datini. Alle origini del capitalismo italiano* (Corbaccio, Milano 1957) ch.1.
[55] Bernstein (n 34) 115; Richman (n 17) 19.

The rule-making power of merchant communities was recognised through different legal instruments, among which *statuta corporationis* were the most prominent.[56] These were instruments enacted by guilds and *corporationes* regulating property, contract, company, and bankruptcy.[57] The distinction between public and private law did not exist as we know it now, and the production of legal rules by guilds and *corporationes* could have *erga omnes* effects, similar to the *ordonnances' of towns*.[58] Together with these quasi 'legislative' sources, customary rules also developed within merchants' communities.[59] Hence, in those times, community rules included both quasi-legislative acts, enacted by the merchants' guilds, and customary norms, produced by the merchants' communities.[60] The former disappeared with the acquisition of legislative monopoly by the State in the XVIII and XIX centuries, the latter survived codifications.

If custom is a community-based norm, its rise, development, and decline is inextricably linked to the evolution of the community. Similarly, the validity of customary rules is contingent upon their effectiveness. These rules cease to exist when their application by the relevant community ends.

Arguably, the evolution of custom in relation to that of law suggests that the rise and decline of custom should be read in light of the increasing or decreasing role of the law and, in modern times, legislation. Specifically, it is contended that in a world of customs, as was the world of continental Europe, the Spanish and British colonies in the 17th century

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[56] Luzzatto (n 52) 674.

[57] Emily Kadens, 'Order Within Law, Variety Within Custom: The Character of the Medieval Merchant Law' (2004) 5(1) *Chicago Journal of International Law* 39; and especially Charles Donahue, Jr., 'Medieval and Early Modern Lex Mercatoria: An Attempt at the Probatio Diabolica' (2004) 5(1) *Chicago Journal of International Law* 21.

[58] Galgano (n 46) 36-37; Jürgen Basedow, 'The State's Private Law and the Economy—Commercial Law as an Amalgam of Public and Private Rule-Making' (2008) 56(3) *American Journal of Comparative Law* 703.

[59] Mary E. Basile, Jane F. Bestor and Daniel R. Coquillette (eds) *Lex Mercatoria and Legal Pluralism: A Late Thirteenth-Century Treatise and Its Afterlife* (Cambridge, MA: The Ames Foundation, 1998); Charles Donahue, Jr., 'Benvenuto Stracca's De Mercatura: Was There a Lex mercatoria in Sixteenth-Century Italy?' in Vito Piergiovanni (ed.), *From lex mercatoria to commercial law*, *Comparative Studies in Continental and Anglo-American Legal History*, vol. 24 (Berlin: Duncker & Humblot 2005) 70.

[60] Statute regulated primarily the relationships between merchants and third parties, in particular craftsmen. They granted monopoly control over production at the local level. Relationships among merchants were, instead, mainly regulated by customary rules collected by the merchants themselves. The latter had extraterritorial effects regulating contract and company law, See Galgano (n 46) 41, 56 building on Alessandro Lattes, *Il diritto commerciale nella legislazione statutaria delle città italiane* (Hoepli, Milano 1884) 138.

and before, international commerce was primarily regulated by community norms set by traders.[61] It was only with the primacy of legislation brought by the enlightenment and materialised with the French codification that custom ceded its primacy to legislation. The State acquired the monopoly on law, or so it was claimed. In fact this monopoly was, if at all, monopoly of *lex;* it never became monopoly of *jus*. Civil society was deprived of the power to produce legislative norms. According to this view, after the French revolution, law coincided with legislation. The codification of private and commercial law transferred rule-making power from society and communities to the State.[62]

The thesis based on that narrative is that the strength of custom is proportionally inverse to that of law. This narrative is both historically inaccurate and theoretically flawed. The distinction between *jus* and *lex*, *droit et loi*, *Recht und Gesetz*, *derecho y ley*, maintained its relevance together with the distinction between public and private law following the European codifications.[63] Certainly, in the 19th century, a significant redistribution of rule-making power took place, from the aristocracy and clergy to the bourgeoisie. But this redistribution did not deprive trading communities of the power to produce legal norms. The redistribution of rule-making power between the aristocracy and the bourgeoisie did not concern trade, where the rule-making power stayed in the hands of the merchants when the State acquired legislative monopoly.[64] Merchants' communities kept their rule-making power even after the 19th century codifications. Commercial law preserved its specificity even where the formal distinction between civil and commercial law was not in place.

This is demonstrated by the significant difference between trade or commercial usages, on the one hand, and customary rules applied to property, contracts, wills, family law and other areas unrelated to commercial law on the other. It is by design and not by

[61] Galgano (n 46) 41.
[62] Clearly this transformation did not occur in common law countries where the relationship between judge made law and custom was characterised by much less radical turning points.
[63] Michaels (n 47) 447, 468; Ralf Michaels, 'The Mirage of Non-State Governance' (2010) 2010(1) *Utah Law Review* 31, 45.
[64] Gino Luzzatto, *Breve storia economica dell'Italia medievale* (Torino, Einaudi 1966); Galgano (n 46) 41.

chance that while the former maintained, even in continental systems, priority over the dispositive law, the latter were either eliminated or downgraded.[65]

The primacy of legislation might have occurred in a specific time, and, mainly, for domestic trade.[66] If a longer-term, broader perspective is adopted, the narrative described above presents significant shortcomings.[67] By no means did customary commercial law follow a single path; very different pathways have developed depending on the nature of the traded commodity, on the participants in the trade, and on the degree of interaction between commerce and finance.

To be fair, the narrative referred above, acknowledges the difference between common and civil law. The relationship between legislative commercial law as it developed in continental Europe differs from that of common law systems where, at least until the end of the 19th century, legislation of commercial transactions was limited and the role of trade usages and custom was recognised by common law.[68] At common law, the relationship between custom and judicial-made law was different from continental law until statutory law became a significant pillar of national commercial laws even in common law systems.[69] This process began with the enactment of sales law in England at the end of the 19th century and that of UCC in the US in the early 20th century.

The approach taken in this article differs from the narrative just described. It is contended that, but for a few exceptions, the evolutionary pattern has been that of co-evolution between law and custom. Such a co-evolutionary path reflects the interaction

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[65] This difference is clear in those systems that distinguish between civil and commercial codes.
[66] Even within continental Europe the primacy of legislation in commercial transactions is debatable.
[67] Basedow (n 58) 703: 'The law of business relations has been created and applied outside state or seignorial courts for centuries before the growing territorial states started to incorporate this body of law into their own state law from the seventeenth century onwards. But even the commercial codes of the nineteenth century left the door open for private regulation.'
[68] Ibbetson (n 42) 153-155.
[69] Goode (n 20) 3: 'So for the purpose of this article the phrase "transnational commercial law" is used to describe the totality of principles and rules, whether customary, conventional, contractual or derived from any other source, which are common to a number of legal systems, while the phrase "lex mercatoria" is used to indicate that part of transnational commercial law which is uncodified and consists of customary commercial law, customary rules of evidence and procedure and general principles of commercial law, including international public policy.'

between States and communities and, before the rise of the modern States, between public power and communities.

The existence of a co-evolutionary pattern does not imply that law and custom do not influence each other. On the contrary, they do, but it is not necessarily the case that strong law coincides with weak custom and weak law with strong custom. At times custom complements law, at times it supplements law and precedes rules subsequently introduced by international soft, or even hard, commercial law.

Commercial custom and commercial law co-evolve, and their relative strengths and weaknesses are correlated. Strong custom has developed with strong and well-established legal institutions.[70] It was only where the legal infrastructure was solid that international commercial custom could develop.[71] When strong legal institutions were absent, custom was weak and unstable. Hence, law and custom have worked as institutional complements rather than alternatives. The redistribution of rule-making power occurred more within the different groups in civil society than between state and civil society.

Clearly, a second important factor is the stability of the community where custom arises and consolidates. When that community changes its composition, then custom changes accordingly. The evolution of the merchants' communities with colonialism, for example, brought about important changes in international commercial laws because the colonies favoured the emergence of new merchants. The complementarity is between instruments and, more broadly, between States and communities.[72]

5. Some distinctive features of customary rules

The relationship between legal instruments and custom is often examined in relation to the conflicts between norms and their resolution. Conflicts between norms at the national level are usually solved through hierarchy. In civil law systems, the hierarchy of sources stipulates that a custom conflicting with law should be overruled. Only

[70] ibid 11.
[71] Cafaggi (n 7) 919 where the institutional preconditions for the emergence of custom are analysed.
[72] Greif (n 49) 525, 531; Greif (n 21); Goldberg (n 49); Greif (n 49) 445.

secundum legem and, to a limited extent, *praeter legem* custom is admissible. *Contra legem* custom is not admissible, given the priority of legal rules over customary ones. A less restrictive approach is taken at common law.

The hierarchical structure is different at a transnational level where, as we shall see, custom cannot violate mandatory rules but can supersede default rules.

A co-evolutionary perspective, like the one proposed in this article, suggests that the interplay between law and custom is relevant not only in conflict situations but also in the context of coexistence—for example where principles and rules have to be integrated by customary rules. In fact, the co-evolutionary perspective presented here shifts the primary focus from conflict to coordination between state and community rules.

Conflict resolution requires a dynamic perspective that compare changes in legal and customary rules. Unlike changes of legal rules, changes of customary norms are very sensitive to social changes. Changes of customary rules occur when either the pattern of behaviour or the belief, that is normatively binding, change.

Conflict is not only between legal rules and custom but also within custom. Trade usages express the majoritarian behaviour.[73] It is only when most of the members belonging to the relevant community stop following that practice that the binding force of the customary rule comes to an end. This formation of trade usages is not necessarily democratic. The reason for the majoritarian requirement is based on transaction costs, rather than on democratic principles. It is only when a pattern of behaviour becomes majoritarian that it is economically rational to give that behavioural pattern the qualification of a legal rule.

This is a significant distinguishing element from the commercial legal rule. In fact, even when the default rule loses its majoritarian feature, it does not lose its binding character. Effectiveness is usually not a metric of legal validity for state-based norms, whereas it is for community-based norms. It is only a new legislative act or, at common

[73] It is contended that majority not unanimity within the community is necessary for a practice to become a rule. The power to opt out from the custom logically presupposes the possibility that some members might diverge and still be subject to the customary rule. See Vogenauer (n 30) 236-237 who speaks of regular and widespread observance of the usages and that it is known by the majority of traders.

law, a judicial decision, that can modify the default rule and realign the legal world with parties' preferences. From a formal standpoint, the community's behaviour is not relevant for the binding force of the default rule. Substantively, instead, it matters a great deal whether a default has become obsolete and is no longer followed by the traders.

A second, distinguishing feature, concerns the scope of custom. Unlike soft and hard legislation, that is usually territorial in scope, custom may or may not be territorial. Usages develop according to the activity of the trading community that may cut across several territories. With the creation of artificial communities based on communication technologies, custom may no longer be territorial and coincide with the activities of the community.[74] A customary contract rule might apply to a trading community regardless of its geographic and territorial location.[75] The territorial aspect of rule-making is reflected in the differences between States that are in modern times territorial entities, and trading communities that may not be territorial units and still produce customary rules.

6. Transnational Commercial Law and custom: The contemporary co-evolutionary pattern

The co-evolutionary thesis outlined above must be clarified in light of the recent evolution of transnational commercial law.[76] Not only must co-evolution be framed differently depending on whether commercial law is mandatory or dispositive (default), but the relationship between law and custom also differs depending on whether commercial

[74] Trading platforms with hundreds of thousands of traders may develop their own custom related to the working of the platform but unrelated to any physical territory.
[75] Goode (n 20) 11: "Trade usage, like custom in public international law, may vary widely both in its sphere of influence and in its degree of specificity. Its sphere of influence may be delineated in a number of ways, for example: (1) geographically, by reference to a particular town, port or region; (2) politically, by reference to a particular political grouping or affinity; (3) economically, by reference to a particular economic grouping or affinity; (4) legally, by reference to a particular legal tradition; (5) commercially, by reference to a particular trade or market." Each of these groupings is to some extent independent of the others, so that, for example, an international trade usage may be confined to a particular type of business activity (e.g., bank documentary payment undertakings) but may be near-universal in geographical scope, whilst on the other hand there may be usages which apply to business activities generally but only within a defined geographical area or a particular legal family.'
[76] Roy Goode, *Commercial Law in the Next Millenium*. *The Forty-ninth Hamlyn Lectures* (London: Sweet & Maxwell 1998) 3.

law is hard or soft. Different modes of complementarity with custom characterise hard and soft transnational commercial law.

In the analysis that follows, the distinction and the relationship between hard and soft transnational commercial law and customary rules will be addressed first; then, the distinction and the relationship between mandatory and default rules in commercial law and custom will be examined to shed light on the features of institutional complementarity and co-evolution.

The distinction between soft and hard law in transnational commercial law is often described by comparing CISG with PICC.[77] The former is a Convention, hence hard law, the expression of political compromise among different domestic legal traditions. The latter is considered soft law;[78] the expression of a cooperative work where different legal traditions have been combined with practices.[79] Soft law instruments include Legal Guides, Model laws, General Principles, codes of conduct.[80]

At the outset it is important to underline that soft law and custom are different. Soft law is not an alternative to custom. The assumed non-binding nature of transnational commercial soft law does not automatically qualify it as custom. Hence it would not be accurate to describe the proliferation of transnational soft commercial law as a replacement of customary commercial law. Customary rules remain different as to both their origin and their nature.

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[77] Susan Block-Lieb and Terence C. Halliday, *Global Law Makers: International Organizations in the Crafting of Global Markets* (Cambridge: Cambridge University Press 2017) 265-266.

[78] See Legal Guide to Uniform Instruments (n 11) 74: "Similarly to the CISG and the Limitation Convention, the UPICC were designed and drafted under the auspices of an international organisation. However, unlike those and other conventions in the area of transnational commercial law, they are a so-called "soft-law" instrument; therefore, they do not impose an obligation on States to bring the rules of the instrument into force by way of national legislation, constitutional arrangements or other mechanisms of transposition."

[79] Susan Block Lieb, 'Soft and Hard Strategies: The Role of Business in the Crafting of International Commercial Law' (2019) 40(3) *Michigan Journal of International Law* 433. It is argued that the ICC Principles were drafted by experts and ratified by UNIDROIT's governing council but did not receive formal approval from UNIDROIT's member states. UNDROIT's approach to the ICC Principles—that is, its failure to seek formal approval from member states—resembles that followed in its Principles of Reinsurance Contracts but is distinct from that of its other soft law projects, such as UNIDROIT's Principles on the Operation of Close-Out Netting Provisions, which were prepared by a working group, approved by the governing council, and subsequently ratified by creating a group of "governmental experts." (at 466).

[80] Block-Lieb and Halliday (n 77) 265.

The distinction between soft transnational commercial law and custom is not based on the (absence of) binding nature, but rather on the origin and the nature of the rule. Transnational commercial soft law principles and rules emanate from international organisations that follow formal procedures and are driven primarily by the agreement of member States. States remain the dominant actors in the production of these instruments. Customary rules, instead, are community-based norms, traditionally driven by the interests of their members.

The choice between hard and soft law at the international level has driven a rich and interdisciplinary debate over the last 20 years.[81] In contrast, the specific relationship between transnational commercial law and custom has not attracted sufficient attention.[82]

The soft instruments adopted by UNCITRAL, UNIDROIT, and The Hague Conference are not binding on States, which may or may not enact legislation to implement them. Their addressees are private parties, courts, arbitrators, and States. More and more frequently, they are applicable to transnational commercial contracts. The non-binding feature of soft law instruments leaves contractual parties with the freedom to choose whether to deploy them in their transactions. This is, however, not limited to soft law instruments; it is a possible feature of hard law as well. Conventions like CISG, where the opt-in regime was adopted, give parties the choice to deploy the international instruments or to regulate the transaction through national laws.

This development of soft law occurs in a framework of regulatory cooperation between international organisations and between IOs and private organisations, like the International Chamber of Commerce (ICC) and the International Standard Organization (ISO). International organisations involved in the regulation of commercial contract law engage in cooperation to coordinate the instruments and their implementation in international commercial contracts.[83] Private organisations and trade associations create

[81] Kenneth W. Abbott and Duncan Snidal, 'Hard and Soft Law in International Governance' (2000) 54(3) *International Organizations* 421 (developing the concept of 'legalization' in distinguishing between hard and soft international law); John J. Kirton and Michael J. Trebilcock, *Hard Choices, Soft Law: Voluntary Standards in Global Trade, Environment and Social Governance* (Ashgate: Aldershot 2004); Gregory C. Shaffer and Mark A. Pollack, 'Hard vs. Soft Law: Alternatives, Complements, and Antagonists in International Governance' (2010) 94(3) *Minnesota Law Review* 706, 713.
[82] But see Block Lieb, (n 79) 433.
[83] See for a recent example the Legal Guide to Uniform Instruments (n 11).

guidelines or codes implementing international instruments: for example, the ICC Incoterms.[84] They specify and standardise rules that derive from the principles issued by the international organisations and from practices. What cannot be achieved through political compromise in inter-governmental organisations can be pursued within the business community by creating models.

Inter-organisational cooperation is both formal and informal. It can translate to the endorsement of the instruments crafted by another organisation, as has happened for the UNIDROIT Principles and for ICC Incoterms.[85] UNCITRAL has endorsed practically every edition of ICC Incoterms, recognising that the terms could usefully apply to sale contracts.[86] Such an endorsement reinforces the authoritativeness of Incoterms for their use in transnational commercial contracts. The endorsement implies that, when using CISG, parties ought to have known about Incoterms.

International regulatory cooperation can also result in collaboration related to the drafting of model clauses. It was in the process of the implementation of CISG and PICC, with the definition of standard contracts and model clauses, that the interaction between

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[84] Ulrich Magnus and Burghard Piltz, 'Trade Terms and Incoterms' in Larry A. DiMatteo, André Janssen, Ulrich Magnus and Reiner Schulze (eds.), *International Sales Law. Contract, Principles & Practice* (Oxford: Beck, Hart, Nomos 2016) 267.

[85] See for example the endorsement of ICC INCOTERMS by UNCITRAL "Taking note of the usefulness of Incoterms 2010 in facilitating international trade, the Commission, at its 955 the meeting, on 3 July 2012, adopted the following decision: "The United Nations Commission on International Trade Law, "Expressing its appreciation to the International Chamber of Commerce for transmitting to it the revised text of Incoterms 2010, which entered into force on 1 January 2011, "Congratulating the International Chamber of Commerce on having made a further contribution to the facilitation of international trade by making Incoterms 2010 simpler and clearer, reflecting recent developments in international trade, "Noting that Incoterms 2010 constitute a valuable contribution to facilitating the conduct of global trade, "Commends the use of the Incoterms 2010, as appropriate, in international sales transactions."

[86] ICC requested the UNCITRAL Commission to consider possible endorsement of Incoterms 2010, which had entered into force on 1 January 2011. 142. "It was noted that the Incoterms rules, the ICC rules on the use of domestic and international trade terms, generally facilitated the conduct of global trade by providing trade terms that clearly defined the respective obligations of parties and reduced the risk of legal complications. Created by ICC in 1936, Incoterms had been regularly updated to keep pace with the development of international trade, with Incoterms 2010 being the most recent update. It was recalled that the Commission had endorsed Incoterms 1990 at its twenty-fifth session, in 1992, and Incoterms 2000 at its thirty-third session, in 2000. The Commission was informed that Incoterms 2010 updated and consolidated the "delivered" rules, reducing the total number of rules from 13 to 11. It was further suggested that Incoterms 2010 offered a simpler and clearer presentation of all the rules, taking account of the continued spread of customs-free zones, the increased use of electronic communications in business transactions, heightened concerns about security in the movement of goods and changes in transport practices".

law and custom was operationalised through international cooperation enshrining a co-evolutionary model. This is co-evolution through cooperation.

The PICC defines principles to be applied across international commercial contracts.[87] The ICC defines model contracts like international sales, franchise, distributorship, agency. They include in their models reference to CISG or PICC.[88] For the international sales contract model, ICC makes reference to CISG in relation to areas not explicitly regulated by the model contract.[89] For other contracts, reference is made to PICC.[90] Force majeure and hardship clauses represent a good illustration of the co-evolutionary path taken through the informal dialogue between ICC and UNIDROIT.[91]

The proliferation of soft law instruments recently produced by international organisations like UNIDROIT, UNCITRAL, and the Hague conference on private international law is usually explained by the flexibility and adaptability of soft law

[87] See PICC preamble 2016 ed. "These Principles set forth general rules for international commercial contracts. They shall be applied when the parties have agreed that their contract be governed by them. They may be applied when the parties have agreed that their contract be governed by general principles of law, the *lex mercatoria* or the like. They may provide a solution to an issue raised when it proves impossible to establish the relevant rule of the applicable law. They may be used to interpret or supplement international uniform law instruments. They may serve as a model for national and international legislators."

[88] It should also be highlighted that, in drafting the terms of the contract and general conditions themselves, the ICC used the CISG as the primary model for the default clauses. See Legal Guide to Uniform Instruments (n 11).

[89] The ICC model contracts usually contain provisions on the applicable law, and refer to international instruments as the default rule, leaving it to the parties to modify this choice if they so prefer. "The ICC Model International Sale Contract (Manufactured Goods), published for the first time in 1997 and reviewed and updated in 2020, contains a reference to the application of the CISG in its general conditions. Article 1.2, in particular, states that any questions which are not settled in the contract itself (including agreed general conditions) shall be governed by the CISG and, to the extent that such questions are not covered by the CISG and no applicable law has been agreed upon, by reference to the law of the seller's place of business. Parties wishing to choose a law other than that of the seller's place of business to govern questions not covered by the CISG are encouraged to do so in the first part of the Model Contract, where individual terms can be negotiated.

[90] Legal Guide to Uniform Instruments (n 11) 91: "Most of the other model contracts contain a reference to the application of general principles of commercial law and to the UPICC. For example, according to article 24.1 of the ICC Model Contract on Commercial Agency, any question not expressly or implicitly settled by contractual provisions shall be governed by the principles of law generally recognized in international trade as applicable to international agency contracts, by the relevant trade usages and by the UPICC, in that order."

[91] See the Legal Guide to Uniform Instruments (n 11) 91-92: "414. The ICC has also developed stand-alone clauses to address specific issues, such as force majeure or hardship, which influenced the language used by the 92 UPICC provisions on regulating these issues (see art. 7.1.7, on force majeure, and arts. 6.2.1–6.2.3, on hardship). In turn, the UPICC have played a role in the most recent revision of such clauses, particularly the Hardship Clause."

instruments, both in their making and in their modifiability over time.[92] The possibility of adopting subsequent versions of the same instrument without going through the process of ratification by member states ensures the possibility of fast adaptation to changed circumstances. Particularly, recent crises have shown that the ability to change quickly and to modify the instrument according to new needs is a necessity. Therefore, not only are there solid rationales for the use of soft law, but there are also good reasons to avoid the transformation of soft law into hard law to preserve the co-evolutionary pattern between law and custom in transnational commercial contracts.

To what extent might the transformation of commercial law from soft into hard law have an impact on custom? The complementarity between soft commercial law and custom may be affected by a transformation into hard law, generating a crowding-out effect of customary rules. Behavioural sciences suggest that the shift to hard, binding legislation may crowd out the production of customary law.[93] The introduction of binding rules may affect the motivational systems of communities to create customary rules. Communities with intrinsic motivations to cooperate in the presence of soft rules may suffer from a reduction of these motivations with the introduction of hard transnational commercial law.[94] On the contrary, the deployment of soft transnational commercial law may crowd-in customary rules in providing communities with motivations to cooperate for the creation of custom.[95]

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[92] Jürgen Basedow, 'The Hague Principles on Choice of Law: their addressees and impact' (2017) 22(2) *Uniform Law Review*, 304; Henry Deeb Gabriel, The Use of Soft Law in the Creation of Legal Norms in International Commercial Law: How Successful Has It Been? (2019) 40(3) *Michigan Journal of International Law*, 413.

[93] Bruno S. Frey, *Not Just for the Money: An Economic Theory of Personal Motivation* (Cheltenham: Edward Elgar 1997) 18, where it is observed that "The psychological processes identified in the last section also allow us to derive the psychological conditions under which the Crowding Out Effect appears: (1) External interventions crowd out intrinsic motivation if the individuals affected perceive them to be controlling. In that case, self-determination, self-esteem and the possibility for expression suffer, and the individuals react by reducing their intrinsic motivation in the activity controlled. (2) External interventions crowd in intrinsic motivation if the individuals concerned perceive it as supportive. In that case, self-esteem is fostered, and individuals feel that they are given more freedom to act, thus enlarging self-determination."

[94]See more broadly Elinor Ostrom, *Governing the Commons - The Evolution of Institutions for Collective Action* (Cambridge: Cambridge University Press 1990) ch.1.

[95] Generally, hard regulation crowds out intrinsic motivation, while soft regulation might even crowd it in. See Frey (n 93) 32, "Informal norms are often established by trendsetters who display certain psychological characteristics such as for instance autonomy and self-efficacy". See also Bicchieri (n 20) 167, which might be reduced or curbed by a shift to hard regulation.

7. Mandatory, default rules, and custom

It should be, once more, underlined that both mandatory and default rules have binding force. The possibility for parties to opt out of the default rule does not undermine the binding force of either the legal or the customary rule. How does the alternative between mandatory and default legal transnational rules affect custom and influence its evolution?

The alternative can be illustrated by contrasting torts and contracts. In torts, where rules are predominantly mandatory, custom can specify the law when the rules of conduct are left to the professional or trading communities. In the case of conflict between legal rules and custom, the former prevails. Custom can only be a complement when no conflicts arise but can never be an alternative to mandatory rules should conflicts arise. In B2B contracts, rules are predominantly default rules, and custom can play an important role as a complement or as an alternative to the legal rules. Custom complements the legal rule when it is used to fill gaps and is an alternative when parties opt out of the default and select a different rule.

Default rules are typically classified into two categories: hypothetical bargain default rules, and penalty default rules.[96] Other taxonomies have been offered.[97] For the purpose of this analysis these distinctions, albeit highly relevant, will not be considered. However, the different types of default may affect the quality of complementarity with custom. The approach taken by CISG and by PICC is that of complementarity with customary rules. Co-evolution is driven by parties' choices in addition to inter-institutional cooperation. The possibility for parties to exit one regime and enter another makes co-evolution work. The focus of the analysis is particularly on exit, but voice and loyalty play a relevant role as well.

The relationship between conventions and usages is as complex in transnational commercial law as it is in international law.

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[96] Ian Ayres and Robert Gertner, 'Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules' (1989) 99(1) *Yale Law Journal*, 87.
[97] Robert E. Scott, 'A Relational Theory of Default Rules for Commercial Contracts' (1990) 19(2) *Journal of Legal Studies*, 597; Alan Schwartz, 'The Default Rule Paradigm and the Limits of Contract Law' (1994) 3(1) *Southern California Interdisciplinary Law Journal*, 389.

> 'A convention may be evidence of a usage, so as to allow its admission where the convention would not as such be applicable. It may operate concurrently with the usage, it may displace the usage, and it may create or evidence new usage through consistent adoption in cross-border commercial transactions or by non-contracting States.'[98]

Unlike domestic laws, where hierarchy is often established by stating that legislation prevails over usages in case of conflict, in transnational commercial law it is not only widely recognised that dispositive conventional rules can change existing trade usages, but also that trade usages can change dispositive norms of conventions.[99] Similar relationships exist with soft contract law, like the PICC. The principles can directly apply when the parties to a contract explicitly refer to them. If they apply trade usages, they are considered implied terms. As a consequence, parties using PICC also include in their contracts trade usages by virtue of Article 1.9 PICC.[100]

In relation to both CISG and PICC, contractual parties who want to use default or introduce their own terms have to opt out from trade usages and indicate which rule they wish to apply. The opt-out mechanism related to trade usages has a double function. In relation to the specific transaction, it allows parties to choose the rule they prefer. Opting out of custom signals the parties' preferences for a different regulation of their transaction.[101] Individual opt-out does not affect the binding force of the customary rule. As previously mentioned, the *opinio juris sive necessitatis* requires parties' belief that the rule is binding, not that is mandatory. Hence, parties may believe that the rule is binding

[98] Goode (n 20) 18.
[99] Ibid., 25 "Just as a convention may change unwritten international trade usage, so also usage may qualify or override the dispositive provisions of a convention. Moreover, in so far as the convention is evidence of usage its provisions may become applicable qua usage even where the connection to a contracting State prescribed by the convention is missing, e.g., where, in an international sale of goods, one of the parties does not have its place of business in a contracting State. Again, this finds a counterpart in international law, where a State may be taken to have adhered by practice to a convention to which it is not a party.
[100] Vogenauer (n 30) 239, fn. 29 "Usages and practices that are binding under Article 1.9 can conflict with express terms of the contract or with provisions of the PICC. In such a case the express terms prevail over conflicting usages and practices, which, in turn, supersede conflicting provisions of the PICC, unless the latter are mandatory."
[101] Ayres (n 35) 2034.

as they do with default rules, but that they have the power to replace the customary rule with their own express term.

It is only when the majority of the community's members stop complying with the behaviour enshrined in the rule that the customary rule loses its binding force and can no longer be considered a custom. This happens for example in some cases of collective opt-out.[102] Collective opt-out by a single industry would not be sufficient for the custom to come to an end. To determine the disappearance of a customary rule would be necessary for the majority of industries to collectively opt out.

Does the implied-term nature of the usages result in the prevalence of usages over default rules? Simply, yes it does. When trade usages, conflicting with dispositive rules, have been established, they prevail.[103] Hence, when parties do not explicitly regulate the matter, and when two conflicting gap-fillers are in place, e.g., the default rules and the trade usages, the latter prevails in transnational commercial contract law. The rationale is that, unlike in national legal systems, where obsolescence of legislation almost always requires active intervention by legislators, in transnational commercial contracts business communities can overcome dispositive obsolete legislative rules by introducing divergent usages. Substitution is clearly impermissible for mandatory rules. Hence, usages can only supersede the default rules in transnational legal instruments, encompassing both soft and hard ones. These alternatives often arise when ICC rules differ from principles or guidelines produced by international organisations.[104]

The interpretive functions and the gap-filling functions operate in both directions. In relation to the principles of commercial contracts, not only can they fill gaps left by

[102] In some trading communities instead of individual there is a collective opt-out from trade usages or from default. The community designs its own trading rules which are different from those defined by national or international commercial law and even from codified trade usages. See Bernstein (n 34) 115.
[103] Vogenauer (n 100).
[104] Goode (n 20) 5, "the UNCITRAL Convention on Independent Guarantees and Standby Letters of Credit, most of the provisions of which are purely dispositive will usually be displaced by the non-binding Uniform Customs and Practice for Documentary Credits (UCP) or Uniform Rules for Demand Guarantees (URDG) issued by the International Chamber of Commerce, one or other of which is likely to be incorporated into the relevant contract."

conventions, but they can also fill the gaps of model contracts and contract clauses drafted by private organisations and deployed by parties.[105]

8. Co-evolution by choice. Exiting and entering regimes in transnational commercial contracts

Co-evolution operates not only through cooperation by international organisations but also by traders' choices. The current system of transnational commercial contract law is organised around a combination of opt-in and opt-out. The determination of rules that define opt in and opt out is functional to the co-evolution of the legal and the customary systems. If parties can freely move from legal default to customary rules without barriers represented by transaction costs, strategic incentives, and externalities, the co-evolution will be effective. If barriers to enter and exit are high, then stickiness will prevail, access to alternative rules would be costly, and the two systems will not co-evolve, or will co-evolve more slowly.

How does the choice mechanism work? At the outset, parties have to opt into the transnational commercial law instrument, the CISG, the PICC, or both. Once they have opted into the transnational instrument, trade usages enter the contract as an implied contract term. If parties do not like the usages, they can opt out of the implied term, incorporating different trade usage instead. But the current implied term mechanism has limitations. The necessity of an explicit opt-in trade usage can emerge when multiple

[105] Legal Guide to Uniform Instruments (n 11) 78, "353. Adjudicators may also have recourse to the UPICC to fill gaps in national and international contract law regimes. In both the national and the international contexts, the permissibility of gap-filling with reference to the UPICC depends on the relevant rules and principles on the methodology and the limits of gap-filling. In the CISG, for example, the relevant rule is article 7, paragraph 2 (see paras. 127–132 above). Article 35, paragraph 1 (c), of the Arbitration Rules of the Chinese-European Arbitration Centre. IV. Substantive law of international sales. It stipulates those questions concerning matters governed by the Convention which are not expressly settled in it "are to be settled in conformity with the general principles on which it is based". The general principles to which article 7, paragraph 2, refers are overarching rules that permeate the entire Convention, or at least a significant number of its provisions. They are arguably not numerous, and the more detailed UPICC do represent a compilation of such general principles. Nevertheless, both the CISG and the UPICC draw largely on the same sources, and at least some of the rules contained in the UPICC are restatements of general principles of international commercial law on which, among others, the CISG is based. UNCITRAL has formally commended the use of the UPICC for their intended purposes84 and these purposes, as set out in the preamble to the UPICC, include the use of the UPICC to "supplement international uniform law instruments".

divergent usages exist, for example, general trade usages defined by ICC and industry, or supply chain specific usages. When this is the case, a *double opt-in system* would be desirable instead of the current implied term mechanism. Parties should opt into the transnational legal regime, e.g., choose PICC, deviate from the default in the regime, and explicitly opt in the specific customary rule they want.

9. Opting in specific customary rules: Distinguishing between hard and soft transnational commercial law

Default rules feature in both hard and soft commercial law instruments.[106] In both cases, custom can prevail over default, since they are implied terms. Is there a difference in the relationship between hard and soft default rules? In other words, is opting out of a default rule within a transnational hard law regime like CISG any different from opting out of a default rule within a transnational soft law regime like PICC?

Default rules are sticky. Even if they can be freely changed, parties tend to stick to them due to, among other things, the status quo bias.[107] But the degree of stickiness also depends on whether the opt-out is individual or collective, and whether the regime parties would opt in is characterised by the existence of positive network externalities.[108] Most of the literature concerning the stickiness of default rules focuses on individual opt-out. Here, instead, the focus is on collective opt-out. Conventionally, the stickiness of default has been associated with transaction costs, strategic incentives, and network externalities.[109] The claim here is that, unlike individual opt-out, in collective opt-out there might be a reduction of transaction costs and an increase of network externalities, overcoming the stickiness of the default thereof.

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[106] On the properties of default rules see Ayres and Gertner (n 96) 87; Ian Ayres and Robert Gertner, 'Strategic Contractual Inefficiency and the Optimal Choice of Legal Rules' (1992) 101(4) *Yale Law Journal* 729; Ian Ayres and Robert Gertner, 'Majoritarian vs. Minoritarian Defaults' (1999) 51(6) *Stanford Law Review* 1591.
[107] Korobkin (n 1) 608.
[108] This means that the benefits to choose the customary rule are not limited to the individual transaction but consist in participating to a network whose trading rules are defined by the community itself. This is certainly the case for the small world network, but it is not limited to that. See Lisa Bernstein, 'Contract Governance in Small World Networks: The Case of the Maghribi Traders' (2019) 113(5) *Northwestern University Law Review* 1009.
[109] Ben-Shahar and Pottow (n 1) 651.

Collective opt-out can save transaction costs. It is determined by a community that wants to use a different rule in the trading activity carried by its members. The rule that parties opt-in has usually already been defined when the opt-out takes place. Hence, the cost of defining the new rule may already have been borne by the organisation opting out, so that individuals do not bear any costs resulting from the opt-out. The same is true for supply chain contracting.[110] Most of supply chain contracting occurs through standard contract forms, and whether or not default rules are appropriate is a decision made by the drafter (e.g., the chain leader) rather than a bargaining decision between the contracting parties along the chain.[111] Hence, most of the literature concerning the allocation of costs of contracting out of default rules is not relevant here. The unilateral decision to opt out by the chain leader in the GTCs dramatically cuts transaction costs for individual parties belonging to the supply chains. The co-evolution of custom and default should therefore be investigated in light of the reasons and impacts of collective opt-out.

Default rules in hard law instruments are stickier than in soft law instruments. Customary rules contribute to overcome the stickiness of the default in the hard law instruments. Default rules are sticky when parties do not opt out, even if they have a rational interest to use the customary rule.[112] However, they are also stickier as the modification of the transnational instrument requires longer and more complicated procedures. The development of trade usages may facilitate opting out and reduce the stickiness of default. Trade usages may transform a majoritarian default into a minoritarian default when the majority of the merchants' communities decide to opt out from the default and deploy their own usages.

Default rules in soft law instruments are less sticky than in hard law instruments. The modifications of soft instruments are less complicated since they do not require States' intervention, for example, ratification. Hence, they can reflect the parties' preferences to a higher extent than hard law and follow the evolution of market and technological changes in the various industries. Custom, in this case, does not have to reduce the stickiness of default rules but can simply contribute to their evolution. In relation to hard law

[110] Cafaggi and Iamiceli (n 4) 44.
[111] Ibid., 54.
[112] Ben Shaar and Pottow (n 1) 651.

instruments, custom operates more as an alternative, whereas in relation to soft law instruments, it works more likely as a complement.

The advantages of collective opt-out are also related to the existence of network externalities. The argument of network externalities has been used to suggest the difficulties for individual parties to opt out.[113] I propose a reverse network externality argument, stimulating rather than hampering opt-outs. When there is a collective opt-out, the organisation defining the alternative rule generates network externalities for those who opt-in to the trade usages. Presumably to make the opt-out appealing, these externalities have to be larger than those that parties benefited by using the default rule. Entering into the system of customary rules designed by a trade association defines trading patterns different from those outside the association and presumably less efficient and effective.[114] The trade association recommending the opt-out may confer benefits to those who comply with their codes and ensure trading opportunities that would not be otherwise available. This has to occur within the boundaries of competition law principles. The co-evolution of transnational commercial instruments and custom depends upon the choice between hard and soft law instruments and the different degrees of stickiness of the default rules.

10. Concluding remarks

Commercial legal and customary rules differ as to their origins, nature, and effects, and often complement each other. The role of effectiveness is a further point of difference. The definition of customary rules reflects the correlation between validity and effectiveness. A custom is in place if there is a regular observable behaviour by the relevant community. If the rule is not applied by the community of traders, the custom ceases. Hence, effectiveness of the customary rule is a precondition for its validity. This is not the case for legal rules, where effectiveness does not play a role in determining their validity.

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[113] Michael Klausner, 'Corporations, Corporate Law, and Networks of Contracts' (1995) 81(3) *Virginia Law Review* 757; Marcel Kahan and Michael Klausner, 'Standardization and Innovation in Corporate Contracting (Or 'The Economics of Boilerplate')' (1997) 83(4) *Virginia Law Review* 713 (discussing network externalities and learning effects).

[114] See Bernstein (n 108); Kevin E. Davis, 'The Role of Nonprofits in the Production of Boilerplate' in Omri Ben-Shahar (ed.), *Boilerplate. The Foundation of Market Contracts* (Cambridge: Cambridge University Press, 2007) 120.

A legal rule is valid if its formation complied with procedural rules, regardless of whether it is effective.

The evolution of legal and customary rules reflects the different sensitivity to social change. Embedded in the definition of custom is the sensitivity to social change and to business practices in the field of commercial contracts. Changes to legislation or changes to judicially made rules, instead, are not as sensitive to social changes, since their effectiveness is not a requirement of the validity of legal norms. Whereas custom aligns directly and immediately with social changes, legislation does not. The co-evolution, however, permits social changes to affect legal innovation driven by the modifications of custom and trade usages.

Within transnational commercial law two important distinctions have to be considered: that between hard and soft law, and that between mandatory and default rules. The second is often overlooked and has been much less investigated in relation to soft law. It is, however, clear that even within soft law instruments such a distinction plays a role.

Transnational commercial law in recent years has developed through soft law principles and guidelines.[115] The most influential international organisations involved in drafting international commercial legislation have privileged soft law principles to conventions and treaties.[116]

Soft law instruments like the UNIDROIT PICC can distinguish between mandatory and default provisions. Hence the choice by contractual parties to use them is free, but once parties decide to opt-in they are bound to comply with the mandatory rules within the selected regime. The first preliminary conclusion is that there is no coincidence between hard and mandatory rules, and soft and default rules.

To understand the trend towards transnational soft law instruments, preferences of business coalitions, in addition to States' preferences, should be taken into account.[117] Private business actors can influence both the formation and the implementation of soft

[115] Legal Guide to Uniform Instruments (n 11).
[116] Block Lieb (n 79) 433, 443.
[117] John Braithwaite and Peter Drahos, *Global Business Regulation* (Cambridge: Cambridge University Press, 2000) 27; Gregory C. Shaffer, 'How Business Shapes Law: A Socio-Legal Framework' (2009) 42(1) *Connecticut Law Review* 147, 172; J. Pawelyn, I Woiters, R. Wessels, Informal international law making, OUP, 2013, Melissa J. Durkee, 'International Lobbying Law' (2018) 127(7) *Yale Law Journal* 1742.

law instruments to a much greater extent than they can do with international hard law.[118] Soft transnational commercial law is used to complement, supplement, fill gaps of both international and domestic commercial contract law.[119] Private organisations contribute to the implementation of transnational rules by enacting codes and guidelines that co-evolve with transnational commercial law.[120] This contribution can occur via cooperation or choice.

Institutional cooperation, as it often happens between UNCITRAL, UNCTAD, and UNIDROIT and ICC [121], can be formal or informal.[122] Informal cooperation via unilateral acts is as effective as formal cooperation via agreements or the intermediate instrument of memorandum of understanding. But the interplay between public and private actors can also occur through choices made by traders when they exit one regime and enter a different one.

The complementarity between legal and customary rules should therefore account for the differences between hard and soft law instruments. Commercial legal and customary rules co-evolve over time. Custom can fill gaps in transnational instruments and can specify the rules when the law simply states a principle. Complementarity is also operationalised through access mechanisms permitting parties to exit one regime and enter another one. This is true not only at the macro level of an entire regime, but also at the micro level of individual rules via opt-in and opt-out mechanisms.

Co-evolution operates not only through cooperation but also through choice. The co-evolution of legal and customary rules is ensured by engineering mechanisms of parties' entry and exit or opt-in and opt-out of commercial rules. The smoother the possibility for contracting parties to enter and exit each commercial regime, the more effective the co-evolution between law and custom. Hence, co-evolution is not the result of a spontaneous dialectical process between state and community-based legal orders. Rather, it is the outcome of a legal architecture that enables parties to opt in and out from one system and

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[118] Benedict Kingsbury and Richard B. Stewart, *Global Hybrid and Private Governance: Standard-Setting, Market Regulation, and Institutional Design* (forthcoming Oxford: Oxford University Press, 2022).
[119] Block Lieb (n 79) 433, 474.
[120] Ibid., 474-475.
[121] For example, INCOTERMS produced and updated by ICC are referred to by a number of instruments including hard and soft law.
[122] Legal Guide to Uniform Instruments (n 11).

enter the other system. The use of collective opt-in and opt-out reinforces the co-evolutionary mechanisms because it reduces transaction costs, a barrier for the co-evolution, and may increase positive externalities. When trade associations or supply chain leaders decide to opt-out from transnational legal regimes and define the rule to opt-in, they reduce both the costs of negotiating the change and the costs of selecting the optimal rules for a very large number of transactions. Economies of scale and scope are in place.

But transaction costs are not the only barriers to co-evolution between legal default commercial rules and customary commercial rules. The degree of stickiness of default rules may also affect co-evolution. Co-evolution can be stimulated by instruments that can reduce the stickiness and favour parties' choices, reflecting their preferences.

The distinction between legal default commercial rules and customary commercial rules bears consequences for the dynamics of change in transnational commercial law. Legal rules and customary norms related to trade co-evolve over time through cooperation and choice. The causes of the changes are multiple and independent, but the change of legal rules have effects on customary norms and vice versa.