

CUSTOM IN THE COURTS

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ABSTRACT—This Article presents an empirical study of the trade usage cases decided under the Uniform Commercial Code from 1970 to 2007. It then draws on the study’s findings to revisit the debate over the desirability of the trade usage component of the incorporation strategy—the interpretive approach that directs courts to look to course of dealing, course of performance, and usage of trade to interpret contracts and fill contractual gaps. Although the strategy is generally defended on the grounds that, as compared to a more formalistic adjudicative approach, it will reduce specification costs without unduly increasing interpretive error costs, the study reveals that the empirical assumptions on which this defense is based are highly questionable. More specifically, it shows that usages are not typically demonstrated through the introduction of the types of “objective evidence” that the strategy’s defenders suggest will reduce the risk of interpretive error—such as expert witness testimony, industry trade codes, or statistical evidence that a particular practice is widely observed. Rather, usages are most commonly established solely through the testimony of the parties or their employees. Expert testimony is introduced in at most 31.5% of the cases, the introduction of trade codes is rare, and there were no cases in the study in which the regularity with which a practice was observed was demonstrated through statistical evidence rather than the mere assertion of a witness.

After presenting the study’s findings, the Article reexamines the core justifications for the strategy in light of them. It concludes that because the strategy is likely to increase both specification costs and interpretive error costs, and has particularly negative effects on contracts between large multi-agent firms as well as on the types of outsourcing contracts and contracts for innovation that are increasingly important parts of the modern economy, it should be abandoned in favor of a more formalist approach to contract interpretation, at least in contracts between businesses.

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INTRODUCTION

The Uniform Commercial Code (Code) directs courts deciding disputes between merchants to look to usages of trade and other commercial standards and practices to interpret contracts and fill contractual gaps. This so-called incorporation approach¹ was the brainchild of the Code's principal drafter, Karl Llewellyn, and was an important application of legal realist philosophy to commercial law.² The

¹ The term "incorporation approach" refers to the Code's incorporation of course of performance, course of dealing and usage of trade. This Article focuses solely on the incorporation of trade usage. For a discussion of the reasons why it is undesirable to incorporate course of dealing and course of performance into commercial contracts, see Lisa Bernstein, *Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms*, 144 U. PA. L. REV. 1765 (1996).

² See WILLIAM TWINING, *KARL LLEWELLYN AND THE REALIST MOVEMENT* (2d ed. 2012) (describing the realist jurisprudential bent of the Code, but noting that no realist-style social scientific research was done in connection with the Code project). It is, however, important to note that early drafts of the Code were more sensitive than the adopted version to the procedural and strategic considerations identified in this Article. They contained a provision directing "Merchant Experts on Mercantile Facts," to determine the content of usages relating to a variety of subjects including, but not limited to, the conformity or nonconformity of goods, whether a nonconformity was substantial, the reasonableness of actions, and other issues within the purview of "special merchants' knowledge, rather than of general knowledge." See REPORT AND SECOND DRAFT: THE REVISED UNIFORM SALES ACT 251-54 (1941) [hereinafter REVISED UNIFORM SALES ACT]. Llewellyn recognized that these

incorporation approach was both endorsed and expanded in the most recent proposed revision of Articles 1 and 2 of the Code.³ It is also at the jurisprudential heart of many of the most important international commercial law statutes,⁴ including the recently completed Common European Sales Law.⁵

The Code's incorporation strategy has been in operation in U.S. courts for over seventy years and has influenced the development of commercial law around the world; yet the justifications for the strategy have always been predominantly theoretical. The conceptual model underlying the strategy has never been tested or even evaluated against the reality of the way that its trade usage component operates in practice. This Article presents a detailed study of all of the sales-related trade usage cases digested under the Code's trade usage provision from 1970 to 2007. It then draws on the study's findings to reevaluate the core justification for the strategy, namely that as compared to a more formalist (agreement-centric) approach to interpretation, incorporation decreases specification costs without unduly increasing interpretive error costs.⁶

Subject to the usual methodological limitations of studies based on reported cases, the study reveals that the trade usage component of the incorporation strategy works very differently in practice from the way that

determinations were ill-suited to adversarial litigation in front of lay juries, explaining that even "such question[s] as conformity of textiles to a requirement of merchantability can take three weeks merely to prepare for trial," and there is a "tendency of the seller's choice [of witnesses] to be the seller's 'man.'" *Id.* at 251–52.

³ See James J. White, *Good Faith and the Cooperative Antagonist*, 54 SMU L. REV. 679, 679 n.1 (2001) (noting that the invocation of commercial standards that rely on usage of trade for their content has been "expanded" in the revised Code).

⁴ See UNITED NATIONS CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS, Apr. 11, 1980, 1489 U.N.T.S. 3, art. 9.

⁵ See *Proposal for a Regulation of the European Parliament and of the Council on a Common European Sales Law*, COM (2011) 635 final (Nov. 10, 2011); see also Lisa Bernstein, *An (Un)Common Frame of Reference: An American Perspective on the Jurisprudence of the CESL*, 50 COMMON MKT. L. REV. 169, 169–70 (2013) (observing that the Common European Sales Law's reliance on trade usage is similar to the Code's and therefore suffers from many of the same flaws).

⁶ See Jody S. Kraus & Steven D. Walt, *In Defense of the Incorporation Strategy*, in *THE JURISPRUDENTIAL FOUNDATIONS OF CORPORATE AND COMMERCIAL LAW* 193 (Jody S. Kraus & Steven D. Walt eds., 2000); Clayton P. Gillette, *Harmony and Stasis in Trade Usages for International Sales*, 39 VA. J. INT'L L. 707, 707–09 (1999) ("The commercial law literature contains a somewhat traditional story about the efficient incorporation of trade usage Commercial parties, unable to specify every contingency with precision, can reduce transactions costs by incorporating default rules into their contracts; total contracting costs are minimized to the extent that those defaults reflect risk allocations that most parties would have adopted had they negotiated explicitly about the term," and suggesting that "usages of trade . . . provide an alternative source of majoritarian defaults. . . . [that] serve the function of reducing the costs of contracting."); see also Steven Shavell, *On the Writing and the Interpretation of Contracts*, 22 J.L. ECON. & ORG. 289 (2005) (putting forth a specification cost saving justification for looking to usage that is based on a stylized model of contracting that does not take into account error costs or strategic behavior costs).

it has long been assumed to work in theory. The study demonstrates that interpretive error costs are likely to be higher than theorists assume since the types of “objective” evidence of trade usages that incorporation’s defenders suggest will minimize the risk of interpretive errors⁷—such as expert witness testimony, trade codes, and statistical evidence—are not routinely introduced in sales-related litigation. Rather, in a majority of cases, the existence and content of usages was proven solely through the testimony or affidavits of the parties and/or their employees, a type of testimony that may be either deliberately or subconsciously self-serving.⁸ In addition, there was not a single case in which either party introduced any data that the alleged usage was regularly observed. The study also suggests, though by no means proves, that given the weak evidentiary basis of trade usage determinations, the Code’s permissive parol evidence rule, and the ways that courts have interpreted the Code’s hierarchy of authority, the incorporation strategy is unlikely to reduce—and may even increase—specification costs in many transactional contexts.

In light of these and other findings about the incorporation strategy’s effect on motions for summary judgment, transactors’ ability to engage in litigation-related strategic behavior, and the interaction of the strategy and the operational policies and contract administration mechanisms used in large multi-agent firms, this Article concludes that significant commercial law reform is warranted. More specifically, it suggests that if commercial law is to effectively meet the needs of the modern outsourced and highly innovation-dependent economy, its background interpretive presumptions should be shifted in the more formalist/agreement-centric direction of the New York common law, at least in transactions between large business entities.

Part I explores the statutory framework and commonly articulated evidentiary standards for incorporating trade usages into commercial agreements. It also discusses the ways that courts have interpreted and applied the Code’s hierarchy of authority to permit usages to largely override express terms. Part II presents the study of usage in the courts and discusses the limitations of the study’s methodology. Part III draws on the study’s findings to reevaluate the claim that the incorporation strategy is likely to decrease specification costs without unduly increasing interpretive error costs. Part IV explores the desirability of moving the background interpretive rules of American commercial law in a more formalist

⁷ Steven D. Walt, *The State of Debate over the Incorporation Strategy in Contract Law*, 38 UCC L.J. 255, 274 (2006) (“A finding of a business norm requires some objective evidence: a pattern of behavior in the relevant trade.”).

⁸ Llewellyn himself believed that this type of evidence would be biased. *See supra* note 2.

direction, at least for business-to-business transactions. It also suggests some smaller changes to the Code that would be desirable if, as is likely to be the case, wholesale revision of the statute proves politically infeasible. The Article concludes by identifying the issues that need to be empirically investigated before the desirability of incorporation can be definitively assessed from a purely empirical perspective.

I. THE STATUTORY AND DOCTRINAL FRAMEWORK

Articles 1 and 2 of the Uniform Commercial Code have many provisions that, together with their Official Comments, require courts to look to usages of trade in deciding contract disputes. A usage is defined as “any practice or method of dealing having such regularity of observance in a place, vocation or trade as to justify an expectation that it will be observed with respect to the transaction in question.”⁹ Usages are considered part of the transactors’ legally enforceable agreement, which the Code defines as “the bargain of the parties in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance”¹⁰ As the Official Comments explain, “[W]ritings are to be read on the assumption that . . . usages of trade were taken for granted when the document was phrased.”¹¹

Under the Code, usages are also relevant to: interpreting contract terms, filling contractual gaps, determining the reasonable time for the taking of an action when the written contract is silent,¹² determining if a contract or a contract provision is unconscionable,¹³ defining the contours of the actions that can be taken by a party given an option to act at his discretion,¹⁴ defining the meaning of commercial unit,¹⁵ determining when

⁹ U.C.C. § 1-205(2) (2001).

¹⁰ *See id.* § 1-201(3).

¹¹ *Id.* § 2-202 cmt. 2.

¹² *Id.* § 2-309 cmt. 1 (noting that the “criteria as to ‘reasonable time,’” depend upon commercial standards and that an agreement to a “definite time” may be implied by “usage of trade”).

¹³ *See, e.g.,* *Adcock v. Ramtreat Metal Tech., Inc.*, 44 U.C.C. Rep. Serv. 2d (West) 1026, 1032 (Wash. Ct. App. 2001) (“A party defending a limitation of liability clause may prove it is ‘conscionable . . . if the general commercial setting indicates a prior course of dealing or reasonable usage of trade as to the exclusionary clause.’” (quoting *M.A. Mortenson Co. v. Timberline Software Corp.*, 998 P.2d 305, 315 n.12 (Wash. 2000))).

¹⁴ *See* U.C.C. § 2-311 cmt. 1 (noting that it is permissible to leave some “particulars of performance,” to be designated by one of the parties as long as the power is “exercise[d in] good faith . . . in accordance with commercial standards . . . and the range of permissible variation is limited by what is commercially reasonable,” and explaining that “[t]he ‘agreement’ which permits one party so to specify may be found . . . [in] usage of trade”); *see also id.* § 2-305 cmt. 3 (noting that when a merchant exercises an option to set a price he must do so in good faith which requires “observance of reasonable commercial standards of fair dealing in the trade”).

it is reasonable to conclude that the tender of non-conforming goods with a price adjustment will be acceptable,¹⁶ determining the extent to which the opportunity to cure can be disclaimed,¹⁷ creating¹⁸ or excluding implied warranties,¹⁹ defining conforming tender,²⁰ and fleshing out the contours of the implied warranty of merchantability.²¹ Usages are also relevant to discerning the terms of a contract formed under UCC § 2-207(3) and to determining which so-called “different” or “additional terms” in a battle-of-the-forms situation are included in a contract formed under UCC § 2-207(2)(b).²²

The Code’s hierarchy of authority nominally gives express terms priority over inconsistent usages. It provides that “[t]he express terms of an agreement and an applicable . . . usage of trade shall be construed wherever reasonable as consistent with each other,” but when “such construction is unreasonable express terms control . . . usage of trade.”²³ Under the relevant case law, however, courts are inclined to find usages to be consistent with even seemingly contradictory express terms as long as the

¹⁵ See *id.* § 2-105(6) (defining a commercial unit as “a unit of goods as by commercial usage is a single whole”).

¹⁶ See *id.* § 2-508(2) cmt. 2 (“[R]easonable grounds to believe,” that non-conforming goods would be acceptable with a price adjustment, can be found in “usage of trade”).

¹⁷ See *id.* (noting in connection with the right to cure that “[t]he seller is charged with commercial knowledge of any factors in a particular sales situation which require him to comply strictly with his obligations.”).

¹⁸ See *id.* § 2-314(3) (providing that “implied warranties may arise from . . . usage of trade”); see also *id.* § 2-314(3) cmt. 12 (the statutory language “is to make explicit that usage of trade . . . can create warranties.”)

¹⁹ See *id.* § 2-316(3)(c) (“[A]n implied warranty can also be excluded or modified by . . . usage of trade.”).

²⁰ See *id.* § 1-205 cmts. 4 & 8.

²¹ See *id.* § 2-314(2)(a) & cmts. 6 & 9 (providing that to be merchantable goods must “pass without objection in the trade,” and observing that the meaning of merchantable may “aris[e] by usage of trade or through case law,” and pointing out that in applying the statutory language on “evenness of kind” in lots, it should be borne in mind that “precautionary language has been added as a remainder of the frequent usages of trade which permit substantial variations”).

²² U.C.C. § 2-207 cmt. 4 lists examples of clauses that would typically be considered a “material[] alter[ation]” of the contract, and thus be excluded from the contract. These include clauses that restrict quantity leeway more than the “usage of the trade,” permits or a clause giving a shorter time for complaining of defective tender than is “customary or reasonable.” *Id.* Similarly, U.C.C. § 2-207 cmt. 5 lists examples of clauses that do not cause surprise or hardship, including “credit terms where they are within the range of trade practice,” and a clause setting out a time to complain of defective tender that is “within customary limits.” This aspect of the Code’s reliance on usage is difficult to contract around unless the parties are sending purchase orders pursuant to a master agreement, or have statements in their forms (and usually on their website) stating very clearly that unless their terms are agreed to in all their particulars, they are unwilling to go forward with the transaction.

²³ See *id.* § 1-205(4).

asserted usage does not “totally negate” the express term.²⁴ As one court observed, “In making this determination, it must be borne in mind that to be inconsistent the terms must contradict or negate a term of the written agreement; and a term which has a lesser effect is deemed to be a consistent term.”²⁵ More generally, as another court explained, “The trend has been for judges, looking beyond written contract terms to . . . extend themselves to reconcile trade usage . . . with seemingly contradictory express terms. They have permitted . . . usage of trade to add terms, cut down or subtract terms, or lend special meaning to contract language.”²⁶

This approach to interpretation, while seemingly in tension with the Code’s stated hierarchy of authority, finds support in jurisprudence of the Code as reflected in its Official Comments. The Comments emphatically reject the idea that even a seemingly clear contract provision—like “500 tons”—can have a meaning independent of the commercial context in which it is used. They explain that the Code “rejects . . . the ‘lay-dictionary’ . . . reading of a commercial agreement” in favor of an interpretive approach that determines “the meaning of the agreement of the parties” by looking at “the language used by them and by their action, *read and interpreted in the light of commercial practices and other surrounding circumstances.*”²⁷

The usage component of the incorporation strategy is not a pure default rule. Particular usages can reliably be excluded from consideration

²⁴ See *infra* Table 1 and accompanying text (setting out the contract provisions and the alleged usage-based meanings that courts found to be consistent with one another in the interpretation-related Study Group cases that went to trial); *infra* Table 2 (setting out the contract provisions and alleged usage-based meanings that courts implicitly found to be consistent with one another in the Study Group cases involving a motion for summary judgment on an interpretation issue).

²⁵ Michael Schiavone & Sons, Inc. v. Securalloy Co., 312 F. Supp. 801, 804 (D. Conn. 1970); see also Modine Mfg. Co. v. Ne. Indep. Sch. Dist., 503 S.W.2d 833 (Tex. Civ. App. 1973) (same); Campbell Farms v. Wald, 578 N.W.2d 96, 100 (N.D. 1998) (“In cases governed by the Uniform Commercial Code, the courts have regarded the established practices and usages within a particular trade or industry as a more reliable indicator of the true intentions of the parties than the sometimes imperfect and often incomplete language of the written contract. The courts have allowed such extrinsic evidence to modify the apparent agreement, as seen in the written terms, as long as it does not totally negate it.”); Nanakuli Paving & Rock Co. v. Shell Oil Co., 664 F.2d 772, 780 (9th Cir. 1981) (“[T]he delineation by thoughtful commentators of the degree of consistency demanded between express terms and usage is that a usage should be allowed to modify the apparent agreement, as seen in the written terms, as long as it does not totally negate it.”).

²⁶ Am. Mach. & Tool Co. v. Strite-Anderson Mfg. Co., 353 N.W.2d 592, 597 (Minn. Ct. App. 1984).

²⁷ U.C.C. § 1-205 cmt. 1 (emphasis added); see also *id.* (“The measure and background for interpretation are set by the commercial context, which may explain and supplement even the language of a formal or final writing.”); Columbia Nitrogen Corp. v. Royster Co., 451 F.2d 3, 11 (4th Cir. 1971) (“Indeed, the Code’s official commentators urge that overly simplistic and overly legalistic interpretation of a contract should be shunned.”); Roger W. Kirst, *Usage of Trade and Course of Dealing: Subversion of the UCC Theory*, 1977 U. ILL. L.F. 811, 823–25 (discussing the ways that the Code rejects the idea of plain meaning and elevates the search for meaning to a search for intent).

if they are “carefully negated.”²⁸ However, simply including a detailed provision covering a subject is insufficient to negate seemingly inconsistent usages. In addition, the enforceability and effectiveness of a general clause opting out of all trade usages is at best unclear.²⁹ Such a clause might keep some usages out; yet it is unlikely that the influence of trade usage on contract interpretation can be completely excluded in light of the central role usage plays, not only in the Code’s overall jurisprudential approach, but also in defining the contours of the non-disclaimable “obligations of good faith, diligence, reasonableness and care,”³⁰ as well as the merchant’s duty of good faith that includes the “observance of reasonable commercial standards of fair dealing in the trade.”³¹

Despite the central role the concept of trade usage plays in the Code’s jurisprudence, the Code does not provide any guidance on how the “existence and scope” of usages are to be established. It simply requires that a party seeking to introduce usage evidence give the other party

²⁸ U.C.C. § 2-202 cmt. 2. *Quinn*, a leading form book, suggests that transactors should include a version of the following clause for each usage they wish to exclude: “**Specific Trade Usage Excluded.** This Contract was written with the understanding that the following usage of the trade would not affect the content, interpretation, or performance of this Contract and is here expressly excluded. The trade usage excluded would normally require: [*Describe normal effect.*] In substitution, the parties have agreed to the following: [*Describe alternate procedures or allocation of rights adopted.*]” 1 THOMAS M. QUINN, QUINN’S UCC FORMS AND PRACTICE Form 4, at 1-28 (1987).

²⁹ See 5-1 LEXSTAT FORMS & PROCEDURES UNDER THE UCC ¶ 21.06 (2014) (“The structure of Section 2-202 appears to allow the admission of . . . trade usage evidence, even when a merger clause is effective to totally integrate the agreement. Indeed, some doubt exists of the ability of the parties to exclude parol evidence of a . . . usage of the trade.” (footnotes omitted)); David V. Snyder, *Language and Formalities in Commercial Contracts: A Defense of Custom and Conduct*, 54 SMU L. REV. 617, 635 (2001) (“As custom and conduct are part of the agreement not only by the fiat of the UCC definition but also as a practical matter, the parties will have a rough time banishing them generally.”). Courts do, however, sometimes mention the absence of a clause opting out of usages as an additional justification for giving great weight to usage-related evidence. See, e.g., *Columbia Nitrogen*, 451 F.2d at 10–11. In one case, the court found that the Code did not apply, but noted in dicta that if the Code applied, it would have enforced a provision in the contract which stated that “[n]o terms, conditions, prior course of dealings, course of performance, *usage of trade*, understandings, purchase orders, or agreement purporting to modify, vary, supplement or explain any provision of this Agreement shall be effective unless in writing, signed by representatives of both parties.” *Madison Indus., Inc. v. Eastman Kodak Co.*, 581 A.2d 85, 90 (N.J. Super. Ct. App. Div. 1990). In another case, a clause excluding usages was included in the written contract, but not mentioned in the court’s opinion. See *Leighton Indus., Inc. v. Callier Steel Pipe & Tube, Inc.*, 41 U.C.C. Rep. Serv. 2d (West) 1128, 1137 (N.D. Ill. 1991); *Leighton Indus., Inc. & Callier Steel Pipe & Tube, Inc.*, Contract (on file with author) (denying the plaintiff’s motion for summary judgment and explaining that “whether usage of trade in the pipe industry excluded the implied warranty of merchantability is a genuine issue of material fact,” without even mentioning that the contract included both a standard integration clause and a clause stating that “no course of prior dealing between the parties and no usage of the trade shall be relevant to supplement or explain any term used in this agreement.”).

³⁰ U.C.C. § 1-102(3). The Code permits transactors to particularize the “standards by which the performance of such obligations [of good faith and reasonableness] is to be measured,” subject to the constraint that such attempts at particularization must not be “manifestly unreasonable,” a concept that is also given content, at least in part, by reference to usages of trade. *Id.*; see *id.* § 1-102 cmt. 2.

³¹ See *id.* § 2-103(b).

notice³² and that “[t]he existence and scope of . . . a usage . . . be proved as facts.”³³ The Official Comments provide some elaboration. They reject the strict English and common law standards for establishing the existence of a custom, create a presumption that commercially accepted usages are reasonable, make clear that usages are admissible without a showing that the contract language is ambiguous,³⁴ and make the question of whether an extant usage has been incorporated a question for the trier of fact.³⁵ The comments also note that “[i]n cases of a well established line of usage . . . where the precise amount of the variation has not been worked out into a single standard, the party relying on the usage is entitled . . . to the minimum variation demonstrated.”³⁶ Courts too have failed to provide doctrinal guidance on how usages should be proven, yet they have recognized that usage evidence is somewhat unique in that “testimony of trade custom is testimony to a conclusion; and though all evidence . . . is inferential to a degree . . . the chain of inference is longer when the fact testified to is the existence of a trade custom than when it is the color of the defendant’s hair.”³⁷

The Code and the Comments are silent on the question of who has the burden of proving the existence and scope of a usage. The leading Code treatise and the case law suggest that the burden of proof—at least in the gap filling and interpretation contexts—rests on the party attempting to prove the usage exists.³⁸ However, in cases arising under § 2-207(2)(b), the party attempting to demonstrate that an additional term is a “material alteration” may have the burden of demonstrating that its inclusion is not customary in the trade.³⁹

³² *Id.* § 1-205(6).

³³ *Id.* § 1-205(2).

³⁴ *See id.* § 2-202 cmt. 1 (“This section definitely rejects . . . [t]he requirement that a condition precedent to the admissibility of the type of evidence specified in paragraph (a) is an original determination by the court that the language used is ambiguous.”).

³⁵ *Id.* § 1-205 cmt. 9.

³⁶ *Id.*

³⁷ *W. Indus., Inc. v. Newcor Can. Ltd.*, 739 F.2d 1198, 1202 (7th Cir. 1984) (citation omitted); *accord Rich Prods. Corp. v. Kemutec, Inc.*, 66 F. Supp. 2d 937, 965 (E.D. Wis. 1999), *aff’d*, 241 F.3d 915 (7th Cir. 2001) (reiterating the “liberal ‘chain of inference’ accorded to testimony on matters of trade usage”).

³⁸ *See* JAMES J. WHITE & ROBERT S. SUMMERS, *UNIFORM COMMERCIAL CODE* 146 (6th ed. 2010) (“[C]ourts are likely to impose the burden of proof on the party who seeks to benefit from evidence of . . . trade usage.”).

³⁹ Assuming the additional term is not designated as a per se material alteration in the Comments, a party who wants to exclude the term bears the burden of proving that it was a “material alteration.” *See Bayway Ref. Co. v. Oxygenated Mktg. & Trading A.G.*, 215 F.3d 219 (2d Cir. 2000) (holding that the party who opposes the inclusion of an additional term found in a confirmatory memorandum has the burden of proving that it is a material alteration, and such proof can lie in a demonstration that its inclusion is not a usage of trade).

Drawing on these statutory requirements, incorporation's defenders (incorporationists) have developed a fairly well-articulated view of the type and quantum of "objective" evidence that they assume will be submitted to establish the existence, scope, and content of a usage. They maintain that "[u]nder Article 2, there are two principal methods of demonstrating the existence of an observable regularity of conduct," namely "expert testimony and evidence about statistical regularities."⁴⁰ They surmise that "much of the evidence of commercial norms might consist simply in the presentation of evidence of statistical norms—mere frequencies of a given behavior in the trade."⁴¹ The leading Code treatise takes the position that "[t]o prove [a usage of trade], a party must usually call on an expert."⁴² A leading practice manual presumes the same.⁴³

Despite their legal realist roots, incorporationists have never explored the types of trade usage issues that arise in litigation or ways that trade usages are *actually* established in court. Instead, they have been content to assume that transactors have been taking advantage of the potential specification cost savings the strategy might create by leaving contractual gaps, ignoring remote contingencies, and including large numbers of vague and standard-like clauses, or industry terms of art, in their contracts. They have also assumed that transactors prove usages by introducing objective evidence and that courts have been following the Code's hierarchy of authority. As a leading Code commentator put it, "Without a thorough analysis of a large group of cases, why should we believe that courts are systematically ignoring or misapplying these clear and direct commands?"⁴⁴

The next Part takes up the challenge of looking at just such a large group of cases. It presents a study of the cases decided between 1970 and 2007 in which a trade usage argument was raised in an Article 2 sales

⁴⁰ Kraus & Walt, *supra* note 6, at 213; Kirst, *supra* note 27, at 839 (suggesting that "an outside standard does exist to help judge the truth of the assertion that the parties intended the usage to control the particular dispute: the existence and scope of the usage can be determined from other members of the trade").

⁴¹ Kraus & Walt, *supra* note 6, at 213; *see also* Clayton P. Gillette, *The Law Merchant in the Modern Age: Institutional Design and International Usages under the CISG*, 5 CHI. J. INT'L L. 157, 158 (2004) ("The contextual significance of trade usage requires adjudicators to discover the alleged usage, define its scope, and determine its application to the issue at hand.").

⁴² WHITE & SUMMERS, *supra* note 38, at 145; *see also* E. ALLEN FARNSWORTH, *CONTRACTS* 471 (4th ed. 2004) ("A party commonly shows a usage by producing expert witnesses who are familiar with the activity or place in which the usage is observed.").

⁴³ *See* GREGORY M. TRAVALIO ET AL., *NORDSTROM ON SALES & LEASES OF GOODS* 244 (2d ed. 2000) ("[P]resumably expert testimony will be necessary to establish a trade usage.").

⁴⁴ Robert A. Hillman, Comment, *More in Defense of U.C.C. Methodology*, 62 LA. L. REV. 1153, 1157 (2002).

dispute. Its goal is to provide data that can be used to begin to evaluate both the claim and the theoretical arguments behind the claim that, as compared to a more formalist approach to adjudication, the incorporation strategy decreases specification costs without creating a large increase in interpretive error costs.

II. USAGE IN THE COURTS

In an effort to explore how the Code's trade usage provision operates in practice, a data set with information about all Article 2 sale of goods cases decided between 1970 and 2007 that are digested in the *Uniform Commercial Code Case Digest* under the relevant sections of the Code's trade usage provision was constructed.⁴⁵ The cases were coded to identify the types of situations where trade usage arguments are made as well as the type and amount of usage evidence that was introduced by parties, was required to establish the existence of a usage at trial, was needed to establish the existence of a usage on a motion for summary judgment, or was sufficient to raise a genuine issue of material fact as to the usage's existence and thereby defeat a motion for summary judgment.

To obtain detailed information about as many of the 173 cases as possible,⁴⁶ a letter was sent to at least one attorney involved in each case.⁴⁷

⁴⁵ The cases were drawn from the *Uniform Commercial Code Case Digest* under paragraph 1205 "Course of dealing and usage of trade," omitting 1205.1(6) "As to security interests"; 1205.1(10) "As to acceleration"; 1205.1(11) "As to ownership or title"; 1205.1(12) "As to banking practices"; 1205.2(3)–(7) "Bank transactions"; 1205.3 "Course of dealing"; 1205.4(1)(b) "Course of dealing"; 1205.4(3)(a) "Motor vehicles: Course of dealing"; 1205.4(7)(a)–(c) "Banking"; 1205.4(8)(b) "Clothing and fabric: Course of dealing"; 1205.4(9)(b) "Construction materials: Course of dealing"; 1205.4(11) "Security interests"; 1205.4(12)(b) "Other: Course of dealing"; 1205.5(1)(b) "Express terms of agreement control: Course of dealing"; 1205.5(1)(d) "Express terms of agreement control: Course of performance"; 1205.5(3)(b) "Machinery and equipment: Course of dealing"; 1205(4)(a)–(c) "Security agreements"; 1205(5)(a)–(b) "Banking and lending"; 1205.6(2) "Course of dealing"; 1205.8 "Course of dealing—sale of goods." 1-204-2-102.8 UNIFORM COMMERCIAL CODE CASE DIGEST ¶ 1205, at 115–374 (2007). In addition, some cases that were included in the relevant sections of the *Digest* were nonetheless omitted because the case did not deal with sales, the case made no mention of usage, or the court, in remanding or ruling, simply mentioned usage or the possibility of introducing usage evidence in passing. Individual cases dealing with warranty of title were also omitted regardless of where in the *Digest* they appeared.

⁴⁶ The number of cases in the *Digest* seems strikingly small in light of the Code's pervasive reliance on trade usage. The reasons for this are unclear. It might be that trade usage plays only a minor role in Article 2 commercial disputes—perhaps because lawyers consulting treatises and form books would be told that they cannot prove a usage without an expert witness. Alternatively, the small number of published decisions may be due to the fact that the sorts of cases where usage issues are likely to arise are unlikely to result in published opinions. For example, cases that pit one asserted usage against another, or cases where one party introduces evidence to prove and the other party introduces evidence to disprove the existence of a usage, are unlikely to result in a written state trial court published opinion (as these are rare) or an appeal since they turn on factual findings that are unlikely to be reversed on appeal. Similarly, denials of summary judgment in state courts are not typically published, so it is possible that usages are being used to defeat such motions in numbers the study would not pick up.

The letter asked for case documents relevant to the trade usage issues. The documents obtained were supplemented with case documents downloaded from Lexis and Westlaw. Additional information was also obtained from court files where this could be done at a cost under \$150 per case.⁴⁸

Using these methods of data collection, a significant portion of the trade usage-related litigation record was obtained for sixty-three cases (the “detail group”). Another group of forty cases (the “opinion-only group”) was coded using information gleaned solely from opinions available on Lexis and Westlaw.⁴⁹ The remaining seventy cases in the *Digest* were ones where the record could not be obtained and the opinion did not discuss the types of usage evidence that were introduced. These cases were coded separately and used only to determine the type of trade usage issue they involved (the “issue-only group”).⁵⁰

A. Case Characteristics

The cases in the “detail” and “opinion-only” groups [hereinafter the “Study Group”] came from a variety of industries. The only notable concentration in any one area (36%) dealt with agriculture, defined to include farming, animals, seeds, and agricultural chemicals.⁵¹

Across the Study Group, 46.6% of the cases were in federal court⁵² and 53.4% in state court.⁵³ 58.8% of these cases involved trials or appeals from a trial judgment, 32.4% involved motions for summary judgment, 2.9% involved motions to stay or compel arbitration, and the rest involved other procedural postures.⁵⁴

⁴⁷ There were some cases in which the lawyers could not be located in *Martindale-Hubbell*, the leading directory of lawyers in the United States.

⁴⁸ The \$150 limit was determined by the research budget. There were several cases where the case file turned out to be more expensive either because court personnel misestimated the cost, or because additional documents relevant to the issue had to be requested.

⁴⁹ Cases were included in the “opinion-only” group where the opinion made explicit reference to the type of usage information introduced. To rule out the possibility that cases in this group underreported trade usage evidence, a two-sided Fisher’s exact test was run comparing the frequency with which key types of evidence appeared in the “opinion only” and “detail” groups. It found no statistically significant differences between them.

⁵⁰ Data from the “issue-only group” were included in the analysis only to determine whether there were any statistically significant differences between the types of cases in this group and the types of cases in the “detail” and “opinion only” groups, in terms of the issue to which the usage or alleged usage was addressed. No statistically significant differences were identified.

⁵¹ Interestingly, 48.6% of the cases relating to contractual interpretation fell into this category.

⁵² 60.4% of the federal court opinions were trial court decisions and 39.6% were appeals.

⁵³ 10.9% of the state court opinions were trial court decisions and 89.1% were appeals.

⁵⁴ See *Figgie Int’l, Inc. v. Destileria Serralles, Inc.*, 925 F. Supp. 411 (D.S.C. 1996) (motion for a declaratory judgment), *aff’d*, 190 F.3d 252 (4th Cir. 1999); *Bureau Serv. Co. v. King*, 721 N.E.2d 159 (Ill. App. Ct. 1999); *Southland Farms, Inc. v. Ciba-Geigy Corp.*, 575 So. 2d 1077 (Ala. 1991) (a certified question to the state supreme court).

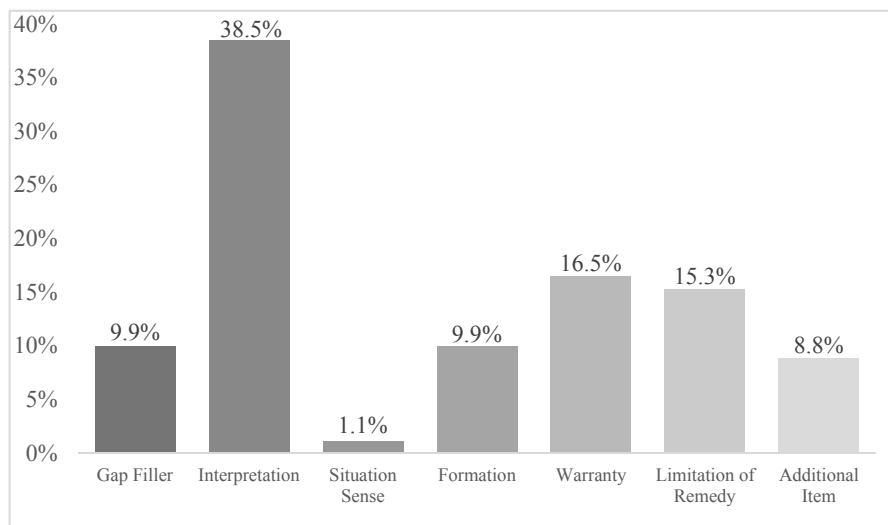
The amounts at stake (in 2012 dollars) varied widely: 3% involved less than \$10,000, 22% involved \$10,000–\$50,000, 15.3% involved \$50,000–\$100,000, and in the remaining 59.7%, over \$100,000 was at stake.⁵⁵

Although it was not always possible to tell if the parties’ contracting relationship was discrete or repeat, at least 43.7% of the relationships in the Study Group cases that raised an interpretation issue were between parties who had done business with one another before.

B. The Types of Issues that Arose

The study sought to identify the types of issues usages were introduced to address. Its findings are set out in Figure 1 below.⁵⁶

FIGURE 1: MOST COMMON USAGE-RELATED ISSUES



Across the interpretation cases, the study also sought to identify the subject matter of the usage-related issue. Its findings are set out in Figure 2 below, which shows that almost all of the usage-related interpretation cases

⁵⁵ The amounts at stake (the percentages) discussed in the text were calculated on the basis of the seventy-two cases for which this information could be obtained. When an opinion awarded damages, the amount awarded was coded as the “amount at stake.” When the opinion did not state a monetary award, but noted the amount the plaintiff was seeking, this was coded as the amount at stake.

⁵⁶ A case was coded as involving gap filling if the written contract in question was silent on the issue the usage purported to cover. Technically, under the Code, usages are part of the transactors’ legally enforceable agreement, so the nomenclature of referring to a gap filled by a usage is inconsistent with the jurisprudential foundation of the Code.

dealt with the core aspects of most deals: price, quantity, quality, delivery, warranty, and payment.

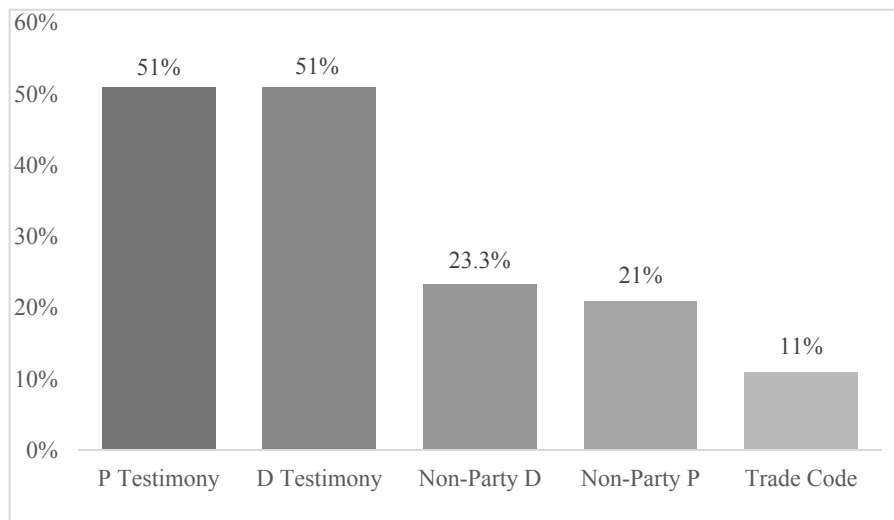
FIGURE 2: SUBJECT MATTER OF THE USAGE ISSUE IN INTERPRETATION CASES



C. The Types of Evidence Introduced

The study also explored the type of trade usage evidence that was introduced to prove the existence and scope of usages. Figure 3 below provides the percentage of Study Group cases in which the following types of evidence were introduced: (1) testimony of plaintiffs or their employees; (2) testimony of defendants or their employees; (3) non-party testimony offered by defendant; (4) non-party testimony offered by plaintiff; and (5) trade codes.

FIGURE 3: TYPES OF EVIDENCE INTRODUCED IN USAGE-RELATED CASES



These findings are broken down further in the discussion that follows.

1. Trial.

a. Party or party employee evidence.—Across the Study Group cases that went to trial, the most common type of usage evidence introduced—or that parties sought to introduce—was the testimony of a party or a party’s own employee.⁵⁷ In the cases where a trial was held⁵⁸ and usage evidence was admitted, plaintiffs and/or their employees (“plaintiffs”) testified in 66% of the cases, while defendants and/or their employees (“defendants”) did so in 45.8%. In 63.15% of the cases, and in 68.4% of the cases in which a usage was found to exist, employee testimony was the only usage-related evidence introduced.

b. Expert/Non-party witness evidence.—The study sought to examine how often expert testimony was introduced. However, it was often difficult to determine whether a particular witness was a fact witness, a lay opinion witness, or an expert witness, even in cases for which full transcripts were available. Given this limitation, all non-party or non-party-employed witnesses were coded together as non-party witnesses.

⁵⁷ Former employees of a party were coded as employees of a party.

⁵⁸ In the cases that went to trial, there was no statistically significant difference (using a two-sided Fisher’s exact test) between the opinion-only group and the detail group in the rate at which either plaintiffs ($p = .28$) or defendants ($p = .30$) introduced testimony of themselves or their employees between the opinion-only group and the detail group.

Across the Study Group cases where a trial was held and the court admitted usage evidence, only 20.8% of plaintiffs and 22.9% of defendants introduced non-party testimony.⁵⁹ Even in cases in which a trial was held and a usage was found to exist, only 31.5% involved the introduction of any non-party witness testimony.⁶⁰ Since only some of the non-party witnesses would have qualified as experts, this data permits the conclusion that the introduction of non-party expert witness testimony is not required to establish the existence of a usage.⁶¹

c. Trade codes and similar writings.—Parties attempted to introduce trade codes and other trade association publications in 11% of the cases,⁶² but courts admitted such evidence in only 6% of the cases. In three of the five cases where the court admitted a trade code, it also found that a usage existed.

Interestingly, there was no statistically significant difference between the rate at which usages were found to exist in cases that went to trial and involved the introduction of only party evidence on the usage issue and cases that went to trial and involved the introduction of trade code-based or non-party witness testimony-based evidence on the usage issue.⁶³

d. Regularity of observance.—The doctrinal requirement that, to qualify as a usage, a practice must be “regularly observed” was typically established (to the extent that it was addressed at all) through a mere

⁵⁹ There was no statistically significant difference (using a two-sided Fisher’s exact test) between the detail and opinion-only groups in the rates with which plaintiffs or defendants introduced non-party witness testimony. This test was conducted to explore the possibility that even those opinions that detailed some of the usage-related evidence introduced might not faithfully recount all of the evidence introduced.

⁶⁰ In these cases, 15.8% of plaintiffs and 21% of defendants introduced non-party witness testimony.

⁶¹ The inability to distinguish expert witnesses from lay opinion witnesses makes it impossible to establish whether or not expert testimony, when introduced in a particular case, was or was not treated as conclusive by courts.

⁶² The relative infrequency with which trade codes were introduced may be due, in part, to the fact that a large number of the industries that produce trade codes and association-drafted contracts have also created association-run arbitration tribunals to resolve disputes between their members, and between members as well as non-members when an arbitration provision is explicitly included in a contract. *See, e.g.*, Bernstein, *supra* note 1 (describing the trade codes and arbitration tribunals created by the National Grain and Feed Association); Lisa Bernstein, *Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 21 J. LEGAL STUD. 115 (1992) (describing the trade codes and private arbitration tribunals used to resolve disputes in the New York diamond industry); Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms, and Institutions*, 99 MICH. L. REV. 1724 (2001) [hereinafter Bernstein, *Creating Cooperation*] (describing the trade rules and arbitration tribunals operative in the cash cotton trade).

⁶³ A usage was found to exist in 85% of the cases in which a trial was held and only party testimony was introduced on the usage issue, and 73% of the cases where non-party testimony and/or a trade code was introduced.

assertion by a witness that a practice was common or that they had never seen things done differently.⁶⁴ Across the gap filling and interpretation cases in the Study Group, there was not a single instance in which a party sought to establish regularity of observance using statistical *data* about how frequently a practice was observed. Even in the cases with the largest stakes, the best lawyers, and the testimony of witnesses with traditional expert qualifications, proof of statistical regularity was still a matter of assertion and opinion.

The only type of case in which parties introduced evidence that a claimed usage had actually been observed in *any* specific transactions dealt with the battle of the forms. In six of these cases, the party who sought to have an additional term in its acceptance included in a contract introduced a few contracts drafted by others in their industry in an effort to establish that there were at least some specific instances where similar *written* terms were used.⁶⁵ There were, however, no cases where the proffered evidence came close to establishing the frequency with which the practice was observed in a place, vocation, or trade.

2. *Summary Judgment.*—Across the Study Group, 30.3% of the cases involved motions for summary judgment on a usage-related issue.⁶⁶ In 65% of these cases, the non-movant raised the usage argument in an effort to defeat the motion.⁶⁷ This tactic succeeded 70.6% of the time.

⁶⁴ To get a feel for the types of evidence that courts accept as fulfilling the statutory requirement that the usage be regularly observed, consider the testimony that was actually introduced in *Spurgeon v. Jamieson Motors*, 521 P.2d 924 (Mont. 1974) where a trial was held and the court found the claimed usage to exist. In *Spurgeon* two of the defendant's employees testified as to the usage of the used farm machinery trade. Ingeman Svendsen testified that he had worked with farm machinery for forty years. When asked whether it was customary to warrant used combines, he said "no." That was the extent of his testimony on the scope of the usage. Transcript of Record at 41, *Spurgeon*, 521 P.2d 924 (on file with author). Keith Jamieson also testified to Jamieson Motors' policy of sharing repair costs 50-50 on newer used models and providing no additional warranties. He was then asked if this was "pretty much standard throughout the business in your trade." He replied that it was. *Id.* at 79.

⁶⁵ See, e.g., *M.A. Mortenson Co. v. Timberline Software Corp.*, 970 P.2d 803 (Wash. Ct. App. 1999), *aff'd*, 998 P.2d 305 (Wash. 2000) (where, in a high profile case that attracted an amicus brief from the Business Software Alliance because it had huge potential ramifications for the software industry, the defendant introduced fifteen "true copies of personal software license agreements from 15 well known software developers" that included the provision it claimed was a usage).

⁶⁶ In most jurisdictions, a denial of summary judgment is not a final order and is hence not appealable. As a consequence, these decisions are less likely to show up in digested opinions. It is therefore not possible to know how frequently usage arguments are used to defeat motions for summary judgment.

⁶⁷ Or, looked at from a different perspective, on motions for summary judgment plaintiffs raised the usage issue 28.6% of the time, while defendants did so 71.4% of the time.

In 83.3% of the cases where a usage argument defeated a motion for summary judgment,⁶⁸ the only evidence of the usage introduced by the non-movant was an affidavit of one of its employees. This strongly suggests that courts do not, in fact, require a party to produce a great deal of evidence that a usage exists in order for a usage argument to successfully defeat a motion for summary judgment.⁶⁹

In the 35% of the summary judgment cases where the party moving for summary judgment introduced a usage argument in support of its claim, summary judgment on the usage-related issue was granted 88.9% of the time (eight cases).⁷⁰ However, it is not possible to determine from these cases the type or amount of usage evidence that courts require to grant summary judgment on a usage-related issue. In 75% of the cases where the motion was granted (six of eight cases), the usage-related issue was whether or not an additional *written* term in a variant acceptance was customary in the relevant industry.⁷¹ In all of these cases the movant

⁶⁸ In three of the five cases where a usage argument did not defeat a motion for summary judgment, the non-movant introduced only its own or its employees' testimony. In one of these cases, the court explicitly noted that it was inappropriate to rely on the testimony of a party or a party's employees to defeat a motion for summary judgment. *See Corestar Int'l Pte. Ltd. v. LPB Commc'ns, Inc.*, 513 F. Supp. 2d 107 (D.N.J. 2007). In the remaining two cases, the parties sought to introduce additional types of evidence but the court excluded the evidence. *See Crescent Oil & Shipping Servs., Ltd. v. Phibro Energy, Inc.*, 929 F.2d 49 (2d Cir. 1991) (where the non-movant sought to introduce many maritime documents bearing on the usage it sought to allege, but the evidence was excluded by the lower court and considered and rejected by the appeals court as being insufficient to establish a usage); *Golden Peanut Co. v. Hunt*, 416 S.E.2d 896 (Ga. Ct. App. 1992) (noting that while the defendant had submitted affidavits from an employee and a non-employee as to the content of an alleged usage, the evidence was ruled inadmissible as it contradicted an express term of the contract).

⁶⁹ 50% were primary court decisions and 50% were appeals from a grant of summary judgment or a denial of summary judgment (one case was an interlocutory appeal by leave of court).

⁷⁰ 37% of these cases were at the trial level and 62.5% at the appellate level.

⁷¹ *See Bayway Ref. Co. v. Oxygenated Mktg. & Trading A.G.*, 215 F.3d 219 (2d Cir. 2000) (where the movant-plaintiff introduced the testimony of two expert witnesses, and five industry contracts containing the disputed clause); *M.A. Mortenson Co. v. Timberline Software Corp.*, 970 P.2d 803 (Wash. Ct. App. 1999), *aff'd*, 998 P.2d 305 (Wash. 2000) (where the movant-defendant introduced two expert witnesses and copies of personal software license agreements from fifteen well-known software suppliers); *Gooch v. E.I. Du Pont de Nemours & Co.*, 40 F. Supp. 2d 863 (W.D. Ky. 1999) (where movant-defendant introduced the deposition of the plaintiff's employee which included eleven other herbicide contracts for products he purchased which also included the clause at issue and the court noted that similar clauses had been upheld in other agricultural chemical cases); *Stirn v. E.I. DuPont de Nemours & Co.*, 21 U.C.C. Rep. Serv. 2d (West) 979 (S.D. Ind. 1993) (where an attachment to the movant-defendant employee's affidavit contained six labels from other chemical products produced by DuPont and others containing a similar limitation of remedy clause); *Suzy Phillips Originals, Inc. v. Coville, Inc.*, 939 F. Supp. 1012 (E.D.N.Y. 1996), *aff'd*, No. 97-7042, 1997 U.S. App. LEXIS 41389 (2d Cir. Oct. 2, 1997) (where the movant-defendant introduced the Worth Street Textile Market Rules to argue that a limitation of remedy clause in an acceptance was not a material alteration as it was standard in the textile industry and had been included in numerous previous contracts between the parties); *Adcock v. Ramtreat Metal Tech., Inc.*, 44 U.C.C. Rep. Serv. 2d (West) 1026, 1032 (Wash. Ct. App. 2001) (where the contract at issue was a trade association standard-form contract with a limitation of remedy provision that the plaintiff claimed was unconscionable, the defendant introduced an

introduced evidence other than party and party employee testimony and the non-movant opposed the evidence only with legal arguments. In the remaining two cases, the court granted summary judgment based solely on the testimony of the parties or their employees. In neither of these cases did the party opposing the motion introduce any usage evidence of its own.⁷²

There were only two cases where the parties presented conflicting evidence of usage. The court denied summary judgment in both of them.⁷³

In sum, while Code commentators and academics have long expressed concern that courts might impose too high a requirement for establishing a trade usage, “for it is likely to be confused with ‘custom’ and the law has long encumbered proof of custom with stringent requirements,”⁷⁴ precisely the opposite seems to be the case both in cases that go to trial and in motions for summary judgment.⁷⁵

D. *The Code’s Hierarchy of Authority*

In the Study Group cases, courts applying the Code’s hierarchy of authority were strongly inclined to view usage-based meanings as being consistent with express terms. Table 1 below sets out the contract provisions and the usage-based meanings asserted to explain them in the six interpretation cases that went to trial and pitted a plain meaning against a usage-based meaning. In all but one case, the court accepted—or suggested that on remand the lower court should accept—the usage-based meaning over the plain meaning. In the remaining case, the court admitted the usage evidence but gave an erroneous jury instruction that it was only

affidavit of a trade association executive that the term was commonly used and was granted summary judgment in its favor).

⁷² *Graaff v. Bakker Bros. of Idaho, Inc.*, 934 P.2d 1228, 1230 (Wash. Ct. App. 1997) (granting the defendant’s motion for summary judgment and finding the usage it asserted to exist, based only on an affidavit supplied by one of its employees); *B/R Sales Co. v. Krantor Corp.*, 640 N.Y.S.2d 204 (N.Y. App. Div. 1996) (granting summary judgment for the plaintiff, finding that the defendant had not rejected the goods within a reasonable time, which the plaintiff’s employee testified was forty-eight hours under a usage of the trade).

⁷³ *See Rich Prods. Corp. v. Kemutec, Inc.*, 66 F. Supp. 2d 937 (E.D. Wis. 1999), *aff’d*, 241 F.3d 915 (7th Cir. 2001); *Carter Baron Drilling v. Badger Oil Corp.*, 581 F. Supp. 592 (D. Colo. 1984).

⁷⁴ WHITE & SUMMERS, *supra* note 38, at 144–45.

⁷⁵ *See also* William Hoffman, *On the Use and Abuse of Custom and Usage in Reinsurance Contracts*, 33 TORT & INS. L.J. 1, 4 (1997) (“A review of the growing number of reinsurance usage cases . . . suggests that counsel asserting a reinsurance usage often do not present, nor do the courts require, the evidence necessary [per the common law] to support a finding that a reinsurance usage affects the meaning of the contract. Further, the published opinions . . . in these cases often lack any reference whatsoever to the applicable legal rules for proof of reinsurance usage,” and it is very rare for information about its prevalence in a local market or evidence of actual instances in which it was observed to be proffered).

to be considered if the meaning of the contract was unclear.⁷⁶ The jury found the contract to be clear.⁷⁷

TABLE 1: CONTRACT PROVISIONS V. USAGE-BASED MEANING IN CASES THAT WENT TO TRIAL

| Contract Provision | Usage |
|---|--|
| “Shell’s Posted Price at time of delivery” ⁷⁸ | Shell’s price at the time the buyer bid a job |
| “[Cooling] capacit[y] shall not be less than indicated” ⁷⁹ | Reasonable variation in cooling capacity is acceptable |
| “All cotton produced on 400 acres” ⁸⁰ | 400 acres of cotton |
| “[S]hipment in September–October” ⁸¹ | “[D]elivery in October–November” |
| “[A] minimum of 31,000 tons of phosphate each year” ⁸² | All quantity statements are estimates |
| Two contracts to deliver a total of 100,000 cwt sacks of potatoes ⁸³ | All quantity statements are estimates |

There were nine Study Group cases in which motions for summary judgment turned on an interpretation issue.⁸⁴ In all of them the non-movant attempted to defeat the motion by alleging that a usage-based meaning should be used to interpret the agreement rather than its plain meaning. In two of these cases the court refused to consider the usage on the grounds

⁷⁶ See *supra* note 34 and accompanying text (explaining that no ambiguity need be established for trade usage evidence to be considered).

⁷⁷ *Loeb & Co. v. Martin*, 349 So. 2d 11, 12 (Ala. 1977) (where the court (erroneously) instructed the jury that if it found the contract term “All cotton produced on 400 acres” to be clear, it could not look to the usage to explain it).

⁷⁸ *Nanakuli Paving & Rock Co. v. Shell Oil Co.*, 664 F.2d 772, 778 (9th Cir. 1981).

⁷⁹ *Modine Mfg. Co. v. Ne. Indep. Sch. Dist.*, 503 S.W.2d 833, 837 (Tex. Civ. App. 1973).

⁸⁰ *Loeb & Co.*, 349 So. 2d at 12.

⁸¹ *Harlow & Jones, Inc. v. Advance Steel Co.*, 424 F. Supp. 770, 773 (E.D. Mich. 1976).

⁸² *Columbia Nitrogen Corp. v. Royster Co.*, 451 F.2d 3, 6 (4th Cir. 1971) (holding that although the contract had a quantity provision that set out minimum tonnages evidence that under a trade usage all quantity statements were estimates and that the minimums were not binding should have been admitted as it was not inconsistent with the contract’s provisions).

⁸³ *Heggblade-Marguleas-Tenneco, Inc. v. Sunshine Biscuit, Inc.*, 131 Cal. Rptr. 183 (Cal. Ct. App. 1976).

⁸⁴ There was one additional case that could arguably have been added to this group but was not. In *Steel & Wire Corp. v. Thyssen Inc.*, 20 U.C.C. Rep. Serv. (West) 892 (E.D. Mich. 1976), the contract had a notice provision, which the plaintiff said was trumped by usage. The court found that the length of time the plaintiff took to give notice was unreasonable under U.C.C. § 2-607 without any need for recourse to usage evidence, which the court said was relevant to the interpretation of contracts, but not to the interpretation of the Code’s gap-filling provisions. *Id.* at 898–99.

that it was prohibited by the parties’ contract;⁸⁵ in two other cases the court refused to consider the usage on the grounds that it had not been adequately proven;⁸⁶ and in one case the court refused to consider the usage both because it had not been proven and because, even if established, it would have conflicted with the terms of the written agreement.⁸⁷ In the remaining four cases, set out in Table 2 below, the court denied the motion for summary judgment, and did not note any inconsistency between the asserted usage and the express terms.

TABLE 2: CONTRACT PROVISIONS V. USAGE-BASED MEANINGS IN SUMMARY JUDGMENT CASES

| Contract Provision | Usage |
|---|---|
| “500 Gross Ton” ⁸⁸ | Up to 500 gross ton |
| “March delivery” ⁸⁹ | Delivery in late spring |
| “Operator shall pay contractor” ⁹⁰ | Operator shall pay contractor only when paid by the owner |
| The bull being sold is an “active breeder[,]” whose semen should be tested “shortly before the breeding season” ⁹¹ | Bull should be tested later than beginning of the season so he can mature |

In sum, the data reveal that courts in the Study Group cases were inclined to find usage-based meanings consistent with even seemingly contradictory

⁸⁵ See *Golden Peanut Co. v. Hunt*, 416 S.E.2d 896, 897 (Ga. Ct. App. 1992) (where the court refused to consider usage evidence on the meaning of the contract term “bona fide offer” on the grounds that the contract provided that “[n]o parol evidence shall be relevant to supplement or explain this agreement,” overlooking the fact that usages are not considered parol evidence under the Code, but rather are part of the very definition of the parties’ agreement); *Madison Indus., Inc. v. Eastman Kodak Co.*, 581 A.2d 85, 90 (N.J. Super. Ct. App. Div. 1990) (noting in dicta that due to a clause in the contract, usage evidence would have been inadmissible even if the Code applied to the transaction).

⁸⁶ *Corestar Int’l Pte. Ltd. v. LPB Commc’ns, Inc.*, 513 F. Supp. 2d 107 (D.N.J. 2007) (where the contract had a fixed delivery date that was not met, and the defendant claimed (through the assertions of one of his employees) that per a usage the dates were mere estimates, the court nonetheless granted the plaintiff summary judgment, saying the defendant had not provided enough evidence of the usage); *Crescent Oil & Shipping Servs., Ltd. v. Phibro Energy, Inc.*, 929 F.2d 49 (2d Cir. 1991) (affirming a court’s grant of summary judgment for the plaintiff based on the plain meaning of the term “discharge port” in a pricing term, explaining that the evidence of usage tendered was insufficient).

⁸⁷ See *Bib Audio-Video Prods. v. Herold Mktg. Assocs.*, 517 N.W.2d 68, 72–73 (Minn. Ct. App. 1994) (granting summary judgment on the contract’s plain meaning, explaining that the usage offered to defeat the motion was not proven and that evidence of it should have been inadmissible as it contradicted the contract’s plain meaning).

⁸⁸ *Michael Schiavone & Sons, Inc. v. Securalloy Co.*, 312 F. Supp. 801, 804 (D. Conn. 1970).

⁸⁹ *Dreyfus Co. v. Royster Co.*, 501 F. Supp. 1169, 1172–73 (E.D. Ark. 1980).

⁹⁰ *Carter Baron Drilling v. Badger Oil Corp.*, 581 F. Supp. 592, 593 (D. Colo. 1984).

⁹¹ *Campbell Farms v. Wald*, 578 N.W.2d 96, 97 (N.D. 1998).

express terms. However, because trial courts can exclude evidence of usages if they conclude (as a matter of law) that the usage is inconsistent with the express terms, the data cannot rule out the possibility that in cases that go to trial and do not result in published opinions, courts may be more inclined (than suggested by the data above) to find that usage-based meanings conflict with the plain meaning of express terms. Nonetheless, because the published cases are the precedents on which courts base their decisions and lawyers base their legal advice, it is likely (though not certain) that the shadow effect of these published decisions on the run of cases decided without opinion is significant.

E. Methodological Issues

Before exploring the implications of this data, it is important to highlight the study's methodological limitations—most notably that its findings may have been influenced by the types of selection effects that are present in research that relies on cases decided by reported opinions.⁹²

First, given the origin of the data, a selection effect of the classic Priest-Klein⁹³ variety may have introduced bias into some of the results relating to the types and quantum of evidence introduced. The study therefore cannot definitively rule out the possibility that more or different trade usage evidence was introduced in the cases that were decided without an opinion. However, there are several considerations that suggest that the selection effect problem does not entirely undermine the study's findings.

Across the appellate cases in the Study Group, only 13.4% involved an appeal of a usage issue standing alone. Most cases involved the appeal of multiple issues—22.4% involved two issues, 29.9% involved three issues, and 34.3% involved four or more issues. These data suggest that any selection effect related to the quantum of usage evidence introduced is likely to be quite noisy. In addition, only a small percentage of the cases, for reasons discussed further below, were cases where the court was faced with one party's evidence that the usage was A and another party's evidence that the usage was B, and had to decide between them. This is a classic situation in which the Priest-Klein selection effect with respect to the strength and quantum of evidence introduced would be the greatest.

⁹² In comparison to the entire population of cases that wind up in court, cases decided with a reported opinion tend to be disproportionately in federal court (trial or appellate), one of the rare state trial court decisions memorialized in a published opinion, or state cases that involved an appeal that resulted in a published decision.

⁹³ See George L. Priest & Benjamin Klein, *The Selection of Disputes for Litigation*, 13 J. LEGAL STUD. 1 (1984). For an overview of the Priest-Klein selection effect, see generally Joel Waldfogel, *Selection of Cases for Trial*, in 3 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 419 (Peter Newman ed., 1998).

Rather, in approximately 75% of the cases in the Study Group, one party submitted evidence of usage while the other party claimed that the usage evidence was inadmissible based on a legal argument other than that the evidence submitted was insufficient to meet the burden of proof. In these cases, there is no reason to think that a selection effect is operating to make cases with weaker evidence go to appeal. In fact, for cases in some postures, the selection effect might well lead to a bias in favor of cases with stronger evidence of usage making it into the published reports.⁹⁴

Second, the study's results about the types of issues that arise may have been affected by a factual issue-based selection effect. This effect arises because cases that go to trial and turn on factual rather than legal issues are unlikely to be appealed given the tremendous deference given to trial courts' findings of fact. This selection effect might account, at least in part, for the small number of cases involving gap filling or looking to usage to give meaning to standard-like provisions. In these types of cases, one party will typically claim the usage is A, and the other that the usage is B, so whichever way the court rules, an appeal, and with it a reported decision, is unlikely to occur since the probability of obtaining a reversal is very low.

In an effort to explore the possibility that this type of fact-issue-based selection bias is responsible for the infrequency of these types of cases, a

⁹⁴ To see why, consider the following four situations: (1) Suppose that at trial the plaintiff seeks to introduce a usage, and the defendant seeks to exclude it. Suppose further that the court *admits* the usage, it is found to exist and the plaintiff prevails, and the defendant is deciding whether to appeal. His decision will be based on his estimate of the strength of his legal argument on appeal, not on the strength of the plaintiff's usage evidence. If, on the other hand, the court said the evidence did not establish a usage (meaning the evidence was weak), the defendant would not be likely to appeal since the fact that it was admitted did not affect the outcome. The plaintiff in such a situation is also unlikely to appeal, because appellate courts do not ordinarily reverse factual determinations of this sort except in egregious cases. (2) Now suppose that the court *excludes* the plaintiff's evidence of usage and the plaintiff must decide whether to appeal. Holding constant the strength of the plaintiff's legal argument on appeal, the plaintiff will be more likely to appeal if the evidence he proffers will, if admitted, be sufficient to establish the existence of a usage. Thus, the selection effect here should produce more frequent appeals when the plaintiff's evidence is strong than when it is weak. (3) Suppose that at trial the defendant seeks to introduce usage evidence, the plaintiff claims that it should be excluded, and the court *admits* the usage. If the usage is found to exist, the plaintiff's decision on whether to appeal will be based on his evaluation of the strength of his legal argument. If the court finds that the usage does not exist, the plaintiff will not appeal and neither will the defendant, as reversals of findings of fact are rare. Since cases in which a usage is found to exist should feature admission of stronger, rather than weaker, evidence, there is no reason to think that cases with weaker evidence are being weeded out of the sample, and in fact the reverse seems to be true. (4) Finally, suppose that the defendant seeks to introduce usage and the court *excludes* it. Holding the strength of the defendant's legal argument constant, the defendant will be more likely to appeal if his usage evidence is strong, since the likelihood is greater that if he is successful on the legal appeal and the case is remanded, the outcome of the case will change. In sum, in cases that arise in this posture, the selection effect, if any, inclines towards cases with stronger evidence of usage being more likely to appear in the appellate courts than cases where usages are weak.

data set was constructed that looked at the Westlaw Trial Court Document Database for Illinois State and Federal Court Filings.⁹⁵ A search of the term “usage of trade” turned up 170 hits for the years 1999–2010, a total of 104 independent cases. After excluding the types of cases that the large study excluded,⁹⁶ and cases that merely cited statutory language referring to usage, without asserting that a usage existed or suggesting that a usage-based argument was in the offing, twenty-four cases remained. Of these cases, one (4.2%) involved gap filling in the context of a contract by conduct, one (4.2%) involved filling a gap in a written contract, and one (4.2%) involved making a general clause more specific. These findings echo the results of the case study in terms of the type of trade usage issues that wind up in courts. Whether or not gap filling or giving meaning to standard-like provisions by usage is occurring in the shadow of the law—or in the shadow of extra-legal understandings—in disputes that arise but do not result in legal filings cannot be determined.

In light of these methodological limitations, and mindful of the fact that their magnitude cannot be quantified, the next Part re-examines the core theoretical arguments used to justify the incorporation of trade usages and other commercial practices in light of the study’s findings.

III. REVISITING INCORPORATION ON ITS OWN TERMS

This Part integrates the study’s findings into the theoretical debates over the desirability of the incorporation strategy. It begins by discussing the implications of the data for interpretive error costs, the component of the incorporation strategy that the empirical study was designed to most directly explore. It then considers how this data, together with the study’s findings about the types of cases that arise, the ways that courts interpret and apply the Code’s hierarchy of authority, and the ways that information about contract terms is transmitted through large multi-agent firms, bear on the incorporationists’ claim that the strategy is likely to reduce specification costs.

A. Interpretive Error Costs

1. *Evidence on Interpretive Error Costs.*—Incorporationists recognize that the strategy may slightly increase interpretive error costs—

⁹⁵ The database is Illinois Trial Court Documents and according to Westlaw it includes “selected motions, trial court memoranda, trial pleadings and other civil trial filings from the Illinois state and federal courts.” Illinois Trial Court Documents, WESTLAW, web2.westlaw.com/scope/default.aspx?db=IL%2DFILING%2DALL&RP=/scope/default.wl&RS=WLW11.07&VR=2.0&SV=Split&FN=_top&MT=208&MST= (last visited Oct. 24, 2015).

⁹⁶ See *supra* note 45.

that is, the costs of courts mistakenly finding usages to exist when they do not, the costs of courts making errors in defining the scope and content of usages, and the cost of courts mistakenly incorporating extralegal understandings into legally enforceable contracts. They maintain, however, that any increase in these costs is likely to be insignificant because a party seeking to establish the existence and scope of a usage will have to introduce “objective evidence of a business norm”⁹⁷ such as expert witness testimony, industry trade codes, statistical evidence that a practice is regularly observed, or, at a minimum, some examples of *actual* commercial transactions in which the practice was followed.⁹⁸

The study demonstrated, however, that “objective” usage-related evidence was neither commonly introduced nor required by courts to establish the existence of a usage. Parties only introduced or sought to introduce “objective evidence” in the form of non-party testimony or a written trade code in 39.8% of the Study Group cases. Even among the cases that went to trial and *found a usage to exist*, objective evidence was only introduced 38.4% of the time. On motions for summary judgment, parties introduced objective evidence in only 16% of the cases where a usage-based argument succeeded in defeating the motion.⁹⁹ And, even more notably, there was not a single case in the Study Group in which the regularity of observance was established by data rather than by mere witness assertion. Moreover, there were only six cases in which either party introduced any evidence that the usage had been observed in *any* actual transactions other than those between the parties to the dispute. In sum, the study confirmed Llewellyn’s prediction, expressed during the New York Law Reform Commission hearings on the proposed Code, that in the absence of a merchant jury provision, disputes over the content of trade usage would turn primarily on the word of the buyer’s man and the seller’s man.¹⁰⁰

Although the Code could, in theory, be amended to require the existence of a usage to be proven through the introduction of particular types of evidence such as expert witness testimony, trade codes,¹⁰¹ or data

⁹⁷ Walt, *supra* note 7, at 277.

⁹⁸ *Id.* at 271–75.

⁹⁹ Across all motions for summary judgment, parties attempted to introduce objective evidence in 30.3% of the cases.

¹⁰⁰ See *supra* note 2.

¹⁰¹ Given that the theory behind incorporating unwritten usages is that they arise from the competitive selection of rules and practices and are presumptively efficient and reasonable given their widespread use by merchants, looking to trade codes and standard form contracts as proxies for usage is conceptually problematic. First, although trade codes are often assumed to be mere codifications of customs, a look at their preambles and the process through which they are adopted reveals that their

showing that a practice is, in fact, widely observed, as discussed further below, practical and conceptual concerns suggest that interpretive error costs would remain significant.

2. *Practical and Conceptual Problems in Proving Usages.*—Even if the Code were amended to require the submission of statistical information about “regularity of observance,” there are practical barriers to the compilation of such evidence. Many businesses are reluctant to share information about their contracting relationships. Confidentiality provisions, many of which preclude the parties from revealing even the existence of a contracting relationship, are common in large business contracts¹⁰² and firms are likely to fear that inquiring into the contracting practices of their competitors could be viewed as anti-competitive. Moreover, even if these and other practical barriers to obtaining this type of statistical information were overcome, courts would not necessarily be able to use this type of evidence to identify “such regularity of observance in a place, vocation or trade as to justify an expectation that it will be observed” in any *particular* transaction.¹⁰³ To see why, it is useful to think about several concrete examples of the ways such evidence might be interpreted.

Consider a contract for the supply of electronic components in the computer industry where there is a highly variable demand for the computer manufacturer’s end product. In such contexts, the manufacturer’s procurement department often adopts a portfolio approach to quantity

drafters had to choose among customs and often quite explicitly sought to improve upon, rather than merely codify, existing practices. See Lisa Bernstein, *The Questionable Empirical Basis of Article 2’s Incorporation Strategy: A Preliminary Study*, 66 U. CHI. L. REV. 710 (1999) [hereinafter Bernstein, *Questionable Empirical Basis*]. Second, while associations whose members are buyers one day and sellers the next and that also have well-constructed committee structures and voting rules may generate the types of trade rules and standard-form contract provisions that are likely to be efficient, see, e.g., Lisa Bernstein, *The NGFA Arbitration System at Work*, NGFA (Mar. 15, 2007), http://www.ngfa.org/wp-content/uploads/trade_rules/Arbitration-Study.pdf [http://perma.cc/FU72-S873], many associations will not. There are many trade associations that represent only buyers or only sellers, and some trade associations that run private legal systems govern transactions between members who play fixed roles in the chain of production and distribution, making rent-seeking in trade rules and standard-form contract creation a serious potential issue. See Bernstein, *Questionable Empirical Basis*. As a consequence, in order to determine which association rules and standard-form contract provisions should be incorporated as substitutes for unwritten usages that evolve over time, courts would need to engage in a detailed game theoretic analysis of the associations’ rules-creation process, an inquiry that is likely to exceed the limits of their institutional competence. See Robert D. Cooter, *Structural Adjudication and the New Law Merchant: A Model of Decentralized Law*, 14 INT’L REV. L. & ECON. 215 (1994).

¹⁰² For examples of such clauses, see Lisa Bernstein, *Private Ordering, Social Capital, and Network Governance in Procurement Contracts: A Preliminary Exploration*, 7 J. LEGAL ANALYSIS (forthcoming 2015) and examples cited therein.

¹⁰³ U.C.C. § 1-205(2) (2001).

management.¹⁰⁴ It enters into one contract for a fixed-quantity of the component based on the relatively certain part of the forecasted demand for the company's end product. It then enters into a variable quantity contract (valid over a specified range of quantities) with either the same or a different component supplier. Any additional components needed are purchased on the spot market. The price differential between a fixed and a flexible quantity-components contract can be large. At Hewlett Packard, this price differential is estimated to be 15%, yet the company still purchases significant quantities of most components through flexible quantity contracts.¹⁰⁵ If one were simply to look at contracting behavior under contracts in this industry, one might well see variations in the quantity delivered under a majority of the contracts. However, such an observation, even if accurate, would not tell us whether in a nominally fixed quantity contract there is really a usage to vary the quantity.

More generally, as this example demonstrates, in order to accurately determine whether a usage exists, it may be necessary to explore the types and distribution of contract provisions in the relevant market that are related to the subject of the usage. Otherwise, it would be impossible to determine whether there was a usage of "fixed quantities" meaning "variable quantities," or simply an underlying population of contracts where variable quantity provisions were more common. However, as explained above, this type of information is unlikely to be available given firms' reluctance to share information about their contracts, contracting partners, and contracting practices.

The conceptual problems with demonstrating usages however, go beyond the need for data that will almost never be available. To better understand why interpreting even good data on behavioral regularities might not yield an accurate picture of the existence or nonexistence of a usage even if all of the underlying contracts in the market were identical, consider the following scenario: on December 30, 2010, two parties enter into a contract for the delivery of 100 bales of hay on the first of each month over the calendar year 2011 for a price of \$50 per bale. On April 20, 2011, the price of hay suddenly increases and on May 1 the seller delivers only 85 bales, claiming either that there is a usage in the hay business that quantity statements in contracts are only estimates or that delivering any

¹⁰⁴ See, e.g., Venu Nagali et al., *Procurement Risk Management (PRM) at Hewlett-Packard Company*, 38 INTERFACES 51 (2008).

¹⁰⁵ Global Logistics & Supply Chain Strategies, *HP Invents New Framework for Managing Supply Chain Risk*, SUPPLY CHAIN BRAIN, <http://www.supplychainbrain.com/content/research-analysis/supply-chain-innovation-awards/single-article-page/article/hp-invents-new-framework-for-managing-supply-chain-risk-1/> [http://perma.cc/24E2-S2V4]. See also, Nagali et al., *supra* note 104, at 58.

amount plus or minus 20 bales is considered acceptable under a trade usage.¹⁰⁶ Suppose that the case goes to trial and the seller introduces a study which looked at 100 contracts that called for the delivery of 100 bales of hay on the first of the month and found that: under one third of the contracts 80 bales were tendered and accepted; under another third, 100 bales were tendered and accepted; and under the final third, 120 bales were tendered and accepted. If the court looked at this data through the lens of the Code and Official Comments, it would likely conclude that the data established a usage that when a contract says 100 bales, 100 bales plus or minus 20 bales is considered proper or customary tender.

Given the structure and operation of the hay trade, however, a more accurate interpretation of this behavior is that the contractual relations observed were among transactors who trusted one another and dealt with one another on a repeat basis, so that within any individual relationship where 80 bales were accepted one month, a look at the next month's tender would show 120 bales were tendered. Among parties who trust one another and have sufficient inventory, it might be much cheaper to take the level of precaution that results in an average of 100 bales per month being delivered, rather than the level of precaution associated with delivering exactly 100 bales each time. Yet if relations between these parties broke down and they did not anticipate dealing with one another in the future, and one party delivered 85 at a time when the price had risen substantially above the contract price, to excuse delivery of the additional 15 bales on the basis of a usage would be far from implementing the parties' intent.¹⁰⁷

As this example illustrates, courts face interpretive difficulties in these situations because transactors' willingness to make the types of adjustments that look on their surface like behavioral regularities often depends on the existence or non-existence of conditions whose existence or relevance in a particular case may be observable to the parties but not verifiable by a court. These include the degree of trust between the transactors, the expected benefit of future dealings, and the likelihood that the difference will be made up in a future deal even if the market price makes it non-advantageous to do so. Transactors' willingness to make these adjustments may also reflect implicit understandings such as that quantity variations are only acceptable when prices are stable, or that late delivery is only

¹⁰⁶ *Columbia Nitrogen Corp. v. Royster Co.*, 451 F.2d 3 (4th Cir. 1971) (quantity statements are mere estimates); *Heggblade-Marguleas-Tenneco, Inc. v. Sunshine Biscuit, Inc.*, 131 Cal. Rptr. 183, 189 (Cal. Ct. App. 1976) (same).

¹⁰⁷ See Alan Schwartz, *Karl Llewellyn and the Origins of Contract Theory*, in *THE JURISPRUDENTIAL FOUNDATIONS OF CORPORATE AND COMMERCIAL LAW 12* (Jody S. Kraus & Steven D. Walt eds., 2000) (noting that Llewellyn's academic writing explicitly recognized this possibility).

acceptable when there are adverse weather conditions. As a consequence, when courts incorporate behavioral regularities into contracts as trade usages, some of the regularities they incorporate are likely to be the types of norms that transactors are willing to follow when they want to preserve their relationship—“relationship preserving” or “informal norms”—but that they would have been unwilling to promise to follow in their written agreement for any of a number of reasons.¹⁰⁸ When courts incorporate informal norms into commercial agreements, they may well be acting directly contrary to the parties’ intent and may therefore be creating large interpretive error costs.

Incorporationists view the incorporation of informal norms as “simply . . . another potential source of interpretive error [costs].”¹⁰⁹ However, when courts routinely incorporate informal norms the consequences for efficient contracting are more significant than when courts simply make occasional errors in filling gaps or determining the meaning of written contractual provisions. In contexts where both formal and informal norms are common and nonlegal sanctions (including termination of dealing) are sufficiently strong, transactors will often find it beneficial to structure their contracting relationship using a mix of (1) legally enforceable promises that condition on verifiable information, and (2) informal agreements—both express and tacit—that turn on information that may only be observable. The incorporation strategy, however, transforms most of the commitments reflected in both formal and informal norms into legally enforceable contract obligations. This makes it very difficult—if not impossible—for transactors to fully realize the significant efficiency gains that this two-tiered contractual structure may offer. Transactors must either bear the interpretive error costs that come with the mis-incorporation of informal norms, or structure their relationships using a set of second-best terms that they are willing to follow in their work-a-day interactions and have courts enforce in the event of a dispute.

Incorporationists maintain that the incorporation of informal norms is unlikely to cause significant problems given their “speculation” that “observable patterns of commercial behavior more often than not reflect formal rather than informal norms,”¹¹⁰ and their contention that the Code does not require courts to take informal norms into account. However, they do not offer any empirical evidence that most commercial norms are

¹⁰⁸ For a comprehensive discussion of the ways that relationship-preserving norms and end-game norms impact commercial behavior and the consequences of confusing them in adjudication, see Bernstein, *supra* note 1.

¹⁰⁹ Kraus & Walt, *supra* note 6, at 209.

¹¹⁰ *Id.* at 210.

formal,¹¹¹ and there is nothing in the Code or its Official Comments to suggest that courts have the authority to distinguish between formal and informal norms. The Code defines the existence of a trade usage by the regularity of its observance and the reasonableness of the expectation that it will be *observed* in a particular contracting relationship. Applying these criteria, informal norms are often indistinguishable from formal norms¹¹² because transactors, particularly those in repeat-dealing relationships, fully expect one another to abide by many informal norms, at least when the implicit pre-conditions for their relevance are met.

Moreover, even if the Code were interpreted, or explicitly amended, to give courts the authority to incorporate *only* formal norms, such a rule would be difficult to implement. Incorporationists suggest that “[t]he paradigm evidence of an informal norm [can be] provided by tradewide testimony that a practice is not intended to be given legal effect,”¹¹³ and that any transactor in the relevant market could be called to testify about their own subjective beliefs about whether a usage was meant to be legally enforceable. However, absent the type of social scientific survey that would be prohibitively expensive to conduct and that transactors would be hesitant to participate in, it is unclear how the general subjective understanding of transactors across a relevant market could be reliably established.

In sum, the conceptual difficulties in proving usages suggest that the interpretive error costs occasioned by the strategy cannot, as incorporationists have maintained, be reduced to an acceptable level

¹¹¹ In defending this position, incorporationists explain that because “informal norms most commonly will develop in the context of relational, rather than discrete, contracts . . . and [m]any, perhaps a majority, of the transactions governed by Article 2 are discrete,” informal norms will not be common in contracting relationships governed by the Code. *Id.* However, the data show that a significant proportion of the interpretation cases arising under the Code involve transactors who have dealt with one another before, often over an extended period of time. Across the cases that went to trial on an interpretation issue, at least 43.7% involved transactors who had previously dealt with one another. More importantly, however, incorporationists overlook the fact that the existence or non-existence of the type of informal norms that will appear to be behavioral regularities across a market or industry is not determined only by the characteristics of the parties to a particular dispute, but also by structural and interpersonal features of the relevant market. These sorts of norms are likely to arise when many transactions in the market are repeat and the same types of adjustments and/or contractual flexibility will benefit a large number of transactors. In such contexts, if a case goes to court, the regularity of behavior in the market (the supposed predicate for finding a usage) is independent of whether the case at bar is a dispute between transactors with a longstanding relationship, or transactors who have never dealt with one another before. As a consequence, the number of discrete or repeat relationships that wind up in court is a poor proxy for the risk that informal norms will be mistakenly incorporated.

¹¹² In markets where such norms are common, they are often backed by an array of non-legal sanctions that make them, in effect, self-enforcing over a range of typical market conditions. It is therefore quite likely that they will, in fact, be observed by a majority of transactors most of the time.

¹¹³ Kraus & Walt, *supra* note 6, at 208.

through procedural and evidentiary changes in how usages must be demonstrated.¹¹⁴ Even if the Code were amended to require the introduction of the types of objective usage evidence incorporationists envision, usage-related evidence would remain difficult for parties to obtain and difficult for courts to interpret. Moreover, as discussed further below, such changes would also fail to eliminate the negative effect that usage-based arguments and evidence have on the outcomes of motions for summary judgment.

3. *Interpretive Error Costs and Motions for Summary Judgment.*—

The conceptual debate over the magnitude of the interpretive error costs introduced by incorporation has largely ignored the strategy's effect on motions for summary judgment. However, the usage study revealed that a party opposing a motion for summary judgment can assert the existence of a usage plausibly enough to defeat the motion based on nothing more than a cursory affidavit supplied by one of its own employees. Indeed, in 83.3% of the cases where the party who raised the usage issue succeeded in defeating a motion for summary judgment, an affidavit from its employees was the only usage-related evidence introduced. This suggests that summary judgment determinations may be subject to significant interpretive error costs and may enable transactors to more easily engage in potentially costly strategic behavior by falsely asserting the existence of a usage to defeat summary judgment and thereby obtain a more favorable settlement. More generally, because 32.4% of the cases in the Study Group involved motions for summary judgment, any evaluation of the incorporation strategy's merits must take into account its effect on motions for summary judgment.

4. *Conclusion.*—In sum, the central finding of the empirical study—that trade usages are not typically proven through the introduction of either “objective” evidence or statistical norms—might even give pause to incorporation's strongest defenders. As they have explained, “[A]n analysis counts as an interpretation of custom only if it adequately fits relevant commercial behavior and attitudes [demonstrated through actual instances of commercial behavior]. Otherwise, the analysis is not an interpretation of anything. It instead serves as a recommended decision rule.”¹¹⁵ Indeed, a broader look at the cases in the study suggests that usage evidence, along with the economic and business rationales proffered to explain it, may, in practice, be serving as just such a “recommended decision rule.”

¹¹⁴ *Id.* at 221–24 (suggesting that critiques of the UCC's incorporation strategy could easily be dealt with through changes in the procedural and evidentiary rules relating to trade usage evidence and are not endemic to incorporationist adjudicative approaches more generally).

¹¹⁵ *Id.* at 205.

Understood in this light, the incorporation strategy might be defended as providing courts with contextual information that helps them decide cases in a commercially sensible way. However, to conclude that the types of usage evidence introduced in typical Article 2 cases frequently establish a “usage of trade,” as that term is defined in the Code, is in practice a legal fiction.

B. Specification Costs

Given the study’s findings about the interpretive error and uncertainty costs created by the incorporation strategy, it is useful to revisit the core theoretical defense of the strategy—namely, that its “chief virtue” lies in its “promise” to reduce specification costs in its shadow.¹¹⁶

1. *The Theory and Limited Empirical Evidence on Specification Costs.*—The claim that the incorporation strategy reduces specification costs starts from the empirically unsubstantiated assumption that a majority of merchant transactors want contracts to be given their usage-based meaning.¹¹⁷ Incorporationists speculate that when transactors know that courts will look to usages to fill gaps and interpret their agreements, they will ignore remote contingencies, leave more contractual gaps, and will choose to forgo drafting complex (and expensive) written provisions, in favor of either standard-like provisions that are inexpensive to draft, or provisions that include terse industry-specific short-hand phrases that implicitly reference complex “terms that have domain-specific meanings”¹¹⁸ or reflect inchoate understandings that “carry with them an array of implications that might be difficult even to bring to mind, let alone commit to paper.”¹¹⁹ Together, these drafting choices are said to significantly reduce specification costs.

Although the study of usage in the courts was not designed to directly test the strategy’s effect on specification costs,¹²⁰ its findings are strikingly inconsistent with what one would expect to find if transactors were taking

¹¹⁶ *Id.* at 193.

¹¹⁷ This assumption is not only empirically unsubstantiated, but also goes against the weight of what limited empirical evidence is available. *See infra* notes 159, 168, and accompanying text.

¹¹⁸ Kraus & Walt, *supra* note 6, at 199.

¹¹⁹ *Id.* If courts do incorporate usages of this description, these usages will become defacto mandatory rules, since transactors who want to exclude them will not be able to carefully state and negate them in a contract. *See also* QUINN, *supra* note 28, Form 4, at 1-28 (noting that a contract provision that seeks to specifically negate a usage should include a statement describing the usage to be negated).

¹²⁰ The incorporationists themselves explicitly acknowledge that there is no “[d]irect survey or experimental evidence” about the size of these specification cost savings and that any estimates must necessarily be “indirect, based on inferences from other data.” Walt, *supra* note 7, at 278.

advantage of the specification cost savings the strategy might create.¹²¹ If the strategy influenced drafting choices in the ways incorporationists suggest, a significant number of trade usage cases would deal with gap filling, allocating risks arising from remote contingencies, giving meaning to standard-like provisions, incorporating inarticulable usages, and discerning the complex meanings attached to short-hand industry terms of art.¹²² However, this is not, for the most part, what the study found.

Across the Study Group only 9.9% of the cases involved gap filling and none dealt with remote contingencies.¹²³ These findings are confirmed—albeit weakly, due to the small number of cases—by the pilot study of the usage-related issues raised in Illinois case filings. In addition, the detail group did not include a single case in which usage evidence was introduced to give meaning to a standard-like term. Most of these cases involved usages that were introduced to “interpret” a clear, detailed, or highly specific clause embedded in a detailed agreement. While it is impossible to rule out the possibility that transactors were trying to establish the existence of complex usages that could only be articulated ex post, none of the usages alleged in any of the cases would have been complex or difficult to articulate at the time of contracting.

The only incorporationist prediction that was borne out in the Study was that usages were commonly introduced to give meaning to industry-specific terms of art. This was done in 32% of the interpretation cases that went to trial and one interpretation case that involved a motion for

¹²¹ There is no way to directly test whether the availability of the incorporation strategy decreases specification costs. To do this, one would need a representative sample of contracts from a cross-section of industries, a jurisdiction with similar demographics that adopted a formalist interpretive approach (which is impossible given that the UCC has been adopted in every state but Louisiana), and controls that would take into account the wide variety of other considerations that might affect firms' drafting decisions. Furthermore, even if this data were available, it would be difficult to definitively interpret. If the data revealed that there were lots of vague and standard-like provisions relating to core terms, it would make plausible the incorporationists' claims that transactors include such provisions intending that they be given their customary meaning. However, the presence of such provisions might be equally compatible with the explanation that transactors think that they will have more information by the time the clause becomes relevant and that this information will help them negotiate (or renegotiate) a better provision than they could have agreed on at the time of contracting. Similarly, if the study revealed very detailed contracting about core matters, this would not necessarily indicate that transactors wanted to reject the incorporation strategy, as there are many reasons for memorializing obligations in writing apart from clarity for the sake of judicial enforcement. *See* Bernstein, *supra* note 102 (discussing the many different roles that detailed written contract provisions and specification play in complex commercial deals).

¹²² The argument in the text assumes that the study cases are representative of the underlying population. *See supra* text accompanying notes 92–96 (discussing the limitations of the data and the small-scale examination of Illinois filings which suggests, though does not prove, that the selection effect does not undermine the validity of the findings in this respect).

¹²³ The study defined a “remote contingency” as a low probability event that did not relate to the core terms of the deal.

summary judgment.¹²⁴ Although the use of these terms of art may have slightly reduced specification costs, a comparison of the terms of art invoked and the usages proffered to give them meaning (set out in Table 3 below) suggests that the magnitude of the specification cost reduction realized through the invocation of these terms of art may be less significant than incorporationists suggest. First, at least a third of these contracts were standard form contracts, so any costs of specifying the meaning of the terms would likely have been prorated over many contracts. Second, most of the definitions at issue were simple to state concisely and all related to the core terms of any agreement, with 67% relating to definitions of quality.

TABLE 3: CONTRACT PROVISION V. USAGE-BASED MEANING IN CASES THAT WENT TO TRIAL (STUDY GROUP)

| Contract Provision | Usage-Based Meaning |
|--|--|
| “[H]igh-quality SEW pig[.]” ¹²⁵ | Pig must cut out at 51% lean |
| “[F]irst quality” ¹²⁶ | No flaws versus 3%–5% flawed |
| “[S]law cabbage” ¹²⁷ | Big cabbage versus any cabbage that can be made into cole slaw |
| “Scotch Mint Roots . . . of a good solid stand” ¹²⁸ | Maximum 10% contamination |
| “[B]arren” ¹²⁹ | Barren does not mean a horse that conceived and aborted |
| “85% chemical[ly] lean” ¹³⁰ | Excludes BCVL quality designation |
| “Agricultural Grade CAN” ¹³¹ | CAN that is granular |
| “[A]cres” ¹³² | Acres with every row planted |

However, in thinking about the implications of Table 3 for the magnitude of specification costs more generally, it is important to

¹²⁴ See *Crescent Oil & Shipping Servs., Ltd. v. Phibro Energy, Inc.*, 929 F.2d 49 (2d Cir. 1991) (whether the meaning of the term “NOR discharge port” meant “an NOR issued at the first lightering port,” or “the NOR issued at the designated and agreed discharge port”).

¹²⁵ *Trumm v. Feeder’s Supply, Inc.*, 49 U.C.C. Rep. Serv. 2d (West) 44, 46 (Iowa Ct. App. 2002).

¹²⁶ *Foxco Indus., Ltd. v. Fabric World, Inc.*, 595 F.2d 976, 979 (5th Cir. 1979).

¹²⁷ *Williams v. Curtin*, 807 F.2d 1046, 1049 (D.C. Cir. 1986).

¹²⁸ *Fred J. Moore, Inc. v. Schinmann*, 700 P.2d 754, 756 (Wash. Ct. App. 1985).

¹²⁹ *Keck v. Wacker*, 413 F. Supp. 1377, 1381 (E.D. Ky. 1976).

¹³⁰ *A.J. Cunningham Packing Corp. v. Florence Beef Co.*, 785 F.2d 348, 349 (1st Cir. 1986).

¹³¹ *Ind. Farm Bureau Coop. Ass’n, v. S.S. Sovereign Faylenne*, 24 U.C.C. Rep. Serv. (West) 74, 78 (S.D.N.Y. 1977).

¹³² *Morgan v. Stokely-Van Camp, Inc.*, 663 P.2d 1384, 1386 (Wash. Ct. App. 1983).

recognize that firm conclusions about ex ante specification cost savings cannot be made solely on the basis of ex post data. It is possible that in the absence of the strategy, transactors would have chosen to spell out the meaning of the clause at issue under a variety of conditions other than the one that arose in the particular case, and would also have elected to include detailed definitions of numerous other terms as well, thereby increasing specification costs.

The small number of cases involving gap filling and the absence of cases involving the interpretation of standard-like provisions might also be viewed as an indication that the incorporation strategy is functioning extraordinarily well. It might be enabling transactors to avoid litigation by encouraging them to look to usages to cooperatively fill gaps and/or give meaning to any under-specified provisions in their agreements.¹³³ This explanation, however, is hard to reconcile with the large number of cases where parties argue about the existence, content, and admissibility of usages that are alleged to be relevant to interpreting industry quality specifications like “healthy, high-quality SEW pigs”¹³⁴ or industry shorthand terms relating to core terms of the contract. That is, to believe that the shadow effect of the strategy were working so perfectly, it would be necessary to explain why the usage-based meaning of written trade terms is less clear to the parties than the usage-based meaning of similar types of terms that are not written down.

2. *Specification Costs and the Code’s Hierarchy of Authority.*—The debate over incorporation has long focused on the specification cost *savings* the strategy might create; yet it has overlooked the possibility that in light of the ways courts have implemented the Code’s hierarchy of authority and the relatively thin evidence required to establish a usage, the strategy might actually increase specification costs.

When transactors want to control the meaning of their contract through express terms and are drafting in the shadow of the incorporation strategy as it operates in practice, they will need to include additional detail and/or additional provisions to fortify their contract’s terms against usage-based interpretation. As a leading form-book explains, to ensure usages

¹³³ In addition, the situations in which usages are most likely to exist—when transactors deal with one another on a repeat basis or within a well-defined market where most participants are buyers one day and sellers the next—are also the situations in which transactors who want to continue to do business with one another in the future are likely to work out any rough edges in their relationship in a cooperative manner. As a consequence, they might well fill gaps and give meaning to standard-like provisions without recourse to court (or, for that matter, usages) regardless of the interpretive approach that a court would apply.

¹³⁴ *Trumm v. Feeder’s Supply, Inc.*, 49 U.C.C. Rep. Serv. 2d (West) 44, 46 (Iowa Ct. App. 2002).

cannot be used to interpret a contract, the contract should include a provision specifically setting out, negating, and replacing each usage-based interpretation that the transactors wish to exclude.¹³⁵

A simple example based on elements of decided cases can be used to get a feel for the specification costs that might be required to fortify even a simple transaction against incorporationist interpretation. Consider a contract for the sale of 200 tons of fertilizer with a 22% nitrogen content to be delivered FOB to seller's place of business on March 1 for a price of \$X. Suppose that the price of fertilizer rose after the contract was signed, and the seller delivered 180 tons of fertilizer with a 16% nitrogen content on March 7. If the buyer sued for breach of contract and these facts were undisputed, he might nevertheless be unable to prevail on either a motion for summary judgment or at trial. The seller could claim there was a usage that quantities were mere estimates,¹³⁶ or that any quantity within 20 tons of the promised amount was considered good tender per a trade usage. The seller might also claim that although the contract called for 22% nitrogen content, there was a usage that any nitrogen percentage within 8% of the promised amount was considered good tender.¹³⁷ The seller could also assert that the delivery dates were mere estimates or any of a number of other usages under which its late delivery would be considered acceptable. The seller might also claim either that the buyer was in breach as he failed to add sales tax to his payment,¹³⁸ or that the time for cure should be extended because the usages outlined above made it reasonable for him to conclude that the nonconforming fertilizer would be accepted with a price adjustment. Conversely, the buyer too could potentially make a number of usage-based claims. If the price of fertilizer fell, the buyer might reject a portion of the delivery, claiming that the 200-ton number was merely an estimate or an upper bound.¹³⁹ She might also claim that the stated price was merely an estimate. As a consequence, to ensure that this simple agreement would be given its plain meaning, it would have to include provisions reciting and negating all of the above-mentioned usages as well

¹³⁵ See QUINN, *supra* note 28, Form 4, at 1-28 (providing template clause for opting out of a trade usage).

¹³⁶ See *Columbia Nitrogen Corp. v. Royster Co.*, 451 F.2d 3 (4th Cir. 1971); *Heggblade-Marguleas-Tenneco, Inc. v. Sunshine Biscuit, Inc.*, 131 Cal. Rptr. 183 (Cal. Ct. App. 1976) (where a contract was for delivery of a fixed number of bushels of potatoes, the court interpreted it as being a contract for an estimated number of potatoes due to a usage of the potato processing industry).

¹³⁷ *Modine Mfg. Co. v. Ne. Indep. Sch. Dist.*, 503 S.W.2d 833, 837 (Tex. Civ. App. 1973) (where the contract provided that the cooling capacity of an air conditioner "shall not be less than indicated," the court said a usage that 6% variation in cooling capacity was admissible as it did not contradict the contract).

¹³⁸ See *Cont'l Eagle Corp. v. Tanner & Co. Ginning*, 663 So. 2d 204 (La. Ct. App. 1995).

¹³⁹ See *Michael Schiavone & Sons, Inc. v. Securalloy Co.*, 312 F. Supp. 801 (D. Conn. 1970).

as all of the usages that either of the transactors might be able to plausibly assert in the event of a dispute.

In sum, while incorporationists claim that parties do not have to take steps to protect their writings,¹⁴⁰ given how courts define “conflict” and the relatively thin evidence that is required to establish a usage, transactors who want their contracts to be enforced as written may have to incur significant specification costs to fortify their contract provisions. The need to incur these costs is likely to have particularly undesirable effects on contractual innovation. Transactors who want to change common contractual provisions, usage-based understandings, or commonly used contractual structures will have to incur greater costs to do so than they would in a regime that enforced contracts as written. The effects on incremental contractual innovation may be especially large. When courts are faced with a new clause that slightly changes an old term and a demonstrated usage reflecting the old term, they are likely to interpret the new term giving weight to the usage, creating a regression to the usage effect that may well retard the gradual evolution of value-creating contract provisions.¹⁴¹

3. *Specification Costs in the Modern Economy.*—Even if the incorporation strategy influenced transactors’ drafting decisions in the way that incorporationists theorize, its effect on the content of commercial contracts might be much weaker than they anticipate. This is particularly true in contexts where transactors are not part of close-knit, geographically concentrated commercial communities or are large entities engaged in multiple business contracts.

In contexts where transactors do not know one another well and are not part of a geographically localized or well-organized market, they are unlikely to know whether a potential contracting partner shares their understanding of trade usages. In the absence of such information,

¹⁴⁰ See Hillman, *supra* note 44, at 1157.

¹⁴¹ In defending the merits of the Code, Karl Llewellyn suggested that over time, as courts found usages to exist and identified their content, tailored sets of industry-specific default rules would emerge and would provide transactors with a set of stock terms on which they could rely, thereby reducing the costs of contracting. Robert E. Scott, *The Rise and Fall of Article 2*, 62 LA. L. REV. 1009 (2002). Had this occurred, it might have provided an additional reason to favor incorporation; yet it might also have led to the encrustation of usages, which would itself lead to inefficiency. Charles J. Goetz & Robert E. Scott, *The Limits of Expanded Choice: An Analysis of the Interactions Between Express and Implied Contract Terms*, 73 CALIF. L. REV. 261, 288–89 (1985). Yet no such industry-specific sets of terms have emerged from courts’ trade usage rulings; it is quite uncommon for courts to refer to the content of a usage established in another case. This might be because usages are not consistent from place-to-place and change too much over time. Or it could be merely that state and federal courts do not issue enough published opinions after trials. Whatever the reason, the fact remains that industry-specific sets of stock rules have not emerged, forcing most parties to litigate the meaning of particular usages anew in each case.

transactors will have to either bear the cost of investigating their putative contracting partner's understanding of the scope and meaning of the usages in the relevant market or will need to memorialize more aspects of their deal in writing. In any given transaction it is difficult to predict whether the cost of investigation or the cost of drafting a more detailed contract will be higher. But the cost of investigation will have to be borne every time a new contracting partner is chosen—and, unlike drafting, will not make disputes more amenable to resolution on a motion for summary judgment—whereas the cost of drafting provisions reflecting the relevant usages must be borne only once. Thereafter, the provisions can be used in subsequent transactions at little or no cost. Transactors, particularly those who enter into many contracts for the purchase or sale of a particular good or set of goods, may therefore find it advantageous to incur the one-time cost of memorializing usages in contract provisions—which they will implicitly prorate over all the future contracts in which they anticipate their use—rather than incurring the significant costs of investigating the usage-related knowledge of all of their future contracting partners.

The benefits of memorializing any usage-based understandings they want to include in their agreements, while including clauses that attempt to negate any usages that are not explicitly mentioned, may be particularly large for transactors who sell their goods on click-to-buy websites.¹⁴² In these situations, sellers typically do not know the identity, location, or business of their putative buyers, making it especially important to specify all parameters of the deal in advance. Indeed, language attempting to exclude usages is very common in the boilerplate of click-to-buy websites, both those that market directly to consumers and those that market primarily to other businesses.¹⁴³

Similar considerations may affect the drafting choices of large manufacturing concerns that outsource the production of many components of the goods they produce. These companies typically use one standard master agreement or a standard set of terms and conditions that is posted on their supplier portal for the vast majority of their supply contracts.¹⁴⁴ The suppliers they deal with are located around the world and the types of transactions they enter into involve numerous discrete markets. In these transactions, the cost to buyers of learning the usages in all of their

¹⁴² Although no data is available on how often click-to-buy websites include provisions in their standard terms of use that opt out of usage, such provisions are far from uncommon.

¹⁴³ See, e.g., *General Terms and Conditions*, MINIATURE GARDEN SHOPPE, <http://www.miniaturegardenshoppe.com/termsandconditions.html> [<http://perma.cc/K2E8-N4T8>] (“This agreement may not be explained or supplemented by any prior course of dealings or trade by custom or usage.”).

¹⁴⁴ See Bernstein, *supra* note 102.

suppliers' markets would be prohibitively high. Even if these usages were widely known, the cost to buyer-firms of adjusting their operations to the usages of multiple individual markets would eliminate many of the cost savings associated with the adoption of standardized internal operating procedures. This may be why the master agreements adopted by these firms typically contain broad "entire agreement" clauses¹⁴⁵—clauses that contract managers view as "productive in supporting successful relationships"¹⁴⁶—as well as many additional provisions that attempt to limit or opt out of the Code's contextualist and incorporationist jurisprudence.¹⁴⁷ The steps that large multi-agent firms take to originate and operationalize their contracts suggest there are several additional reasons firms are unlikely to take advantage of the potential specification cost savings the incorporation strategy might afford them.

In large multi-divisional firms the department in the buyer firm that needs the goods typically provides the purchasing department with a detailed set of written specifications that describe the item to be purchased, the range of acceptable quality parameters, required delivery dates, and the quantity or range of quantities needed. This information is then used by the procurement department to both determine which suppliers are eligible to bid for the contract and to draft the bid solicitation documents. When the deal is finalized these specifications are simply included in or annexed to

¹⁴⁵ See, e.g., *Terms and Conditions of Sale*, ALPHA & OMEGA SEMICONDUCTOR cl. 12(e), http://www.aosmd.com/terms_and_conditions_of_sale [<http://perma.cc/8SSV-2W8D>] ("No course of dealing in prior transactions between the parties and no usage of trade shall be relevant to supplement or explain any term or provision of these Terms and Conditions of Sale."); *Terms and Conditions of Sale*, PHILIPS LIGHTING USA, <http://www.usa.lighting.philips.com/connect/termsandconditions/professional.wpd> [<http://perma.cc/YF45-YCQB>] ("Course of performance or usage of trade shall not be applied to modify these Terms and Conditions."); *Standard Terms and Conditions of Sale*, INFRA-METALS cl. 1, <http://www.infra-metals.com/standard-terms-conditions-sale/> [<http://perma.cc/4UWQ-9V3U>] ("No course or pattern of dealings or conduct between Seller and Customer and no usage of trade shall be relevant to determine the meaning or intent of these Terms and Conditions.").

¹⁴⁶ See TIM CUMMINS, IACCM, 2012 TOP TERMS IN NEGOTIATION (2012) 9–11, http://negotiatormagazine.com/docs/cummins_201302184.pdf [<http://perma.cc/8T27-S39H>].

¹⁴⁷ For examples of these provisions, see Lisa Bernstein, *Merchant Law in a Modern Economy*, in PHILOSOPHICAL FOUNDATIONS OF CONTRACT LAW 238 (Gregory Klass, George Letsas & Prince Saprai eds., 2014) (noting that these provisions (some of whose enforceability under the Code is far from clear) include "clauses making clear that no courses of dealing, courses of performance, actions, inactions or trade usages, are to be construed as waivers or modifications of the agreement's written terms; provisions negating the applicability of usages and industry standards to interpretation of the contract; provisions making clear that any terms in purchase orders or commitments made (either orally or in writing) during the life of the parties' contracting relationship are unenforceable unless memorialized in a signed amendment to the Master Agreement; and . . . a variety of merger, integration, and entire agreement clauses that are not mere boilerplate but rather vary considerably in their specificity and seek to exclude from consideration not only pre-contractual considerations, but some post-contract ones as well," as well as a wide variety of clauses that seek to ensure exact conformity with the contracts quality, quantity, and delivery specifications, regardless of industry practices (footnotes omitted)).

the contract with no additional specification costs, making it unlikely a firm would opt to omit them.

Moreover, taking into consideration the post-formation writings and information sharing activities undertaken by these firms to operationalize their contracts—on both the buyer and seller side—suggests that relying on usages is unlikely to produce a meaningful reduction in deal-rated specification costs. When these firms enter into contracts, the team that negotiates them must hand them off to the team that will implement them. This process usually involves a half-day of meetings as well as the preparation of a detailed contract summary form that captures all relevant operational and financial aspects of the deal.¹⁴⁸ To the extent that usages or other aspects of the negotiating or contracting context inform the meaning of, or add provisions to, these agreements, they will have to be memorialized in writing in these hand-off documents. As a consequence, firms anticipating these costs are likely to choose to memorialize them in their contracts, since the marginal cost of doing so is small, and doing so will enable them to both reduce uncertainty and increase the likelihood that any disputes reaching a court can be resolved on summary judgment. Together, the ex ante sunk costs of the writings produced as part of the procurement process and the ex post writings needed to operationalize complex contracts make it unlikely that these types of large commercial transactors will choose to omit these terms. They are therefore unlikely to realize any meaningful specification costs savings from the availability of the incorporation strategy.

Moreover, large firms sometimes go to great lengths to educate their suppliers about the meanings of their written contracts and the many ancillary documents that are incorporated into them. These activities

¹⁴⁸ See, e.g., IACCM, Contract Briefing Template (July 2011) (on file with the *Northwestern University Law Review*) (discussing the handoff process and noting that the summary should include: “Goals of the Customer (summarise the outcomes sought from this deal) . . . Goals of supplier (summarise the outcomes sought from this deal) . . . Scope — (what is in, anything specific that is out (but could be a source of confusion)) . . . Beneficiaries (ie who is eligible to participate) . . . Performance measures / KPIs (including any specific obligations re: on-going price reductions, performance improvements) . . . Consequences of non-performance (in particular areas such as LDs) . . . Change procedures (and major sources of anticipated change) . . . Review, reporting, communication procedures (internal and external) . . . Responsibilities of Customer [including contract page number, name of lead person, and date for performance] . . . Responsibilities of the Supplier . . . Active Terms [including page number, lead person, and date for performance] . . . Milestones [same] . . . Time-bound activities and responsibilities [same] . . . Risks (noted during bid and negotiation phase [including ‘mitigation/management/allocation assumed when contract signed’] . . . Opportunities noted during bid and negotiation phase [and designations for follow through] . . . Useful information discovered concerning customer/supplier organisation and personalities, relevant to managing the contract . . . Governance Requirements [including manager names and committee names] . . . Other relevant information we already obtained that will help with interpretation of the contract (e.g. Legal Advice taken on key points) . . . [and] Subcontract details”).

suggest that firms are not confident in their contracting partners' ability to understand even the written and explicit aspects of the deal. Caterpillar, for example, runs a Supplier Development College, which has courses on many subjects including one on "Understanding Purchasing Orders Terms and Conditions."¹⁴⁹ Similarly, John Deere has webinars to explain the core aspects of its Supplier Quality Manual, an eighty-eight-page document that is incorporated into all of its supplier contracts.¹⁵⁰

Finally, it is important to note that the incorporation strategy is also said to be disadvantageous for another type of contract that is increasingly important to the American economy: contracts for innovation, which govern highly collaborative, often tentative relationships that involve "iterative collaboration between firms."¹⁵¹ In such contexts, the incorporation of usages is said to be quite undesirable, as "trade usage, which use[s] wider industry norms to interpret the meaning of a contract, will likely lead the court astray since collaborators are often actively trying to forsake industry conventions as they innovate."¹⁵²

4. *Conclusion.*—In sum, although the study did not yield any definitive conclusions about the strategy's effect on specification costs, its findings about the likely magnitude of interpretive error costs strongly suggest that specification costs are likely to increase as well. Although incorporationists maintain that the desirability of the strategy turns on a comparison of these two categories of costs, and have concluded that "incorporation reduces specification costs significantly more than it increases error and administrative costs,"¹⁵³ they have failed to realize that interpretive error costs and specification costs are actually interrelated in a *dynamic* way. As interpretive error costs increase, transactors who want to control the meaning of their contracts will need to enter into even more

¹⁴⁹ CATERPILLAR SUPPLIER DEV. C., <https://supplierconnect.cat.com/wps/portal/catconnect/SDC> [<https://perma.cc/7P22-LTR8>].

¹⁵⁰ John Deere Supply Network, *JDS-G223 Supplier Quality Manual* (Mar. 12, 2009) (on file with the *Northwestern University Law Review*). See also John Deere Supply Network, *JDS-G223 Supplier Quality Manual Overview Training Presentation* (Jan. 2015), https://jdsn.deere.com/wps/wcm/connect/dbac790046eeace29093fae206e2b4ca/JDS-G223_Training_Presentation.pdf?MOD=AJPERES [<http://perma.cc/D8DQ-W82W>]. It is important to note that some of the obligations explained in the John Deere manual may well reflect industry-wide written usages—most buyers require their suppliers to comply with ISO standards and many of the requirements of the Deere manual are restatements of these obligations—yet Deere still chooses to write them down even though they are codified elsewhere.

¹⁵¹ Ronald J. Gilson, Charles F. Sabel & Robert E. Scott, *Contracting for Innovation: Vertical Disintegration and Interfirm Collaboration*, 109 COLUM. L. REV. 431, 435 (2009); see also Matthew C. Jennejohn, *Contract Adjudication in a Collaborative Economy*, 5 VA. L. & BUS. REV. 173, 179 (2010).

¹⁵² Jennejohn, *supra* note 151, at 179. For a more complete discussion and analysis of the contracting practices of John Deere and similar companies, see Bernstein, *supra* note 102.

¹⁵³ See Walt, *supra* note 7, at 263.

detailed and specific contracts in an effort to fortify the terms of their contracts and thereby constrain the range of meanings a court might attribute to their agreement—thereby incurring higher specification costs.

IV. REFORMING COMMERCIAL LAW

A. *The Argument for Large Scale Legal Reform*

In response to the problems created by the incorporation strategy and other aspects of the Code's highly contextualized and quasi-mandatory approach to adjudication, neo-formalist scholars¹⁵⁴ suggest replacing the Code's interpretive approach (at least in transactions between businesses) with a rule that makes a formalist/agreement-centric approach to interpretation the default, but that also leaves transactors free to contract ex ante for a more contextualized interpretation of either their contract as a whole or of some of its provisions.¹⁵⁵ They explain that such a change would reflect the preferences of a majority of business transactors, and transform the Code's current quasi-mandatory interpretive approach into the type of majoritarian default rule the law generally favors.¹⁵⁶

The shift to a more formalist interpretive default rule would arguably give transactors a way to largely avoid some of the most significant costs associated with the incorporation strategy. It would enable transactors to draft contracts that would be more amenable to summary judgment-based adjudication, permit businesses to select adjudication on a truncated evidentiary base,¹⁵⁷ and reduce the internal firm information-transmittal and contract-administration costs occasioned by the strategy. In addition, if combined with a change that also permitted the parties to opt out of the incorporation strategy in its entirety—including its course of dealing and course of performance components—a more formalist default rule would

¹⁵⁴ Avery Wiener Katz, *The Economics of Form and Substance in Contract Interpretation*, 104 COLUM. L. REV. 496, 503 (2004) (identifying Robert Scott, Alan Schwartz, and Lisa Bernstein as leading neo-formalists).

¹⁵⁵ Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L.J. 541 (2003); Bernstein, *supra* note 147, at 251–53 (demonstrating that supply contracts entered into by Big Box retailers and other firms with highly outsourced production processes often include numerous provisions attempting to opt out of the Code's incorporationist jurisprudence).

¹⁵⁶ See Schwartz & Scott, *supra* note 155. Alternatively, such a rule could also be structured to permit parties to elect incorporationist adjudication only if they also designated an industry expert arbitrator or arbitration panel to make binding determinations about the content of usages. It might also be designed to impose additional requirements that would have desirable information forcing effects and largely eliminate commonly litigated issues. It might for example, require parties electing incorporation to stipulate that they are both merchants and to specify the industry and location whose usages are to govern their transaction.

¹⁵⁷ Transactors would likely desire this in many transactional contexts. See *id.* at 583–84.

both reduce the intra-firm agency costs created by the strategy¹⁵⁸ and enable transactors to more fully capture the benefits of using a two-tiered contractual structure consisting of both legal and extra-legal terms. Moreover, as discussed further below, such a shift in default rules would be likely to significantly reduce, though not entirely eliminate, transactors' ability to engage in "private language"-based strategic behavior in which a transactor who is disadvantaged by a contract's plain meaning, argues *ex post* that the contract was actually written in a "private language" consisting of usage-based meanings that favor his legal position.¹⁵⁹ Finally, such a change would also increase the returns to careful drafting, which would in turn encourage contractual innovation, decrease the social cost of disputing meaning (as fewer disputes reach the legal system), and increase contractual clarity which would in turn facilitate the creation and maintenance of cooperative contracting relationships.

B. *Reducing Strategic Behavior Costs*

The adoption of the neo-formalists' proposed interpretive default would most likely reduce the incidence of private language-related strategic behavior. Yet it is unlikely to do so as successfully as some of its proponents have suggested.

Under the proposed rule, when transactors accept the formalistic default, their ability to claim that their contract should be interpreted in a particular way because it was written in a "private language" will be constrained. However, parties often seek to introduce usage evidence by framing their usage-based arguments as a claim that the usage creates an "additional term," or a precondition to the invocation of a clear written term, rather than as a factor to be taken into account in interpretation. As a

¹⁵⁸ Bernstein, *supra* note 147 (explaining that the Code's course of performance and course of dealing provisions make it necessary for firms to put controls on the flow of information within the firm and the actions of their employees that are expensive to implement and may prevent or discourage their employees from making value creating flexible adjustments to contracts).

¹⁵⁹ Schwartz & Scott, *supra* note 155, at 584–90. The study of usage in the courts confirmed that transactors do, in fact, make these types of private language claims, and that courts are inclined to permit usage-based private language meanings to trump even seemingly contradictory express terms. However, the study was unable to draw any conclusions about the frequency of strategic behavior. First, there were only six reported cases that involved a trial on a plain meaning versus usage-based meaning. Second, it is actually quite difficult to determine whether or not the claims made in these cases were in fact strategic. Private language based claims might reflect strategic behavior, but might also simply reflect a party's good faith attempt to demonstrate the parties' true intent at the time of contracting. Alternatively even if private language based claims do not involve a party being strategic in the sense of asserting the existence of a nonexistent usage in attempt to override plain meaning, they may well involve a transactor falsely arguing that a practice that transactors opt to follow on an occurrence-by-occurrence basis must actually be followed all of the time, or that a usage that exists under certain market conditions (such as stable prices) should be applied in a situation where conditions are very different (such as a time of price volatility).

consequence, in order for the proposed formalist default to be effective, it would have to be combined with the adoption of both a strong parol evidence rule that treats usage as parol and a rule giving strict effect to integration clauses.

Some proponents of the proposed rule suggest that it will also significantly reduce strategic behavior even when contextual adjudication is selected.¹⁶⁰ They reason that a party selecting a contextualist default will only be able to play a language game by claiming that the plain meaning of the contract trumps the alleged contextual meaning, something that will occur infrequently and only by happenstance. In practice, however, given the low evidentiary threshold for establishing a usage, it remains likely that a party seeking to establish a usage-based meaning favorable to his position, will be able to find an employee willing to testify to any of a wide range of favorable meanings, thus reintroducing the prospect of strategic behavior.¹⁶¹

Even if employees were not inclined to lie or shade the truth for their employers, there is nonetheless likely to be significant play in the range of plausible (and perhaps even truthful) usage-based meanings of particular terms. First, it is nowise clear that transactors understand what a usage is, even when it is explained to them by a lawyer, a court, or a survey researcher. Many of the witnesses who testified in the usage cases referred to “my usage” or the “usage of my firm,” rather than “the usage,” a distinction courts did not detect. In addition, when transactors in the Texas grain industry were asked to give examples of usages, their answers tended to be either vague invocations of “old boy” norms like “my word is my bond,” or references to practices that were actually memorialized in the written documents governing their deals.¹⁶² Second, studies of the existence

¹⁶⁰ Schwartz & Scott, *supra* note 155, at 585–86 (suggesting that the change in default rule will markedly reduce strategic behavior even when transactors choose contextualism). *But see* Bernstein, *supra* note 147, at 259–60 (arguing the opposite).

¹⁶¹ *See* Bernstein, *supra* note 147, at 259–60.

¹⁶² *See id.* at 246–49. In addition, the sociology of management literature suggests that even within a firm, language differences arise across divisions and other types of clusters to such an extent that they create “difficulty in moving ideas between groups,” without the aid of individuals (known in the literature as “brokers”) who know the language of both groups and can translate between them. *See* RONALD S. BURT, *BROKERAGE AND CLOSURE: AN INTRODUCTION TO SOCIAL CAPITAL* 17 (2005) (“Opinions and behaviors within a group are often expressed in a local language, a dialect fraught with taken-for-granted assumptions shared within a group. The local language makes it possible for people in the group to exchange often-repeated data more quickly . . . [yet] the more specialized the language within groups . . . the greater the difficulty in moving ideas between groups.” (citation omitted)). If these language difficulties exist within the divisions of a single firm, they are also likely exist (and, perhaps, to be even more extensive) between firms. This suggests that there is reason to question the idea that words have industry-wide tacit meanings as well as the idea that two firms—especially ones that have not dealt with one another for a long period of time—are likely to enter into a contract with a shared set of tacit understandings of language even if they are in the same industry. *See also* Bernstein,

and content of trade usages from the Middle Ages¹⁶³ to the present have documented that, to the limited extent that trade usages exist at all, they tend to be far less precise and far more local in scope than either the Code or incorporationists typically assume—making the range of usages that can be plausibly asserted extraordinarily broad in most transactional contexts.¹⁶⁴ As Llewellyn himself acknowledged in the early comments to a draft of the Code, “[U]sage may be unclear, or in the process of change, or different as between the market the seller knows and the market familiar to the buyer.”¹⁶⁵ Thus, with the exception of situations where the private language at issue is codified in a written set of rules—such as the Incoterms,¹⁶⁶ or the Worth Street Textile Rules¹⁶⁷—when parties opt for contextualism, the likelihood of strategic behavior is likely to be either slightly reduced or essentially unchanged from what it is under the current approach.

C. *The Limited Evidence on Majoritarian Preferences*

The assumption that transactors want their contracts to be given a usage-based and highly contextual meaning is deeply woven into the Code; yet there is no empirical evidence that business transactors actually prefer contextualist adjudication. Indeed, the limited available empirical evidence suggests that certain types of merchants and many business entities actually prefer more formalist approaches to adjudication.

Studies of dispute resolution in merchant industries (particularly cash commodities markets) suggest that merchants strongly prefer formalist

supra note 102 (noting that Harley Davidson produces a glossary of Harley-specific abbreviations for the use of its suppliers).

¹⁶³ Emily Kadens, *The Myth of the Customary Law Merchant*, 90 TEX. L. REV. 1153, 1177 (2012) [hereinafter Kadens, *Myth*] (suggesting that there were not widely known usages of trade relating to sales transactions during the Middle Ages and that such usages as existed were highly local); Emily Kadens, *The Medieval Law Merchant: The Tyranny of a Construct*, 7 J. LEGAL ANALYSIS (forthcoming 2015), <http://jla.oxfordjournals.org/content/early/2015/06/25/jla.lav004.full.pdf+html> [<http://perma.cc/GAT7-VQ8Z>] [hereinafter Kadens, *Medieval Law Merchant*].

¹⁶⁴ For a summary of these studies, see Kadens, *Myth*, *supra* note 163 and Kadens, *Medieval Law Merchant*, *supra* note 163.

¹⁶⁵ REVISED UNIFORM SALES ACT, *supra* note 2, at 52 (Comment to § 1-C).

¹⁶⁶ The Incoterms are a codified set of rules dealing with the shipment and transport of goods in international commerce. They are promulgated by the International Chamber of Commerce and are revised every few years. INTERNATIONAL CHAMBER OF COMMERCE, INCOTERMS 2010, <http://www.iccwbo.org> [<http://perma.cc/YSC9-ZR4L>].

¹⁶⁷ The Worth Street Textile Rules are a set of trading rules that are used to resolve disputes under the textile industry’s private arbitration rules that are administered by the American Arbitration Association. The Worth Street Rules cover most of the same subjects as the UCC, and include a standard form sales note and several compilations of industry customs for different branches of the trade. For a discussion of the genesis of these rules, see Bernstein, *Questionable Empirical Basis*, *supra* note 101, at 730–35.

interpretation.¹⁶⁸ In many of these markets, contracts are governed by industry-drafted trade rules and are interpreted and enforced in trade-association-run arbitration tribunals. Although the tribunals are staffed by industry-expert arbitrators who would be expected to be well versed in any extant trade usages, the tribunals nonetheless adopt formalistic adjudicative approaches. They do not look to courses of performance and courses of dealing to interpret contracts and only look to usage if the parties' contract, the relevant association's trade rules, and the UCC are all silent on a particular question—that is, in the case of a true contractual gap.

The best available systematic evidence about the interpretive preferences of large corporate transactors suggests that they too prefer formalistic adjudication. A recent study of choice of law provisions in large commercial contracts¹⁶⁹ found that transactors preferred to be governed by relatively formalist/agreement-centric New York law than by relatively contextualist California law. The study concluded that “[t]he testimony of the marketplace—the verdict of thousands of sophisticated parties whose incentives are to maximize the value of contract terms—is that New York’s formalistic rules win out over California’s contextualist approach.”¹⁷⁰ Similar preferences were revealed by a European study that looked at choice of law provisions in business contracts subject to arbitration at the International Chamber of Commerce. It found that transactors strongly favored British law, the most formalistic of the available EU alternatives.¹⁷¹

More generally, it is important to note that large businesses entering into many types of contracts—including executive employment agreements,¹⁷² consulting agreements,¹⁷³ large retailer supply contracts,¹⁷⁴

¹⁶⁸ See Bernstein, *supra* note 1 (describing the formalistic adjudicative approach used in the grain and feed industry’s private arbitration system); Bernstein, *Creating Cooperation*, *supra* note 62 (describing the formalistic adjudicative approach used in the cotton industry’s arbitration system).

¹⁶⁹ Theodore Eisenberg & Geoffrey P. Miller, *The Flight to New York: An Empirical Study of Choice of Law and Choice of Forum Clauses in Publicly-Held Companies’ Contracts*, 30 CARDOZO L. REV. 1475 (2009) (looking at choice of law clauses in large commercial contracts, though not exclusively ones for the sale of goods).

¹⁷⁰ Geoffrey P. Miller, *Bargains Bicoastal: New Light on Contract Theory*, 31 CARDOZO L. REV. 1475, 1478 (2010).

¹⁷¹ See Stuart Popham, Clifford Chance LLP, *The View of European Business: Survey Results Presentation* (Mar. 14, 2008), http://denning.law.ox.ac.uk/news/events_files/Popham_-_presentation.PPT [<http://perma.cc/AHC8-E9UQ>].

¹⁷² See, e.g., Netsmart Technologies, Inc. & James L. Conway, Employment Agreement cl. 11(e) (Aug. 15, 1996) (on file with the *Northwestern University Law Review*) (“No course of conduct or dealing between the parties and no custom or trade usage shall be relied upon to vary the terms of this Agreement.”).

¹⁷³ See, e.g., Home Depot U.S.A., Inc. & Dennis J. Carey, Consulting Agreement cl. 14 (Aug. 14, 2002) (on file with the *Northwestern University Law Review*) (“Neither the course of conduct between the parties nor trade usage will act to modify or alter the provisions of this Consulting Agreement.”).

¹⁷⁴ See Bernstein, *supra* note 147, at 251–53.

and the supply contracts of large original equipment manufacturers¹⁷⁵—sometimes include a variety of provisions that seek to limit the role of contextualist interpretation. These include provisions excluding course of dealing, course of performance and usage of trade from gap filling and/or interpretation, as well as provisions calling for contracts to be given their “plain meaning,” or to be interpreted in accordance with the goals set out in their preamble without any expansion of rights or duties. Additional examples abound.¹⁷⁶

D. Smaller, More Politically Feasible Changes

The best available empirical evidence about the existence of usages, the operation of the Code’s trade usage provision, and the preferences of business transactors support making more formalist interpretation the default approach in transactions among businesses (especially larger businesses who receive legal advice). But the history of the American Law Institute’s most recent attempt to overhaul Article 2 suggests that at present large scale reform of American commercial sales law may be politically infeasible, whatever its potential economic benefits. It is therefore useful to consider some possible changes in the way that the Code is interpreted—some of which are even more consonant with the views of its drafter than the approaches courts presently adopt—as well as a number of smaller, and perhaps more politically feasible amendments to the Code that might create significant benefits.

One way courts could greatly improve the operation of the Code would be to give full effect to integration clauses that specifically exclude usages of trade, courses of performance, and courses of dealing. This would transform the Code’s adjudicative approach from a quasi-mandatory rule to something closer to a true default rule. Another would be for courts to more strictly enforce the Code’s hierarchy of authority and to adopt a more robust definition of “conflict” that would make it more difficult to override express terms with usages or alleged usages. Although these proposed changes, like the neo-formalist proposal to shift the default rule, would not eliminate strategic behavior unless accompanied by significant

¹⁷⁵ See Network Engines, Inc. & VA Linux Systems, Inc., Supplier Agreement cl. 20.18 (Mar. 1, 2000) (on file with the *Northwestern University Law Review*) (“This Agreement shall not be modified and/or amended by any course of dealing, course of performance or trade usage.”); Compaq Computer Corp. & Brocade Communications Systems, Inc., Corporate Purchase Agreement cl. 31.6 (Feb. 1, 2000) (on file with the *Northwestern University Law Review*) (“This Agreement . . . shall not be supplemented or modified by any course of dealing or trade usage. Variance from or addition to the terms and conditions of this Agreement in any Order, or other written notification from Seller will be of no effect.”).

¹⁷⁶ See Bernstein, *supra* note 147, at 251–53.

parol evidence rule reform, such changes might nonetheless greatly increase party control over the meaning of their agreements.

Finally, if commercial law reformers insist on remaining true to Llewellyn's vision, as they did during the latest (failed) attempt to revise Article 2, they might consider excluding usages related to the core dickered terms of a contract—which in Llewellyn's view included price, quality, quantity, payment terms, and delivery time—while permitting their introduction in relation to other issues. As Llewellyn explained in the Comments to early drafts of the Code, deference to written terms is based on the idea that they reflect “bargains whose detailed terms the two parties had looked over,” and when this is true “[i]t requires what the parties’ have bargained out to stand as the parties have shaped it, subject only to certain overriding rules of public policy.”¹⁷⁷ In contrast, with respect to the non-dickered terms, Llewellyn thought that courts should look to “the fair and balanced general law and the fair and balanced usage of the particular trade,”¹⁷⁸ noting that “[d]isplacement of these balanced backgrounds is not to be assumed as intended unless deliberate intent is shown that they shall be displaced.”¹⁷⁹

Other changes that would improve the operation of the Code would require small, yet potentially controversial, amendments to the Code or its Official Comments. One potentially significant small change would be to amend the comments to § 2-207 to make limitations on consequential damages, limitations on warranty, and clauses providing for arbitration either per se material or nonmaterial alterations. Issues related to these clauses are often litigated and, unlike cases where usages are introduced to interpret a contract provision or add an unwritten implicit clause to an agreement, the party seeking to exclude the different additional term often has the burden of proving that the additional term is not a usage—something that is very expensive and difficult to do.

CONCLUSION

Drawing on a study of the ways that the trade usage component of Article 2's incorporation strategy works in practice rather than in theory, this Article has sought to reexamine the desirability of the Uniform Commercial Code's interpretive approach on the terms put forth by its most ardent defenders. In doing so it has raised serious questions about the core

¹⁷⁷ REVISED UNIFORM SALES ACT, *supra* note 2, at 52–53 (Comment to § 1-C).

¹⁷⁸ See Amy H. Kastely, *Stock Equipment for the Bargain in Fact: Trade Usage, “Express Terms,” and Consistency Under Section 1-205 of the Uniform Commercial Code*, 64 N.C. L. REV. 777, 794 n.110 (1986) (quoting the REVISED UNIFORM SALES ACT, *supra* note 2, at 53 (Comment to § 1-C)).

¹⁷⁹ REVISED UNIFORM SALES ACT, *supra* note 2, at 53 (Comment to § 1-C).

defense of the strategy—namely that as compared to a more formalistic approach to adjudication, it will decrease specification costs without greatly increasing interpretive error costs. This Article has suggested that in light of the way courts interpret the Code’s hierarchy of authority, the thin evidence needed to establish a usage, and the dynamic relationship between interpretive error costs and specification costs, the strategy is likely to raise both types of costs, open the door to strategic behavior, constrain contractual innovation, and inhibit efficient contracting.

In reaching these conclusions, this Article accepted for the sake of argument, that the types of usages the Code seeks to incorporate actually exist and that contextualist interpretation was a majoritarian preference. Yet in reality the existence of trade usages that are both generally known and geographically coextensive with segments of the relevant trade has never been demonstrated empirically, nor have business transactors’ preferences for highly contextual incorporationist interpretive approaches ever been documented. Indeed, the limited empirical evidence available on both of these questions cuts strongly against incorporationists’ assumptions. Given that the search for usages that likely do not exist will increase interpretive error costs and strategic behavior costs without producing any offsetting specification cost savings, and that adopting a quasi-mandatory contextualist interpretive default (when transactors in fact prefer formalistic adjudication) will lead to higher specification costs as transactors fortify their contracts in an effort to constrain the range of meanings a court might attribute to their contract, the costs of retaining the incorporation strategy as a quasi-mandatory default rule may be even higher than the analysis presented here has suggested.

In sum, while we may never have perfect data on which to base commercial law reform, modern law reformers, in ignoring the best empirical data that we do have, have let the perfect be the enemy of the good. In so doing they have failed to see that sales law is deeply broken, both in its present state and in terms of its ability to repair itself. For while Llewellyn sought to create a semi-permanent piece of legislation whose structure and interpretive methodology would ensure that it could be adapted to “unforeseen and new circumstances and practices” as well as other changes in the structure, operation, and organization of trade,¹⁸⁰ Article 2, as interpreted by the courts, has not, in fact, been able to adapt itself to the fundamental changes that have taken place in the American economy since the time the Code was drafted.¹⁸¹ These changes, together

¹⁸⁰ U.C.C. § 1-102(b) cmt. 1 (2001).

¹⁸¹ See Bernstein, *supra* note 147 (discussing the lack of fit between the rules and jurisprudential constructs in Article 2 and the needs of the modern outsourced economy).

with the ways that the incorporation strategy has been operationalized by courts, suggest that whatever the merits of the strategy may have been in 1940, given its likely effects on specification costs, interpretive error costs, and strategic behavior, it cannot be justified as meeting the needs of modern commerce today. It is therefore time to adopt a formalist default approach to the interpretation of business contracts that will also leave transactors free to opt for contextualism. It is only after an interpretive default rule that in practice is a *pure* default has been in operation for a significant period of time, that it will be possible to quantitatively assess whether contextualism or formalism better reflects majoritarian preferences. And, it is only after research establishes that usages of trade that are widely known and geographically coextensive with the extent of trade both exist and reflect obligations that transactors want courts to enforce (as opposed to “informal” or “relationship preserving” norms), that it will be possible to conclude that incorporationist contextualism should even be one of the available interpretive default options.

