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Lisa Bernstein

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# CHICAGO

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## Merchant Law in a Modern Economy

*Lisa Bernstein*

THE LAW SCHOOL  
THE UNIVERSITY OF CHICAGO

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*Merchant Law in a Modern Economy*  
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Lisa Bernstein\*

## Introduction

The Uniform Commercial Code (“Code”), the statute that governs transactions in the sale of goods in the United States, adopts a highly legal realist jurisprudential approach that gives great weight to context, applies a lax parol evidence rule, and looks to usage of trade, course of performance, and course of dealing to interpret contracts, fill contractual gaps, imply warranties, modify agreements, waive obligations, and give meaning to many of the Code’s own standard like default rules. This adjudicative approach (with some nuanced variations) has been widely adopted the world over. It is at the heart of many continental legal systems as well as the United Nations Convention on the International Sale of Goods and the recently proposed Common European Sales Law.

The Code’s contextualized adjudicative approach was designed to provide a set of off-the-rack contract default rules that would “simplify, clarify and modernize the law governing commercial transactions.”<sup>i</sup> By directing courts to look to trade practices and the contracting context to give meaning to both parties’ agreements and the Code’s standard-like defaults, the Code’s drafters sought to provide defaults that would, by virtue of their reflection of the contracting context, be better tailored to parties’ transactional needs than any possible set of clear and definite rules designed to apply across a wide range of transaction types. In adopting this approach, the drafters also sought to create a semi-permanent piece of legislation. A piece of legislation that when applied by courts in a purposeful way that took account of its reason would “provide its own machinery for the expansion of commercial practices . . . through custom, usage and agreement of the parties” thereby ensuring that the Code could adapt itself to “unforeseen and new circumstances and practices”<sup>ii</sup> without the need for legislative amendments.

This essay explores the Code’s adjudicative architecture from both an empirical and a theoretical perspective. Its goal is to assess whether the Code will be able to successfully adapt American commercial law to meet the challenges created by the structural changes in the American economy that have taken place over the past twenty years.

The essay begins by exploring the best available evidence on the validity of the empirical assumptions that are central to the Code's jurisprudential approach and its machinery for adapting to change. The primary focus is on the assumptions that unwritten usages of trade that are widely known across the relevant geographic boundaries of trade exist, that these usages can be found by courts, and that contextualized adjudication is a majoritarian default rule from the perspective of business transactors.

After presenting empirical evidence that suggests that the truth of these assumptions is questionable at best, the essay draws on arguments developed by neo-formalist scholars to explore the reasons that the Code's adjudicative approach is ill-suited to transactions between both merchants and sophisticated business entities. It begins by suggesting that the Code prevents transactors from contracting using their preferred mix of legal and extra legal terms, impedes the very types of flexible work-a-day contractual relationships it was designed to encourage, and encourages certain types of strategic behavior. It then suggests that in transactions between large multi-agent entities, the Code's contextualist interpretive approach imposes significant additional costs on business transactors: it creates or exacerbates *intra-firm* agency costs, increases both information transmittal costs and operating costs, and leads parties to use complex transactional structures that they could more easily forgo if the law gave primacy to the terms of their written agreements and adopted a more formalistic adjudicative approach. In addition, and of increasing importance to the modern economy, the Code's adjudicative approach makes what scholars have termed "contracting for innovation"<sup>iii</sup> more expensive and difficult than it would be in a more formalist, agreement-centric, interpretive regime.

The essay concludes that given fundamental changes in the American economy and the structure and operation of firms that have occurred over the past two decades, it is very unlikely that the Code will be able to successfully adapt to the demands of the modern economy. Rather, for sales law to successfully respond to these changes, reformers will need to rethink commercial law from the ground up. They will need to recognize that recent changes in the structure, organization and operation of large multi-agent firms pose contract governance challenges that cannot be adequately met through a contextualist approach to adjudication that relies on the gradual evolution of usages and practices to respond to economic change. The complexity of modern contractual relationships together with the high levels of coordination and innovation (both inside and outside of the firm) that are needed for economic success, suggest that written contracts that are interpreted as

written will (except when the parties specify otherwise) provide businesses, and by implication markets, with a faster and more tailored way of responding to economic change, than will the continued incorporation of usages and practices, especially in light of changes in the technology of contracting.

## I. The Empirical Basis of the Code's Jurisprudential Architecture

The Uniform Commercial Code was drafted by Karl Llewellyn, one of the leading legal realists of his time and an outspoken advocate of the social scientific approach to law making. Llewellyn sought to draft a statute whose rules were "designed to adapt rules of law to the way that business is actually carried on,"<sup>iv</sup> and that drew on "the practices of businessmen and business houses [as] important factors in construing their contracts and actions and in determining their rights and liabilities."<sup>v</sup> Given this goal it is tempting to assume that the Code's assumptions about the business/merchant world and merchant preferences were based on solid empirical evidence. However, as a leading historian of the Code creation process concluded, "it must be conceded that there was virtually no systematic project research of the kind postulated by the scientific method. There were no orderly research designs, disciplined sampling or carefully tested questionnaires."<sup>vi</sup> In drafting the Code, Llewellyn relied primarily on his knowledge of the medieval Law Merchant,<sup>vii</sup> his own business intuitions and conversations with bankers and lawyers.<sup>viii</sup> "Such fieldwork as was done tended to be adhoc."<sup>ix</sup>

Llewellyn's failure to conduct social scientific research to inform the Code drafting project has long been dismissed by his supporters who claim that despite his methodological lapses, "critics who have been suspicious of his alleged 'unscientific' 'impressionistic' or 'anecdotal' approach to facts have yet to point to any major factual assumptions of the code that were misleading or inaccurate."<sup>x</sup> In recent years, however, an increasing body of historical and empirical evidence has begun to raise serious questions about the soundness of the Code's empirical assumptions. This section draws on the best (though limited) historical and empirical evidence available to explore whether usages of trade actually exist in merchant communities, whether courts can determine the existence and content of usages with reasonable accuracy, and finally, whether there is any reason to question the widely shared assumption that contextualist adjudication is a majoritarian default rule.

### A. *Do Usages of Trade Exist?*

## 1. *The Law Merchant*

A fundamental starting point for defenders of the proposition that meaningful merchant customs and usages exist is the history of the so-called medieval Law Merchant of sales. According to the accounts of the Law Merchant relied upon by Llewellyn,<sup>xi</sup> during the Middle Ages supra-local transactions in the sale of goods were governed by unwritten customs of trade that were widely known, widely followed, and used by merchant arbitrators to decide cases in specialized merchant courts that operated wholly outside of the purview of the state. This image of the operation of the Law Merchant had a powerful effect on Llewellyn's thinking. In fact, early drafts of the Code, provided for "mercantile facts," including trade usages and commercial practices, to be found by panels of merchant experts.<sup>xii</sup> More generally, as one of Llewellyn's assistants in the Code drafting process explained, "[i]t is fair to say that the draftsmen of the Code. . . wanted to correct some false starts . . . and to restore the law merchant as an institution for growth only lightly kept in bounds by statute."<sup>xiii</sup>

Although Llewellyn relied heavily on the history of the Law Merchant in drafting the Code, recent historical scholarship casts doubt on the claim that medieval law merchant—in the sense of a generally accepted set of unwritten sales related customs—actually existed.<sup>xiv</sup> Indeed the account of its operation that Llewellyn himself relied on (that of Levin Goldschmit) has been largely discredited,<sup>xv</sup> and recent research on medieval commerce has concluded that "we lack evidence that [sales-related gap filling customs] became a uniform and universal part of the *lex mercatoria* other than, perhaps, at a very high level of generality. Instead, the evidence suggests that substantive customs remained geographically local or confined to a particular network of repeat players."<sup>xvi</sup> To the extent that robust commercial customs existed in the Middle Ages, they were not part of "sales" law, but rather dealt with bills of exchange. Yet even in this area, usages did not emerge through the evolution of unwritten practices and understandings. Rather, they emerged through the repeated use of written standard form contracts and the emergence of transactional intermediaries like notaries. As a consequence, the history of the so-called medieval law merchant of negotiable instruments cannot be said to provide empirical evidence that the types of unwritten usages of trade that the Code relies on so extensively actually existed in the Middle Ages. It does, however, illustrate the power of written agreements to support trade and introduce contractual innovations, even in an environment where both writing and transmitting a writing were more time-consuming and expensive than they are today.

## *2. Trade Association Codification Attempts at the Turn of the 20<sup>th</sup> Century*

In an effort to conduct the type of social scientific studies that Llewellyn might have conducted had he applied his ideas about social science research to the Code drafting project, one study looked at the efforts of trade associations in four merchant industries—grain, feed, hay, textiles and silk to codify their customs into written trade rules in the 50 years prior to the start of the Code project.<sup>xvii</sup> All of the industries studied were ones where the preconditions for the emergence of customs were met-- transactors interacted on a repeat basis in relatively similar transactions over a long period of time. Nevertheless, the debates leading up to the adoption of these rules revealed that transactors did not agree about the meaning of even very common trade terms and that there was no consensus about the ways that common aspects of business were generally conducted.

In the hay industry for example, before the first set of national trading rules was adopted the “packaging, shipping and handling [of] hay was an irregular business. There were no established customs to govern, and every transaction was typical of the parties engaged in it.”<sup>xviii</sup> Transactors did not even agree about the meaning of the term “bale” of hay, for “the large bales of New York and New England means a different bale from the large bale in the Western States.”<sup>xix</sup> Even within local areas no uniform definitions emerged. As participants at the fourth convention of the National Hay Association discovered, “in Chicago at present there is a lack of definition of small bales.”<sup>xx</sup> Attempts to develop rules on the reasonable time for payment of various fees also led to contentious debate. As one participant in the debate aptly observed, “that reasonable time business will not [tell you] anything. You might as well leave it out.”<sup>xxi</sup>

Disagreement about the meaning of terms and the content of usages was also rampant in the grain industry. Shortly before the rules drafting process began the trade press concluded that “there are customs in the grain trade that are supported to be established, but the trouble in respect to them is, [that] they are not fixed, [and] are not understood alike, some understand them in one way and other in another way, and for that reason, if for no other [they] cause difficulty.”<sup>xxii</sup> The national grain rules were adopted in 1902 after only a two year drafting process. However, it took much longer for them to supplant the rules of local associations. As late as 1928, the chairman of the national rules committee observed that “uniformity in the rules is a matter of slow growth as the different markets are very conservative in making changes in rules of years standing”<sup>xxiii</sup>

In the textile and silk industries, the disagreements about the content of customs were even more significant and the debates over the creation of rules were even more heated. This is not surprising because the rules in these groups did not govern transactions between merchants who were buyers one day and sellers the next, but rather transactions between merchants who played a fixed role in the chain of production and distribution and therefore had industry-segment level interests.

The drafting of the textile rules, known as the Worth Street Rules, “was fraught with conflict, involved negotiation among numerous trade associations,”<sup>xxiv</sup> and took 18 years to complete. Consensus was so difficult to achieve that the drafting committee ultimately decided to create several different sets of codified customs for different segments of the industry; yet even with this high degree of particularization, many terms remained uncodified since a consensus on their meaning could not be reached. In the silk industry, the creation of rules was equally hard fought and, as in textiles, many different sets of rules governing different stages in the chain of production and distribution were adopted. Interestingly, silkmen did not revere usages. As one silkman put it “huge question marks are boldly inscribed on the walls of custom, hoary with age, and covered with the ivy of reverence.”<sup>xxv</sup> And, as one of the association’s annual reports explained, silkmen were reluctant to codify usages because “when a business routine is established in an organization it often requires . . . a so-called shake up to introduce innovations.”<sup>xxvi</sup>

Eventually, each of these industries shifted their efforts from codifying customs, to negotiating agreed meanings of common terms (frequently in ways that revealed a desire to change not to harmonize local meanings).<sup>xxvii</sup> Although the trade rules they adopted might have been loosely informed by practices prevailing in different parts of the country, they were not mere codifications of common understandings. The process by which they were drafted and adopted was quasi-legislative in nature. Rules drafting committees actively sought to consider practice and policy considerations so as to better promote trade. As the by-laws of these associations and other trade associations made clear, their goal was to “*promote* uniformity” of practices and “to seek certainty in usages,” all in an effort to avoid “misunderstandings.”<sup>xxviii</sup>

Some critics have characterized these studies as “highly controversial.”<sup>xxix</sup> They have variously argued that the individual case studies of particular industries do not shed light on the contracting preferences of businesses in general;<sup>xxx</sup> that the period chosen for study had not given transnational usages long enough to evolve;<sup>xxxi</sup> and that evidence from the turn of the nineteenth century is of little importance



today.<sup>xxxii</sup> Critics also point out that even if usages are uncommon, evidentiary rules provide sufficient protection against courts looking to non-existent unwritten usages.<sup>xxxiii</sup>

The first of these objections is certainly true. Extreme caution is always warranted when extrapolating from case studies. However, it is notable that the contextualists have not identified any studies that contradict the findings of the case studies discussed here. Rather, they justify their positions by reference to the “pre-theoretical empirical presumption that widespread, identifiable, and effective commercial practices do exist,”<sup>xxxiv</sup> and by proffering ad hoc examples like the fact that a 2x4 is not a board measuring two inches by four inches.<sup>xxxv</sup> It is, however, unclear what a “pre-theoretical empirical assumption” is, and as discussed further below, the example of the 2x4 actually undermines the claim that unwritten usages that are coextensive with the extent of trade (or important and delineated subsets of it) evolve over time and coalesce into workable trading norms in merchant communities.

During the last decades of the 1800s, as trade in lumber became national in scope, lumber industry participants soon realized that there were different understandings of lumber size and grading designations in different parts of the country, and even within some local areas.<sup>xxxvi</sup> These differences led to many disputes, and were viewed by lumbermen as a major impediment to trade; yet by the early 1920s no consensus on the meaning of lumber size and grade designations had emerged. Lumber dealers widely agreed that the term 2x4 did not mean a board that measures two inches by four inches, but there was no consensus about the actual dimensions that a board described as a 2x4 should have. For example, the Northern Pine Manufacturers Association defined a 2x4 as measuring 1-5/8 x 3-5/8, while the North Carolina Pine Association defined it as 1-3/4 x 3-3/4.<sup>xxxvii</sup>

When an industry wide definition finally emerged (which even today is different for dry and green lumber)<sup>xxxviii</sup>, it came about through a quasi-legislative effort, rather than through the evolution of customary practices. In 1919, under the sponsorship of the Commerce Department,<sup>xxxix</sup> lumber associations representing different regions of the country and segments of the industry negotiated and codified definitions of the 2x4 and other common size designations. In the course of their deliberations these groups did look at the prevalence of different meanings across the country,<sup>xl</sup> many of which had already been codified by regional associations, local associations, and individual sawmills. Yet they also took into account the functional uses to which boards of different sizes were commonly put, and tailored the definitions they

adopted to reflect the minimum engineering standards needed to accomplish these various ends.<sup>xli</sup>

Today, the meaning of 2x4 and other common lumber size designations is codified in a voluntary product standard put out by the National Institute of Standards and Technology. In sum, the history of the 2x4 suggests that it is a poor example of an unwritten and generally understood trade usage that emerged overtime through informal evolving industry consensus.

The second objection to the case studies is that at the time the codification efforts began the industries studied had not been national for long enough for customs to evolve. This objection is difficult to evaluate as critics do not put forth any metric for assessing the expected pace of customary evolution. However, the grain trade had been national in scope for over 60 years before the first trade rules were adopted,<sup>xlii</sup> and the hay trade had been inter-regional and at least partially national 30 years before the rules codification process even began.<sup>xliii</sup> Even more strikingly, important parts of the American textile trade were centered in New York for over 300 years before the process of creating trading rules even began. Indeed, they were concentrated on Worth Street itself for 75 years prior to the adoption of the Worth Street Trading Rules.<sup>xliii</sup> Similarly, the American silk industry had been centered in the northeast since the mid 1840's with a significant concentration of silkmen in New York and Patterson, New Jersey. These silkmen met with one another on a regular basis and also formed a variety of clubs and associations to further their business interests.<sup>xliii</sup> The industry was thus organized into meaningful groups/associations for over fifty years before the Silk Association of America's trade rule codification process even began.

In light of these facts, the claim that the codification efforts began before national--or in the cases of textiles and silk, local--customs had had sufficient time to develop, cannot provide a plausible account of the lack of agreement on the meaning of terms that everyone acknowledged were in wide spread use. Regardless, the important point for commercial law and commercial law reform is that even if usages might have emerged in the long-run, however defined, usages had not evolved quickly enough to meet the needs of commerce. Otherwise codification, an expensive and time consuming enterprise would not have been needed.

Finally, in assessing the relevance of the case studies to contemporary commerce, it is important to note that the conditions for the emergence of usages were more nearly met in the contexts studied

than they are in most industries today. Although the studies do not (and do not purport to) prove that usages do not exist today, their evidence is powerful enough to suggest that those who continue to advocate incorporating trade usages into commercial contracts should be moved to provide proof of their existence.

### *3. Usage in the Contemporary Texas Cattle Feed Market*

In a follow up to the case studies discussed above, and to begin to explore whether usages exist in modern merchant industries, a pilot case study of transactional practices in the contemporary cattle feed market in and around Amarillo Texas was conducted.<sup>xlvi</sup> This market is characterized by the preconditions typically associated with the emergence of well-developed trade usages. Most transactors have relatively few trading partners<sup>xlvi</sup> and most of their contracting relationships are long-standing and repeat.<sup>xlvi</sup> Most transactions take place in a geographically limited area characterized by a high degree of social and ethnic homogeneity.<sup>xlvi</sup> The firms surveyed were mostly well-established market participants.<sup>1</sup> All were members of either the Texas Grain and Feed Association, an organization that runs the private legal system that governs transactions in this market, or the Texas Cattle Feeders Association, an association of feedlot owners and feed brokers, who view themselves as being part of a close-knit group.<sup>li</sup> As a consequence, the entities studied were quite likely to be well versed in any trade usages that were indeed widely followed; yet the study found that even under these near ideal conditions, unwritten work-a-day practices varied widely with respect to aspects of exchange where the Code would look to usage to give meaning its own standard like default rules.

For example, transactors widely (though not universally) agreed that giving a grace period for payment was appropriate,<sup>lii</sup> yet they did not agree on the proper length of the grace period which differed for new and old transactors.<sup>lii</sup> Moreover not a single respondent indicated that they would determine the appropriate grace period by an industry norm or practice. Most of those who commented on the subject indicated that their actions would be determined by the identity of their contracting partner and the reason for the delay.<sup>lii</sup> Transactors were also split about how frequently they would accept nonconforming tender with a price adjustment,<sup>liv</sup> and how that price adjustment was to be determined—some thought it should be individually negotiated while others thought that it should be determined on the basis of a regional scale of discounts, or a local scale of discounts.<sup>lvi</sup> Finally, although most contracts in the market contained an FOB delivery term, transactors could not agree about its meaning, or even what the acronym stood for.<sup>lvii</sup>

More generally, the study also sought to explore whether the transactors themselves thought that unwritten customs and usages of trade exist. They were asked “[w]hen you use written contracts, or purchase and sale orders, are there some unwritten rules or customs or practices that you expect your trading partner to follow even though they are not explicitly written down?”<sup>lviii</sup> Initially, 72% of the respondents said unwritten practices existed, although four changed their minds when asked to give an example. Among the 65.3% who ultimately answered that these usages existed, all but two eventually provided an example,<sup>lix</sup> but most did so only after a follow-up probe that attempted to focus their attention on “quality or time or cost considerations.”<sup>lx</sup>

Interestingly, most of the examples given by respondents would not have qualified as unwritten usages under the Code.<sup>lxi</sup> Half of the respondents either described practices that were set out in one the two relevant sets of written trading rules, (the TGFA Trading Rules or the Southwest Scale of discounts),<sup>lxii</sup> or referred to these sets of rules themselves as customs.<sup>lxiii</sup> Twenty five percent made references to “old boy” rules of thumb,<sup>lxiv</sup> and 19% noted aspects of agreements that were sometimes left unwritten without noting whether they were given meaning through usages or bilateral understandings.<sup>lxv</sup>

More broadly, the study suggests that merchants have a very inaccurate understanding of the concepts of custom and usage, a finding that raises questions about the reliability of merchant testimony (whether expert or lay) about the content of trade usages. As discussed further below, in most trade usage cases this is only type of usage evidence introduced in court.

In sum, the studies of merchant industries discussed here suggest that the types of trade usages the Code relies on so heavily may not in fact exist in merchant communities. They do not seem to have existed in the middle ages, they did not exist in important American industries at the turn of the 20<sup>th</sup> Century, and the Texas study provides some limited evidence that they do not presently exist even in a market as small and homogeneous as the feed trade within 500 miles of Amarillo Texas, a context where unlike most modern contexts, the preconditions for the emergence of usages are largely present. Although these studies and historical investigations are not perfect, it is notable that there are no studies documenting that usages do exist. Contextualists repeatedly dismiss the importance of investigating this issue, explaining that if usages do not exist or are far less prevalent than commonly believed, the rules of evidence can be relied on to ensure that nonexistent usages will be excluded so they will play no role in contract adjudication.<sup>lxvi</sup>

This argument assumes, however, that courts and juries will do a relatively good job distinguishing extant from nonexistent usages, and that courts will not permit mere assertions that a usage exists to defeat motions for summary judgment unless meaningful evidence of its existence and scope is introduced. These are assumptions that need to be evaluated not in the abstract, but rather in light of the way Code's trade usage provision operates in practice. Interestingly, while the Code drafters were concerned that courts would set the evidentiary bar for establishing usages too high,<sup>lxvii</sup> schooled as they were in the stricter requirements for establishing a custom, precisely the opposite occurred. As discussed further below, a recent study found that in practice the evidentiary requirements for establishing a usage in court are, in practice, quite lax.

### *B. Can Courts Find Usages*

In defending the Code's reliance on trade usage, contextualists have long assumed that to prove a usage a party will have to introduce "objective" evidence that the usage exists, in the form of either "expert testimony and evidence about [the] statistical regularity of observance," or the submission of a "considerable mass of behavioral data,"<sup>lxviii</sup> meaning "evidence of statistic norms—mere frequency of a given behavior in the trade."<sup>lxix</sup> This assumption is echoed in the leading Code treatise, which opines that to prove a usage "a party must usually call on an expert," or introduce a written trade code.<sup>lxx</sup> Similar assertions are made in most formbooks and practice manuals.<sup>lxxi</sup>

However, a study of all of the trade usage cases digested under the Code's trade usage provision from 1970-2000 demonstrates that in practice the evidentiary requirements for establishing the existence of a usage at trial are far less stringent.<sup>lxxii</sup> The study found that non-party testimony (a category that includes both lay and expert witnesses) was introduced in less than 30% of the cases and that parties sought to introduce trade codes in only 11%. In cases that both went to trial and found a custom to exist, non-party testimony was introduced by 16% of plaintiffs and 28.2% of defendants. In over 50% of these cases, the testimony of the parties and/or their employees was the *only* evidence of usage introduced. Moreover, there was not a single case in which statistical information about the regularity or frequency with which the usage was followed was introduced. To the extent that regularity of observance was mentioned at all in witness testimony, it was most almost always simply asserted. There were only a few cases where evidence of even a few actual transactions in which the usage was followed was introduced.

The study also found that similarly thin evidence was all that was needed to demonstrate the existence of a usage with enough plausibility to defeat a motion for summary judgment. Non-movant's were successful in using usage-related arguments to defeat the motion 70% of the time; and in 83% of the cases in which they did so, the only evidence they introduced was a cursory affidavit from a party or a party's employees.

These and other findings of the study suggest that court determinations relating to the existence, content and scope of usages are likely to be both inaccurate and highly unpredictable, as they are typically made on the basis of very limited information.<sup>lxxiii</sup> This study also raises, though does not answer, the question of why, if usages are as well-established and well-known as the Code assumes, more robust evidence of their existence is not introduced in court, especially since most of the sources consulted by practicing lawyers would suggest (albeit incorrectly) that introducing such evidence is a necessary precondition to a finding that a usage exists.

### *C. Do Transactors Clearly Prefer Contextualized Adjudication*

The contextualized interpretive approach reflected in American commercial law is often defended as a majoritarian default rule that reflects the hypothetical bargain that transactors would have struck with regard to interpretation had they been able to costlessly negotiate over it.<sup>lxxiv</sup> There are, however, no studies documenting that such an approach actually corresponds to transactors' preferences.<sup>lxxv</sup>

It is impossible to measure the extent of parties' preferences for formalistic adjudication by looking at their contracts. This is due, in part, to the fact that the Code's contextualist interpretive approach is, in practice, quasi-mandatory.<sup>lxxvi</sup> Nevertheless it is useful to explore common contracting practices. A careful review of major supply agreements reveals that certain types of contracts commonly include a variety of provisions designed to ensure the primacy of the contract's written terms and to constrain the types of contextual considerations courts can take into account.<sup>lxxvii</sup> The inclusion of these provisions is particularly notable because, under current law, some of them are not consistently enforced. The enforceability of others is either unclear or remains untested despite their apparent conflict with the Code and its Official Comments.<sup>lxxviii</sup>

Consider, for example, the Master Vendor Agreements used by large Big Box retailers in their relationships with the vast majority of their suppliers. These agreements typically contain provisions attempting to negate the Code's formation rules (including but not limited to the

battle-of-the-forms);<sup>lxxxix</sup> clauses making clear that no courses of dealing,<sup>lxxx</sup> courses of performance, actions, inactions or trade usages, are to be construed as waivers or modifications of the agreement's written terms;<sup>lxxxi</sup> provisions negating the applicability of usages and industry standards to interpretation of the contract;<sup>lxxxii</sup> clauses noting that no estimates of future needs are to be relied on or considered relevant in determining the scope of the agreement;<sup>lxxxiii</sup> time is of the essence clauses requiring strict compliance with delivery dates;<sup>lxxxiv</sup> provisions stating that perfect tender is required;<sup>lxxxv</sup> provisions defining cure quite precisely or noting that no cure will be acceptable;<sup>lxxxvi</sup> 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;<sup>lxxxvii</sup> and, finally 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.<sup>lxxxviii</sup> The widespread use of these clauses, which are also common in the Master Supply Agreements between manufacturers and the suppliers of their component parts, suggests a strong preference on the part of these transactors for opting out of the context-specific Code provisions that are at the core of the statute's jurisprudential approach. Together these clauses can be understood as a direct rejection of Code's central assumption that "the course of actual performance by the parties is the best indicator of what they intended their writing to mean,"<sup>lxxxix</sup> and that "the course of prior dealings between the parties and the usage of trade were taken for granted when the document was phrased."<sup>xc</sup>

More generally, a look at a wide variety of Material Contracts filed in the Edgar system reveals that sophisticated transactors often use the clauses described above, as well as an array of other types of clauses that can fairly be understood as attempts to constrain the extent to which courts will contextualize the interpretation of their written agreements in the event of a dispute. The most extreme such provisions, while not in widespread use, require arbitration and direct arbitrators to rule on the basis of the written agreement's "plain meaning."<sup>xc</sup> A more tempered approach, used in a variety of agreements for complex services, attempts to assert the primacy of both the scope and meaning of the agreement's written terms by directing that they be given their "plain meaning," while providing a detailed preamble describing the purpose and goals of the transactors business relationship that courts are directed to take into consideration if, and only if, the provisions are found to be ambiguous or the agreement fails to deal with a contingency.<sup>xcii</sup> These clauses reflect

transactors' preferences for the terms they write to be enforced *as written* with a strong presumption that their plain meaning was intended, as well as their recognition that contextualized interpretation may be unavoidable in the case of an ambiguity or a contractual gap. Nevertheless, despite transactors seeming acceptance of the necessity of contextualist interpretation, the detail in these preambles together with the directive that all gaps are to be filled and ambiguities resolved so as to "give full effect to the provisions of th[e] preamble," without "expanding the scope of the Parties direct obligations,"<sup>xciii</sup> suggests that that transactors want to constrain the court's discretion when it engages in even this highly limited type of contextualized purposeful interpretation. Finally, it is interesting to note that attempts to opt out of contextualism are not limited to the largest contracts. Provisions attempting to out of or limit the role of trade usage, course of performance and course of dealing, are also common in the standard Terms and Conditions of small- and medium-sized product buyers and sellers.<sup>xciv</sup>

The transactor preferences expressed in these Master Agreements and Terms and Conditions of Trade are consistent with those reflected in the jurisprudential approaches adopted by trade association-run private legal systems. In these systems contract disputes are resolved by panels of merchant arbitrators who do not apply the Code, but rather the Trade Rules developed by and voted on by the very transactors whose contracts they govern.<sup>xcv</sup> Arbitrators do not look to course of performance, course of dealing, or usage of trade to interpret contracts. They only look to usages when faced with a contractual gap, a concept they define far more narrowly than courts applying the Code. Good faith and fair dealing provisions are also conspicuously absent from the trade rules and play no role in the resolution of cases. In the main, these private legal systems have adopted a highly textualist approach to contractual adjudication.

Although there are a number of reasons that the costs of textualism may be lower in private legal systems than in the public legal system, the consistency of this preference across most merchant-run systems suggests that at the time the Code was adopted, merchant transactors preferred clear, definite, and specific rules together with a formalistic adjudicative approach. Indeed, at the New York Law Reform Commission's hearings on the adoption of Article 2, representatives of the Commerce and Industry Association specifically objected to some of the Code's most contextualist provisions. They objected to its lax formation rules and its lenient statute of frauds on the grounds that "you may find you have an unintended contract on your hands even



though the ‘memorandum’ concerning a ‘sale omits all of the following: price, time and place of payment, time and place of delivery, general quality of goods, and warranties!’<sup>xcvi</sup> They also opposed the Code’s non-waiveable obligations of good faith, commercial reasonableness and reasonable care, explaining that looking to these considerations will “not tend to greater precision in the law . . . the determination will result in much litigation.”<sup>xcvii</sup> They also strenuously objected to the definition of the merchant’s duty of good faith, explaining that it made “a merchant . . . guilty of breach of contract if he does not observe reasonable commercial standards,” yet “[t]he usages, customs, and practices of business are far from being uniform, and the determination of whether a merchant has conformed to reasonable commercial standards would be difficult and would produce excessive litigation.”<sup>xcviii</sup> Additional examples abound.

Although caution is warranted in abstracting from the trade association context and there are no studies of the frequency with which the contract provisions discussed here are included in commercial agreements, some systematic evidence about whether sophisticated transactors prefer highly contextualist or more formalist adjudicative approaches can be found in studies of choice-of-law provisions in large commercial contracts.<sup>xcix</sup> A recent study looked at whether transactors entering into a variety of types of large commercial agreements (not exclusively sale of goods transactions) preferred to be governed by relatively contextual California law or relatively formalist New York law that is more protective of the terms of written agreements. It found a marked preference for New York law concluding that “the 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. As predicted by theory, sophisticated parties prefer formalistic rules of contract law.”<sup>c</sup> The generality of this conclusion is buttressed by the findings of two studies. One looked at the choice of law provisions in European business transactions subject to ICC arbitration; it found a strong transactor preference for British Law, which is considered the most formalist of the EU countries.<sup>ci</sup> The other surveyed contract managers about the types of contract provisions they thought would be most “proactive in supporting successful relations;” it found that “entirety of agreement clauses,” were the second most common response.<sup>cii</sup>

In sum, the types of contract provisions discussed here, together with the adjudicative approaches of merchant tribunals and the choice of law provisions in corporations’ material contracts, suggest that both

merchant transactors engaged in the sale of cash commodities and sophisticated transactors entering into complex supply chain transactions attempt to reject the Code's contextualist adjudicative approach. In its place, transactors attempt to contract for an interpretive approach that both gives primacy to the terms of their written agreement and protects those terms from erosion,<sup>ciii</sup> modification, or waiver through the actions, inactions, and communications (both written and oral) of either transactors' employees that occurred before and after their written agreement was signed.

It is impossible to determine from the empirical evidence currently available whether contextualism or formalism is a majoritarian preference. The evidence discussed here, however, is nonetheless strong enough to suggest that transactors do not have a uniform preference for contextual adjudication. Together with the theoretical arguments presented below, this evidence suggests that the Code's adjudicative approach, which is, in practice, a quasi-mandatory rule rather than a pure default rule, should be turned into a pure default that transactors can opt out of either on a contract-by-contract basis, or as some commentators have suggested, a term-by-term basis.<sup>civ</sup>

## II. CONTEXTUALISM AND THE MODERN ECONOMY

Over the past few decades the structure of important sectors of American businesses have undergone a shift from large vertically integrated concerns to large multi-agent firms who keep only their "core competencies" in house. These firms outsource the production of important components of their products, many of which are specially manufactured and thus involve specific investment. A number of these firms also adopt some variant of just-in-time inventory practices. This section explores the uneasy fit between these types of supply relationships and the jurisprudence of the Code. It begins by suggesting that the Code's contextualized adjudicative approach is ill-suited to these transactions for many of the same reasons that it is ill-suited to the simple merchant transactions in industries that have created private legal systems—it stifles work-a-day flexibility, prevents firms from contracting using their preferred mix of legal and extralegal terms, and facilitates strategic behavior. It then identifies additional respects in which the Code is particularly ill-suited to transactions among multi-agent firms paying special attention to its impact on intra-firm agency costs, intra-firm information costs, operational costs, and the costs of entering into contracts for innovation.

### *A. Flexibility*

The Code's provisions on course of dealing and course of performance were designed to encourage work-a-day contractual flexibility; yet they are likely to have precisely the opposite effect. In the course of business operations, there are adjustments that transactors find it worthwhile to make at a particular point in time that they would, for any of a number of reasons, be unwilling to promise to make in a legally enforceable agreement. Sometimes these adjustments implicitly condition on information that is observable but not verifiable (such as whether or not one's contracting partner is trustworthy). Other times they simply reflect on the spot compromises that seem reasonable (or necessary) to the employee making them at the time they are made, but that might not be desirable on a go forward basis under all circumstances. Because the Code creates a risk that these actions, if taken more than twice, will be considered binding courses of performance or dealing (or, at a minimum, be looked to understand what the parties intended their written agreement to mean), transactors are less likely than they would be in a more formalist system to behave flexibly and make value creating on the spot adjustments; they know that if they do so and a dispute arises, they may no longer have a right to insist on compliance with their contract's written terms.

Under the Code, firms can take action to reduce this risk by sending letters stating that any concessions are on a one-time basis only. However, to ensure that letters were sent where needed, firms would have to educate employees at many levels of their organization about the terms of the firm's written agreements (so they would at least be aware when they do something non-conforming). This process would be quite expensive. The firm would also have to put monitoring systems in place to ensure that actions at variance with the contract's written terms were detected and the proper letters sent. In addition, in certain types of contractual relationships (such as highly personal long standing relationships between smaller firms), the sending of these letters might result in significant relational costs.<sup>cv</sup> Recognizing the costs and difficulty of making these decisions on an occurrence-by-occurrence basis helps explain the ubiquity of anti-waiver provisions in these agreements.

In recent years, however, firms have begun to use automated systems to detect certain types of deviations from the contracts written terms and generate these letters automatically. For example, many big box retailers have programmed their contract administration software to generate these notices whenever a delivery ticket is scanned into the system that indicates a delivery is late or the quantity on the ticket does not match the quantity in the relevant purchase order. The

depersonalized nature of these letters and the widespread adoption of this software has made the sending of these notices so routine that they no longer seem to result in relational costs.

*B. Preferred Mix of Legal and Extralegal Terms*

In some contracting contexts (often, though not exclusively, when reputation information is widely available) parties may find it desirable to supplement the terms of their written legally enforceable contracts with extralegal commitments backed only by reputation bonds and other types of nonlegal sanctions. These commitments can add significant value to transactions. For example, in certain types of feed transactions where reputation is important, contracts often specify that a federal weight must be obtained at the shipment's destination. However, actually getting a federal weight is both time-consuming and expensive. As a consequence, transactors who trust one another often agree to waive this requirement and use one another's in house weights so long as each believes the other is acting in good faith. If one or the other becomes suspicious, they can simply demand a return to the contract's written terms, confident that in the event of a dispute the industry's private legal system will not find their course of conduct to have altered the terms of their written agreement. If, however, these transactions were covered by Code, the parties would be much less likely to enter into these value creating extralegal agreements, since the Code would likely wind up enforcing them in the event of a dispute.

An example of a value creating extralegal commitment in the context of the modern supply chain can be found in buyers' written commitments to provide their suppliers with regularly updated forecasts of their purchasing needs, while at the same making it abundantly clear in their contracts, service level agreements, and vendor guides that these forecasts are not to be relied on, are not guaranteed to be accurate, and do not commit the buyer firm to purchase a specified or even any amount of goods.<sup>cvii</sup> This type of extralegal commitment creates value by enabling the seller to engage in better planning and giving the buyer greater confidence that the seller will produce enough to meet its orders in a timely fashion; yet it is precisely the type of commitment a buyer would be much less likely to make, were it legally enforceable. Additional examples of value creating but legally unenforceable commitments in business relationships are common.<sup>cvii</sup>

The significance of preventing transactors from structuring their contracting relationship using their preferred mix of legally enforceable and legally unenforceable terms depends on the contracting context. In the context of discrete one-time contracts for the purchase of standard

goods in a market the buyer rarely enters, the loss may be small or non-existent. In contrast, in markets where reputation information is widely available and parties deal with one another or within a segment of a market on a repeat basis over a long period of time, the losses occasioned by Code's adjudicative approach may be significant.

### C. Strategic Behavior Costs

Neoformalist scholars<sup>cviii</sup> writing in the law and economics tradition have suggested that the Code's contextualized approach to interpretation together with its trade usage provision encourage strategic behavior by enabling a party who is seemingly disadvantaged by the ordinary meaning of a contract's explicit terms to strategically claim that the contract was written in an industry-specific (usage-based) "private language" that favors his position.<sup>cx</sup> They argue that replacing the Code's quasi-mandatory contextualist interpretive approach with a textualist default (which they maintain is the clear majoritarian preference), while permitting transactors to explicitly opt into contextualism, will largely eliminate this type behavior. When textualism is the default, transactors who want a court to look to a private language will have to specify this choice *ex-ante*; if they don't they will be barred from raising this type of argument *ex-post*. The rule will therefore eliminate purely strategic *ex-post* claims that the contract was written in a private language. At the same time, it will enable transactors who genuinely want a court to interpret their contract on the assumption that it was written in a private language to easily select this option simply by including a provision saying something like: "this contract is to be governed by the usages in the widget industry," a provision that under the proposed approach would be summarily enforced.

Although this proposed switch to a textualist default would largely eliminate private language-related strategic behavior when transactors opt for textualism, it will not (as some theorists suggest)<sup>cx</sup> do so as effectively when parties opt for contextualism, even if they include a clause specifying the private language in which their contract is written. As the case studies of codification revealed, even within highly local areas, and trades narrowly defined, there is much disagreement about the meaning of even basic terms of trade. Consequently, unless the private language selected is codified in written set of rules (such as the Incoterms) *ex-post* a party will almost always be able to plausibly assert the existence of a different private meaning that supports his interpretation, thus reintroducing the strategic behavior problem.<sup>cx</sup>

Nevertheless, the adoption of a textualist default is superior to the current quasi-mandatory contextualist interpretive regime for several reasons. First, it is far less costly for transactors who want contextualized adjudication to include a provision opting for it than it is for transactors who want to opt out of the Code's approach to do so (even to the arguably limited extent that this is possible).<sup>cxii</sup> Second, requiring transactors to opt in to a private language alerts them to what they are doing and creates an incentive for them to specify the particular private language they are choosing. Although, as noted above, they will still be able to engage in strategic behavior as to private meanings, making this designation may at least partially cabin the range of private meanings they can plausibly assert. This suggests that strategic behavior costs may be lower and, in any event, are unlikely to be higher, than they are under the present rule. Third, reversing the default will eliminate issues surrounding the question of whether a transactor knew or had a reason to know the content of these private languages, since the issue will be resolved by contract. Finally, if neoformalist theorists are correct that businesses prefer a textualist default (which can be defined in many ways other than the caricature of plain meaning or "hard literalism" asserted by most contextualists as the relevant alternative),<sup>cxiii</sup> the interpretive default approach of commercial law will again reflect majoritarian preferences.

The benefits of adopting a more textualist default rule are even greater once the effects of the new rule on motions for summary judgment are taken into account. As the study of usage in the courts discussed above revealed, under the Code's approach, even if a private language does not exist, a party can claim it does, introduce nothing more than a cursory affidavit from one of his employees asserting its existence, and thereby (with a significantly high probability) defeat a motion for summary judgment, a move that greatly reduces the settlement value of a claim<sup>cxiv</sup> as well as the value of any judgment the moving party eventually receives. Under the textualist default, in contrast, transactors opting for textualism will have more ready access to summary judgment, and for those who prefer contextualism summary judgment will be no less available than it is under the current interpretive regime.

A final benefit of the proposed change to a textualist interpretive default and the one that is most important to the law's ability to adapt to support complex private commercial contracting, is that when transactors opt for textualism, the return they receive from careful contractual drafting will increase because the terms they write will be enforced as written and will not eroded or undermined by usage based

interpretation. Although the Code's hierarchy of authority states that express terms trump conflicting usages, in practice courts routinely permit usages to override or erode written provisions. Usages are commonly found to be "consistent" with seemingly contrary express provision unless the usage is found to "totally negate" the express provision,<sup>cxv</sup> a finding that is very rarely made. As one court observed, "[i]n 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, so long as it does not totally negate it."<sup>cxvi</sup> And, as another explained "the trend has been for judges, looking beyond written contract terms to reach the 'true understanding' of the parties, to extend themselves to reconcile trade usage and course of dealing with seemingly contradictory express terms. They have permitted course of dealing and usage of trade to add terms, cut down or subtract terms, or lend special meaning to contract language."<sup>cxvii</sup> By removing the interpretive discount on written terms, the neoformalist proposal will increase the return to contract drafting, which will likely lead to clearer contracts, fewer disputes occasioned by misunderstandings, and a decrease in the social costs of disputing.

Contextualists oppose a shift to a more textualist default on the grounds that it will greatly increase the specification costs of entering to a contract because transactors will choose to spell out more aspects of their agreement. However, the widespread use of master agreements, standard purchase orders, and detailed vendor guides (which are routinely incorporated into contracts), together with the availability of model contracts from both the internet and law firms specializing in particular sorts of outsourcing contracts (such as technology outsourcing), suggests that any increase is likely to be small on a per contract basis. The shift in default rule will also decrease the specification costs occasioned by transactors' desire to fortify their contracts against contextualist interpretation, a saving that may not be insignificant. Finally, as discussed further below, once it is recognized that firms need to memorialize both the explicit and implicit terms of their agreements in writing so that they can be disseminated throughout the firm's organizational hierarchy, it becomes clear that any savings from omitting terms in the contract between the parties is likely to be slight.

Wholly apart from its effects on drafting costs, a switch to a more formalist default rule may produce a variety of other cost savings and

transactional benefits for firms, many of which stem from enabling them to use both legal and extra legal commitments and sanctions to structure their transactional relationship. In addition, as discussed further below, the availability of a textualist default will save firms the cost of adopting a variety of agency cost reduction mechanisms that the Code's contextualism makes it necessary for them to implement and will enable them to adapt more effective and less expensive contract governance structures.<sup>cxviii</sup>

More generally, an interpretive approach that encourages transactors to invest in improving their written contracts will do more to support trade in the face of changing conditions and complex interdependent agreements than any system based on the incorporation of gradually evolving usages. As the case studies discussed above revealed, convergent understandings of trade usages are slow to evolve and consensus on the meaning of terms and industry practices is difficult to achieve even through negotiation among industry participants. This process is especially slow and difficult in contexts where the relevant usages apply to transactions across stages in a chain of production and distribution. Given these difficulties, the complexity of modern outsourcing transactions, and the fact that these transactions typically take place between large multi-agent firms (an aspect of these transactions discussed further below) the evolution of usages related to outsourcing transactions is likely be highly problematic, making the Code a poor vehicle for responding to the contract governance challenges these transactions create.

#### D. *Intra-Firm Agency Costs*

In thinking about the ability of the Code to support contractual relationships between multi-agent firms, it is important to focus not only on how the Code affects the costs of firm A dealing with firm B, but also the way these considerations affect the intra-firm agency and transactions costs *within* firm A and *within* firm B. These intra-firm costs are not part of the standard analysis of the costs and benefits of different types of contract rules and interpretive approaches—which typically compare the effect of a particular approach on specification costs and litigation costs respectively-- and have received only sporadic mention in the legal literature.<sup>cxix</sup> However, they need to be systematically taken into account in any future efforts at legal reform. As the examples below illustrate, the functional consequences of contextualist adjudication for the management and operation of multi-agent firms may be significant.

To get a feel for the way the Code creates and/or exacerbates internal firm agency costs, consider its provision on contract formation which



states that “a contract for the sale of goods may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of such a contract.”<sup>cxx</sup> This provision creates a risk that an employee may, through her words, actions, and/or written communications, knowingly or unknowingly bind the firm to contractual obligations. Large firms routinely hold seminars to educate employees about this aspect of the Code in an effort to prevent them from inadvertently binding the firm. In addition, given the especially large financial exposure the Code’s formation rules create, firms also attempt to control this risk through explicit contractual provisions.

One common method is for the buyer-firm to post a Master Agreement (or a set of Standard Terms and Conditions) on its supplier portal web site along with a prominent statement that these are the only terms on which it will do business.<sup>cxxi</sup> These agreements typically set forth an exhaustive list of the ways the buyer-firm is and is not willing to enter into binding agreements. For example, Dollar General’s Master Agreement states that “in no event will an e-mail or other communication, regardless of its content, that is not a signed paper purchase Order or electronic Order issued via Buyer’s EDI system, constitute an Order for the purposes of this Agreement . . . [Neither] Buyer and/or its affiliates have any obligation or liability with respect to such an email or other communication.”<sup>cxxii</sup> In addition to limiting its exposure when its employees fail to stay in line with the company’s contracting policies, this provision shifts the burden of monitoring compliance with the company’s policy to its vendors—because vendors will not be paid for unauthorized orders, they have an incentive to closely monitor the province of the orders they do receive.

Firms also use these master agreements/standard terms to attempt to opt out of the Code’s battle-of-the-forms provision, a provision that also gives rise to agency problems within both buyer and seller firms.<sup>cxxiii</sup> These agreements typically categorically reject any additional or different terms that might be introduced by a trading partner’s standard forms, the firm’s own service level agreements and purchase orders, or any oral or side understandings. They state very clearly that the firm will not do business on any terms other than their standard posted terms. Although this approach is likely to be effective when the transactors have both signed a master agreement or only one of them has posted a master agreement or set of terms and conditions on the web, it is not uncommon for both buyers and sellers to both post similar statements, a practice that simply recreates the potential for a battle-of-the-forms when the website of suppliers and buyers conflict.

The Code's course of dealing and course of performance provisions create analytically similar agency problems in the performance phase of an agreement. Together they give a firm's employees the power to modify, waive, and alter the meaning of the firm's written contracts; they can do this through their words, their written exchanges with their counterparty, their actions, and their inactions. Large multi-agent firms are highly unlikely to want their employees to have this power. These firms go to extraordinary lengths to adopt explicit written internal policies that carefully articulate the contours of the explicit contractual authority (if any) delegated to managers/employees at different levels of the corporate hierarchy.<sup>cxxiv</sup> Given these (costly) efforts to control the explicit contracting authority of their employees, it seems highly unlikely that these firms would want their employees to be empowered to do indirectly what they are explicitly prohibited from doing directly. Indeed, the difficulty firms face in trying to eliminate the risk of employees affecting the legal meaning of their written contracts, may be one reason for the ubiquity of anti-waiver, anti-modification, and merger/integration clauses in these agreements. However, the interpretive protection offered by these clauses (even in jurisdictions where they are enforceable) is far from complete. Well-drawn clauses may prevent employee's actions from modifying or waiving contractual provisions, but the actions of a firm's agents will remain relevant to interpreting the meaning of the firm's contract if a court find a contract provision to be ambiguous. In addition, while "entire agreement" clauses sometimes try to make these considerations irrelevant to contract interpretation generally, the enforceability of this aspect of these provisions does not appear to have been tested.

Other Code provisions may introduce agency problems that are even more difficult to eliminate or reduce through intra-firm policies or contractual provisions. For example, the Code's provision on demands for adequate assurance of performance can be triggered by the off-hand remarks of an employee indicating financial problems at the firm or the mention of problems the company is having in a contract with an entirely other firm. Similarly, the time for cure may extended beyond the delivery date if the seller makes a nonconforming tender but had a reasonable belief (perhaps based on comments from the buyer's personnel) that it would be acceptable to the buyer with or without a price adjustment. The applicability of these code provisions can be triggered by a wide variety of statements by employees at many levels of a firm's organizational structure and is difficult to control through intra-firm monitoring and/or company policies. As a consequence, to guard against the significant legal implications of statements made by its employees, firms might find it necessary to limit employee access to

information that it might otherwise be desirable for employees to have. Alternatively, within limits, transactors might be able to contract for a limited and exclusive list of events that may trigger a demand for adequate assurances and/or can try to contract out of the Code's cure provisions.<sup>cxxv</sup>

More generally, recognizing the existence of these intra-firm agency costs suggests that in assessing the costs of contextualism, it is important to take into account the costs, including the inflexibility costs, oversight costs, and information flow costs, of the policies, contract provisions, and other mechanisms firms must adopt if they want, as most business concerns do, to control the existence, performance and meaning of their contracts.

### *E. Information Costs*

Within large multi-agent firms, the people entering into contracts are not, for the most part those who carry them out. In order for a deal to be administered within a large organization, the purchasing managers and their subordinates in the buyer's organization, as well as the selling agents and production managers in the seller's organization, all have to understand the quality, quantity, and delivery specifications (including timing, packaging and labeling) of the contract. The "key to a successful outcome," is said to be "carrying out a detailed contract handover session from the bid/negotiation team to the post-award management team."<sup>cxxvi</sup>

According to the International Association for Contract and Commercial Management, "for a complex outsourcing contract . . . this might be a half a day of the pre-award and post award teams sitting together in a meeting room, each with a copy of the contract, going through page by page."<sup>cxxvii</sup> In addition, the bid/negotiation team is advised to provide a great deal of background on the deal. This is often viewed as "more important than handing over documents," because "the interpretation and history of how we ended up where we did in negotiations is key to understanding the risks and opportunities arising and which need to be managed during contract management."<sup>cxxviii</sup> They will also, in the absence of a contract provision to the contrary, have to recount any prior courses of dealing between the parties, something that will be costly and, in the event of a change in personnel, also quite difficult to do with accuracy.

Incident to these handover sessions, and in recognition of the fact that the oral communication of this information about contract terms is subject to considerable error, most firms require the bid/negotiation team to fill out a template form summarizing the key terms of the deal

from various financial and operational perspectives.<sup>cxxix</sup> As a consequence, even if the principals to the contracting relationship had implicit understandings based on usages of trade or prior courses of dealing, or were simply willing to let the Code's context dependant default rules fill the gaps in their agreement, they would still need to memorialize many of these understandings in writing as part of the contract hand-off process, thereby greatly reducing any specification cost saving benefits created by the Code's gap-fillers and its contextualized interpretive approach.

Moreover, because firms are aware that this type of deal hand-off process will be followed, they will have an increased incentive to include these understandings in their writings. The marginal cost of including them in the contract over and above the cost of memorializing them for its own employees will be small, at least with respect to many types of provisions, such as those related to operational specifications and acceptable deviations from quality/quantity provisions. In addition, as contract coding software (that enables users to pull up all operational specifications, all financial specification, or all production metrics with one mouse click) comes into wider use, the contract provisions dealing with these aspects of the deal can be captured by the software and provided directly to operations, thus creating a cheaper more seamless transfer of information that is both less expensive and less prone to error, than the current contract hand-off process.

Indeed, even with all of the efforts firms make to disseminate contract information through these detailed handover sessions, firms report that among those charged with implementing contracts, there remains a well-documented "lack of consensus over what constitutes the contract," and the extent to which it includes emails, oral communications, SOW [scope of work], SLAs [service level agreement] as well as invoices, operational reports, and other communications within and between firms."<sup>cxxx</sup> This confusion, which contract managers work hard to eliminate, is nonetheless entirely understandable given the Codes broad definition of agreement and its lax parol evidence rule.

More generally, the need for the terms of a contract to be disseminated through various levels of a firm's hierarchy suggests that contrary to the implicit assumption of contextualists, the principals to a transaction and the court are not the only audiences for the contract's language. Indeed, taking into account the need to inform agents of the contract's content undermines contextualists main defense of the methods cost saving benefits—namely, that transactors will save on specification costs by relying on default rules and usages rather than spelling out their understandings in explicit contract provisions, while

any increased litigation costs contextualism may create will only be incurred if a dispute goes to court, something that occurs with a low probability.<sup>cxxxii</sup> Once the cost of the bid/negotiation team summarizing and describing to the operations team what a contract that relies on usages and default rules actually requires is taken into account, most if not all of the specification cost savings from the availability of contextualist defaults is likely to disappear. Moreover, given the uncertainty introduced when translating the tacit elements of the transaction into the firm's template term sheet, and the greater likelihood that a dispute will arise due to a misunderstanding of what the contract requires, it is also important recognize that when transactors rely on the availability of the Code's defaults and trade usages, the likelihood of a dispute requiring court adjudication also increases.

#### *F. Operational Costs*

Many large organizations adopt contracting policies that are not tailored to individual agreements, but rather are optimized over a larger set of the firms contracting relationships. Large big box retailers for example, typically memorialize their policies in vendor guides which apply to the vast majority of the firm's routine transactions. These guides cover the extent of permitted quality deviations, what constitutes on time delivery, the types of paper work and SKU codes that must be used, and dozens of different dimensions of logistics (which have a significant impact on the profitability of a deal). The policies set forth in these guides are optimized over a large number of the company's contracts; they are not tailored to the purchase of any particular input and do not take into account usages of trade that might exist in particular industries. As a consequence, if a dispute were to arise and go to court, it would be open to the seller to argue that the buyer is a merchant in the type of goods at issue and should be bound to the usages common in the trade; that the seller's specifications are unreasonable applied as to the transaction at issue; or that the usage is relevant to interpreting the contracts written provisions, even if they are not ambiguous.<sup>cxxxii</sup> These concerns are quite real to firms; as the Target Master Vendor Agreement states: "Regardless of industry standards, no variances with respect to quality, quantity, size, capacity, volume, content or other standard measure of Goods are allowed."<sup>cxxxiii</sup>

More generally, there a fundamental tension between the Code which looks at the usages related to the particular contract at issue, and the policies of large firms, which are developed to be optimal over a large number of contracts that may involve a variety of markets with vastly different practices. Moreover, given the number of individuals within the corporate hierarchy who would have to have actual

knowledge of usages in order to operationalize them, the cost to bigger entities of usages being read into their agreements is potentially large.

### *G. Innovation Costs*

Contract theorists, writing about the economics of supply chain relationships, have suggested that many such contracts involve “contracting for innovation,”<sup>cxxxiv</sup> which they describe as a situation where the transactors’ relationship is not mediated “by fully specified explicit contracts . . . nor by entirely implicit relational contracts supported only by the norms of reciprocity and the expectation of future dealings.”<sup>cxxxv</sup> Rather, in these contracting contexts, “the explicit and implicit obligations interact within a formal governance structure that regulates the exchange of highly revealing information but does not necessarily impose legally enforceable obligations to buy or sell anything,” and thereby supports “iterative collaboration between firms [in creating or improving products and systems] by interweaving explicit and implicit terms that respond to the uncertainty inherent in the innovation process.”<sup>cxxxvi</sup> The success or failure of these ventures is said to depend critically on the parties’ ability to achieve deliberate and delicate “braiding”<sup>cxxxvii</sup> of legal and extralegal obligations and sanctions.

Given the structure and operation of these collaborative ventures, the Code’s adjudicative approach (which as discussed above transforms many legally unenforceable aspects of the transactors’ agreement into legally enforceable contract provisions and many of their work-a-day actions into legally enforceable obligations) is likely to both increase the cost and impair the operation of these types of contracting relationships. Among other things, it will decrease the work-a-day flexibility and free flow of information that is essential to the success of such ventures and greatly increase the likelihood that courts will make interpretive errors when disputes arise. As innovation theorists have noted, the Code’s course of dealing and course of performance provisions undermine collaborative activities, because “there is a constant risk that a collaborators’ experimentation will be interpreted as a modification of the contract,”<sup>cxxxviii</sup> and errors are likely since “courts [will] have insufficient information from which to glean patterns in the disputants’ behavior,” given the “[t]he constant experimentation that generative contracts institutionalize.”<sup>cxxxix</sup> The Code’s usage of trade provision is viewed as similarly disruptive to contracting relationships (especially if, as the evidence presented above suggests, the information base available to the court to distinguish extant from non-existent usages is thin) because the invocation of concepts like “trade usage, which use 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.”<sup>cxl</sup> In addition, and perhaps most importantly, the Code’s overall contextualized approach will increase the cost of entering into “contracts for innovation,” as parties will need to use both complex agreements (with many clauses whose legal enforceability is doubtful) that are costly to draft and adapt to the particular context, as well as detailed governance structures to create zones of collaborative interaction that can operate free from legal intervention.

In sum, the types of conceptual, institutional and operational considerations discussed here, along with a recognition of the role nonlegal sanctions and extralegal agreements and adjustments can play in even the most complex and institutionalized agreements, suggests that the contextualized jurisprudence of the Code is unlikely to qualify as a majoritarian default rule in a 21<sup>st</sup> century, highly outsourced economy. The Code’s adjudicative approach has the effect of both undermining the value of written contracts and impeding the creation and implementation of institutional structures that are designed to create zones of contracting behavior that operate free from judicial oversight or legal consequences yet nevertheless add tremendous value to some of the simplest and most complex contracting relationships alike.

Industries and firms have devised a sophisticated array of methods for minimizing or avoiding the effect of the Code’s default rules and adjudicative approach and increasing the value of the terms of their written contracts. These range from the private legal systems and trading rules created by trade associations in merchant industries, to a variety of mechanisms used in more complex outsourcing transactions that enable transactors to conduct important parts of their contracting relationships largely (though not entirely) outside of the shadow of the legal system. These mechanisms include: supplier qualification processes and vendor scorecard programs that are used to create nonlegal sanctions and harness the forces of the folk theorem of iterative games to support cooperative contracting relationships; the creation of interior remedies in SLAs and easy to exercise termination rights in Master Agreements that provide parties with “self-help” options that reduce the need to rely on legal remedies for breach of contract; and a variety of mechanisms (such as audit rights<sup>cxli</sup> and the right to demand a root cause analysis<sup>cxlii</sup>) designed to enable buyers to determine (without filing a suit for breach of contracting and engaging in civil discovery) whether problems that arise over the life of the contract reflect failed attempts at cooperation or deliberate acts of defection. Although these contracting practices and structures might survive even if the law were moved in the direction of giving greater primacy to written contracts

and respecting transactors' desire for freedom from contract (for the law is limited in its ability to create value for contracting parties), such a change is nevertheless important to the future success of American business. It would not only reduce the agency costs, operational costs, and information costs within firms, but would also eliminate some of the inflexibility costs created by firms attempts to minimize the negative effect of the Code on their operations. More generally, while the type of change contemplated might not entirely eliminate some of the institutional structures, contractual arrangements, and operational processes that were created to better support trade in the shadow of the Code, it would very likely improve their functioning and enable firms and industries to adopt them at a far lower cost than they can in the shadow of the Code.

### CONCLUSION

This essay has explored the questionable empirical basis of the Code's adjudicative architecture. It has also suggested that even if the Code worked in practice the way Llewellyn and modern day incorporationists thought it would work in theory, its highly contextualized adjudicative approach, its reliance on unwritten usages, and its insistence that parties actions under a contract are the best indication of what they intend their writing to mean, would make the Code ill-suited to the needs of important sectors of the modern, highly outsourced, economy, even if it were extensively amended.

These reasons for suggesting that the Code's "machinery" for adapting to change is broken, and that an entirely new approach to the content and theory of sales law is required, are curiously parallel to Llewellyn's reasons for advocating the adoption of an entirely new commercial code rather than proposing extensive amendments to the Uniform Sales Act. As Llewellyn explained, the Sales Act was based on "concepts that took shape on the basis of a face-to-face dealing with present goods," whereas the American economy in the 1920's and 1930's was increasingly dominated by the emergence of a "nationwide indirect marketing structure" in which most contracts were executory and a large portion of trade was mediated by brokers and factors of various sorts. Llewellyn concluded that these structural changes were so significant that the "present trends and present needs" of commerce could not be met through amendments to the Sales Act, but rather required a fundamental reconceptualization of the role of law in commercial life and the adoption of a statute that was responsive to and reflective of those changes.



The ground up reimagining of sales law suggested here would require reformers to recognize that the contracts play many roles in transactions (especially in multi-agent firms) beyond merely regulating the terms of exchange *between* the parties and providing rules in the event of a dispute. They play a significant role in influencing the information flow throughout the firm's organizational hierarchy and provide a framework that enables firms to use the law to create contract governance structures that use interior remedies and nonlegal sanctions much as trade association-run private legal systems do, thereby creating flexible, cooperative contractual relationships that are capable of meeting the needs for precision in quality and timing, as well as the need to respond to changes and make corrections mid course, that are the hallmarks of successful manufacturing outsourcing transactions.

Most fundamentally, however, reformers would have to accept that the institutional structures created by market transactors are far more likely to respond efficiently to changes in business needs than are unwritten customs and judicial conceptions of commerce. This is especially true if the institutions are free to adopt their own rules and courts give primacy to the terms of written agreements, turning to other considerations only in the case of a true contractual gap, narrowly defined. Just as the medieval law merchant of bills and notes--the only law merchant that ever really existed--evolved from the use and adaption of standard-form contracts over time, aided by the rise of institutions like notaries and registrars,<sup>cxliii</sup> so too American commercial law can best and most quickly adapt to the changes it must confront now and in the future, by recognizing the central importance of enforcing the explicit written terms of private agreements and encouraging the emergence and endurance of private institutions that support trade.

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\* Wilson Dickensen Professor of Law, The University of Chicago Law School. I would like to thank Brian Bix, Patrick Barry, Robin Effron, Emily Kadens, Shai Dothan, Matthew Jennejohn, Avery Katz, Steve Burton, Tim Cummins, Nicole DeHorasis, Jean Braucher, Stewart Macaulay, Brad Peterson, Connie Fleisher, Margaret Schilt, Hagay Volvovsky, Bill Schwesig, Margaret Schilt, Sean Ghoetz, Douglas Baird, David Zarfes, Richard Epstein, and Philip Hamburger for interesting comments and conversations. Portions of the research discussed here were sponsored by NSF Grant SBR-9422795.

<sup>i</sup> U.C.C. § 1-102(2)(b).

<sup>ii</sup> U.C.C. § 1-102(b) and Cmt. 1.

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- iii Ronald J. Gilson, Charles F. Sable, & Robert E. Scott, *Contracting for Innovation: Vertical Disintegration and Interfirm Collaboration*, 109 COLUM. L. REV. 431 (2009) [hereinafter *Innovation*].
- iv Walter D. Malcom, *The Proposed Commercial Code*, 6 BUS. LAW. 113, 126 (1951) (quoting the report of the Committee on the Proposed Commercial Code).
- v *Id.*
- vi WILLIAM TWINING, KARL LLEWELLYN AND THE REALIST MOVEMENT 316 (1973).
- vii See James Q. Whitman, *Commercial Law and the American Volk: A Note on Llewellyn's German Sources for the Uniform Commercial Code*, 97 YALE L. J. 156 (1987)(concluding that Llewellyn's thinking was deeply influenced by the account of the law merchant given by Levin Goldschmidt.)
- viii Twining, *supra* note 6, at 316.
- ix *Id.*
- x *Id.* at 319.
- xi The idea of the law merchant continues to influence American commercial law. See e.g., revised U.C.C. § 1-103 cmt 1 (“[a]pplication of the Code ... may be justified by. . . the fact that it is in large part a reformulation and restatement of the law merchant”).
- xii See, *Report and Second Draft: The Revised Uniform Sales Act* (1941) at Sec. 59, reprinted in ELIZABETH SLUSSER KELLEY ED., UNIFORM COMERICAL CODE: DRAFTS (1984).
- xiii Homer Kripke, *The Principles Underlying the Drafting of the Uniform Commercial Code*, 1962 U. ILL. L. F. 321, 331 (1962).
- xiv See also Celia Wasserstein Fassberg, *Lex Mercatoria: Hoist With Its Own Petard?*, 5 CHI. J. INT’L L. 67 (2004) (The “idyllic image of an international community of merchants interacting on the basis of shared values,” cannot be reconciled with the historical evidence that “the law merchant was not substantive, but rather procedural law, that it was neither transnational nor personal, [and] that it was very probably not customary.”)
- xv See Charles Donahue Jr., *Medieval and Early Modern Lex Mercatoria: An Attempt at the Probatio Diabolica*, 5 CHI. J. INT’L L. 21, 37, nn 8 (2004)(arguing that the account of the law merchant given by Levin Goldschmidt was highly inaccurate).
- xvi Emily Kadens, *The Myth of the Customary Law Merchant*, 90 TEX. L. REV. 1153, 1177 (2012); accord Donahue, *supra* note 15, at 36 (“[t]hese customs did not add up to a mercantile legal system”).
- xvii Lisa Bernstein, *The Questionable Empirical Basis of Article 2's Incorporation Strategy: A Preliminary Study*, 66 U. CHI. L. REV. 710 (1999)[hereinafter, *Questionable Basis*].

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<sup>xviii</sup> *Id.* at 720 (citing, National Hay Association, Report of the Eighteenth Annual Convention 3 (1911)).

<sup>xix</sup> *Id.* at 721 (citing, National Hay Association, Report of the Fourth Annual Meeting, 40 (1897)).

<sup>xx</sup> *Id.*

<sup>xxi</sup> *Id.* at 722 citing National Hay Association, Report of the Sixteenth Annual Convention 229 (1909).

<sup>xxii</sup> *Id.* at 727 (citing Minutes of Meetings, *The Secretary's Book* (Nov. 9, 1896)).

<sup>xxiii</sup> *Id.* at 728 (citing, Trade Rules: The Chairman Replies, 17 *Who's Who in the Grain Trade*, 28-29 (Feb. 20, 1923-24)

<sup>xxiv</sup> *Id.* at 732

<sup>xxv</sup> *Id.* at 739 (citing Silk Association of America, Annual Report. 145 (1914)

<sup>xxvi</sup> *Id.* at 739

<sup>xxvii</sup> *Id.* at 719-40.

<sup>xxviii</sup> *See, e.g.*, American Fats and Oils Association, *By Laws of the American Fats and Oils Association, Inc.*, art. I, § I (1994) (noting that a goal of the organization is to “work towards uniformity and certainty in the standards of such products and in the customs and usages of the trade”); American Spice Trade Association, *Handbook of the American Spice Trade Association*, bylaws, art. I, § 2 (1925) (“The object of this Association shall be to maintain just and equitable principles and establish uniformity of commercial usage among its members . . .”); Baltimore Butter & Egg Exchange Inc., 15 *Butter, Cheese and Egg Journal*, no. 26, 17 (1924) (noting that an important function of the group is “to promote uniformity in the customs and usages of trade”); Association of Food Industries, *Constitution and Bylaws*, art. III (1992) ( noting that one purpose of the association is to “seek uniformity and certainty in the customs and usage of the trade”); National Hay Association, *Constitution and By-Laws Preamble*, reprinted in Report of the Second Annual Meeting 29 (1985) (a goal of the association is to “use our best efforts to have established and maintained a uniformity in commercial usages and in the grades of hay and straw in the different markets of the country”); 51 *The Tea and Coffee Trade Journal*, 321 n.3 (1926) (noting that the Tea Association of the United States was formed in part to “procure uniformity and certainty in the customs and usages of said trade and commerce, [and] to settle differences between the members of the association”); 43 *The Tea and Coffee Trade Journal* 207-208 n.2 (1922) (The Green Coffee Association of New York was organized in part to “establish uniformity of commercial usage among its members . . . and to adjust controversies and misunderstandings.”).

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xxix CATHERINE MITCHELL, *INTERPRETATION OF CONTRACTS* 122 (Rutledge, 2007).

xxx Jody S. Kraus and Steven D. Walt, *In Defense of the Incorporation Strategy*, in JODY S. KRAUS AND STEVEN D. WALT, ED. *THE JURISPRUDENTIAL FOUNDATIONS OF CORPORATE AND COMMERCIAL LAW* 201 (CAMBRIDGE, 2000). Clayton Gillette, *Harmony and Stasis in Trade Usages for International Trade* 39 VA. J. INT'L L. 707, at nn. 10 (1999) (“[E]ven if some industries [studied by Bernstein] did not have customs, that tells us nothing about industries that might have had customs or about Article 2's application to such industries”); William J. Woodward, *Neoformalism in a Real World of Forms*, 2001 WIS. L. REV. 971, 984 (2001) (“[G]eneralizing from [Bernstein's] observations in discrete, relatively homogeneous business areas to the broad spectrum of contracts covered by the Uniform Commercial Code is unjustified at this point.”)

xxxi See Gillette, *supra* note 30 at nn10

xxiii Kraus and Walt, *supra* note 30 at 202 (“The dearth of uniform, trade wide customs in the early part of the century provides poor evidence that such customs do not exist now.”); See David V. Snyder, *Language and Formalities in Commercial Contracts: A Defense of Custom and Conduct*, 54 SMU. L. REV. 617, 627 (2001) (noting that “there is the problem of extrapolating from codification debates [described by Bernstein] that took place in the first decade or two of the last century,” to the present).

xxiii See, Stewart Macaulay, *Relational Contract Theory: Floating on a Sea of Custom? Thoughts About the Ideas of Ian Macneil and Lisa Bernstein*, 94 NW. U. L. REV., 775, 778 (2000) (The “empirical findings [of Bernstein's studies] raise questions of evidence rather than challenge the entire approach of the U.C.C. Why isn't it enough to say that one who wants to rely on a usage must prove it?”).

xxiv Kraus and Walt, *Supra* note 30.

xxv See Steven L. Harris, *Rules for Interpreting Incomplete Contracts: A Cautionary Note*, 62 LA L. REV. 1279, 1281 (2002) (“anyone with any familiarity with a [contract for the sale of two-by-fours] . . . knows that [the parties did not contemplate] boards that are two inches by four inches”); Macaulay, *supra* note 33, at 787 (an example of business custom is the fact that “if you go to a lumber yard and ask for a ‘two-by-four,’ the board tendered will not measure two inches by four inches. It will be approximately one-and-one half inches by three-and-one half inches”); John E. Murray, Jr., *Contract Theories and the Rise of Neoformalism*, 71 FORDHAM L. REV. 869, 913 (2002) (noting that the “two-by-four” is “an example [of a usage of trade] that has occurred to neoclassicists for the last fifty years”); Snyder, *supra* note 32, at 651, n. 218 (using the fact that a two-by-four does not measure two inches by four inches as an example

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of usage and noting that “this fact can be proved with testimony from people in the trade, not to mention actual two-by-fours, and birdfeeders made to be mounted on two-by-fours”); Franklin G. Snyder, *Clouds of Mystery: Dispelling the Realist Rhetoric of the Uniform Commercial Code*, 68 OHIO ST. L.J. 11, 47 (2007) (noting that “[t]he classic example is the trade usage that says a “two by four” [sic] piece of lumber will actually measure 3.5 x 1.5 inches”).

xxxvi Forest Products Laboratory, Forest Service, U.S. Dept. Agriculture, History of Yard Lumber Size Standard (1964) (hereinafter “Yard Sizes”) at Appendix A

xxxvii *Id.*

xxxviii National Institute of Standards and Technology, Voluntary Product Standard PS 20-10 (2010) Table 4 p. 9.

xxxix ROYAL S. KELLOG, LUMBER AND ITS USES, 4<sup>TH</sup> ED. (Scientific Book Corp. 1931)

xl See *Recommendations as to Standard Sizes and Grades of Lumber Are Explained by the Central Committee*, *The American Lumberman*, 44 (1923)(reporting the results of surveys of twelve sets of trade association rules that included softwood sizing standards for yard lumber).

xli See *Id.* at 44-45 (discussing the considerations the committee’s relied on in defining the nominal designation of size 2-inches, and the nominal designation of size 4-inches)

xlii See WILLIAM CRONON, *NATURE’S METROPOLIS: CHICAGO AND THE GREAT WEST* Ch. 3 (Norton 1991)(noting that cross country trade in grain had emerged by 1840’s).

xliii See Bernstein, *Questionable Basis*, *supra* note 17 at nn. 30.

xliv From 1635-1835, the trade textile trade was centered on New York’s Pearl Street. However, a fire and changes in the real estate market forced it to disperse throughout lower Manhattan. In 1853, the trade decided it should again locate in one geographic area and it chose Worth Street, less than a mile and a half from Pearl Street. The first large merchants moved there in 1857. By 1861 it was recognized as “the primary mill agency market in the United States” and by 1870, it was considered the “textile center” of the country. See FRANK L. WALTON, *TOMAHAWKS TO TEXTILES: THE FABULOUS STORY OF WORTH STREET* (1953), 61, 62, 102, 104.

xlvi See Philip B. Scranton ed., *SILK CITY: STUDIES ON THE PATTERSON SILK INDUSTRY 1860-1940* (1985).

xlvii This survey was conducted and designed by Martha Van Heitsma and Virginia Bartot of the Small Survey Lab at the University of Chicago. The raw data and research protocols for the study are on file with the author (“NORC Survey”).

xlviii Just over half of the firms surveyed had 27 or fewer such partners.

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<sup>xlviii</sup> Fifty-four percent of transactors reported that their contracting relationships usually lasted more than 10 years, 32% reported they lasted five to ten years, and 12% two to five years. Only one firm reported that its relationships tended to last less than two years.

<sup>xlix</sup> Responses to Question 7. Among their Texas trading partners 86% were based in the “Lubbock, Amarillo, Abilene, Wichita Falls” areas, a radius of about 500 miles.

<sup>l</sup> In addition, the majority of firms in the study were quite mature. Sixty percent of the firms had been in business for more than twenty years, while only 10% had been in business less than 6 years.

<sup>li</sup> Interview with Panelists at TGFA Meeting. See also Resp. 81.

<sup>lii</sup> Among the firms surveyed, 68% gave a grace period for new partners, and 72% did so for old partners.

<sup>liii</sup> The mean grace period for a new partner was 13.8 days (with a standard deviation of X days) while for an old partner it was 20.4 days (with a standard deviation of X days).

<sup>liv</sup> See e.g., Resp. 0005 (noting they would give no grace period for a new trading partner, but for an old trading partner it might be 10 days depending on the relationship and the reason,” and would “call up that firm and ask what the problem was. If they have a reason—someone was sick—might possibly extend more time, if no satisfactory answer, turn it over to the credit people in Kansas city”); Respondent 024 (explain his giving at most 4-5 days grace to new and old trading partners alike, but noting that whether they would get it would “depend on the reason” noting that it must be a “reasonable excuse.”); Resp. 025 (grace period, up to 10 days for a new trading partner and up to a month for an old trading partner, “depends on circumstances,” the “action [I take] depends on the explanation given by the trader.”); Resp. 029 (“[R]eally depends on circumstance, judgment call”); Resp. 030 (if time for payment passed “I’d be knocking on his door or ringing his bell,” and action “could depend on what he’d say”); Resp. 031(explaining that if the grace period passed for an old trading partner, “I’d commence to find out if there was some kind of problem”).

<sup>lv</sup> Among the firms surveyed, 20.4% *never* accept nonconforming tender, 20.4% *frequently* do so, and 59.2% *sometimes* do so.

<sup>lvi</sup> Among the 92% of respondents who said that a discount was reasonable when goods below the expected quality were excepted, there was no agreement about either the size of the discount or the method of determining it. 41.3% of the respondents said that the discount should be individually negotiated, 50% said it should be determined on a regional scale, and 8.7% on a national scale.

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lvii When asked what the term FOB meant, 6% said they did not know, 2% said “factory on balance,” 32% said “free on board,” 22% said “freight on board,” 2% said “freight on delivery” and 34% responded in other ways.

lviii *NORC Survey, supra* note 46 at Q14.

lix Resp. 049 and Resp. 020.

lx *NORC Survey, supra* note 46 at probe to question 14.

lxi The only exception was Resp. 019 who asserted that “everybody [knows] to order for Friday give a weeks notice”.

lxii The TGFA Trading Rules are the rules used to resolve disputes in the association’s private legal system. The Southwest Scale of discounts is a documents setting out standardized deductions for particular types of quality and quantity deviations.

lxiii The examples given were as follows: Resp. 007 (mentioning protein contents and other quality specifications that are defined in the Southwest Scales); Resp. 047 (same); Resp. 017 (the Southwest Scales); Resp. 046 (same); Resp. 83 (same) Resp. 023 (following the written trade rules is a usage); Resp. 001 (describing several practices relating to grading times, and buying in that are set out in the TGFA Trade Rules); Resp. 050a (observing that most trade practices are spelled out in the contract, and giving as an example of an unwritten practice a definition of a delivery term that is in accord with the TGFA Rules); Resp. 081 (noting that the grain quality standards set out in the rules are generally understood and taken fore granted) ; Resp. 021(“if feed is sold on standard terms, I expect them to replace it if it is a mess,” which is just a restatement of TGFA R. 17); Resp. 015 (after being pressed to give an example of a usage in a follow up interview, the respondent gave a long discourse on converting truck measure to rail measures whose content is extensively covered in the TGFA rules); Resp. 008B (the need to observe state laws on truck weight); Resp. 068 (the right to reject for bad quality which is codified in the Trading Rules). In addition, three buyers mentioned being able to reject hay that was either moldy, wet or foul smelling, but this is just a particularization of the rule that the buyer may reject off grade goods. Resp. 058 (even if a written contract is not used, wet hay can be returned); Resp. 061 (“sure there are some. Can’t think of any . . . if you buy a load of alfalfa hay and its moldy you can turn it down); Resp. 063 (“There are some things we take fore granted that you just expect. There a legal term—normal trade practices that you don’t have to spell out,” and noting you may reject wet hay).

lxiv Resp. 010 (when the market shifts, you have to see what your competitors are doing because if you “don’t word gets out real quick”); Resp.024 (“giving the people you deal with courtesy of understanding,”

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and noting he will pay return freight if something is rejected to keep his customers happy) Resp. 045 (“I expect that they’ll do what they say and visa versa); Resp. 054 (“everyone stands on honor to a certain extent”); Resp. 056 (“the basic rule of thumb is that its got to be feed quality”); Resp. 066 (“Be on time, honor their end of the deal” are standard expectations); Resp. 030 (“There are generally accepted rules of conduct in the business that we’re in. . . We sort of expect people to go with the flow,” noting sometimes people do not “holler” if average grade is okay even if some is off); Resp. 76 (“I am sure there is no way you can write everything in a contract. You still deal with someone you trust” so you can work things out.)

<sup>lxv</sup> Resp. 052 (noting that the term “on demand” could have many different meanings, but that “our partners know what we mean”); Resp. 029 (nothing that it expects those it deals with to observe its rules, but not specifying what the rules were); Resp. 072 (noting that delivery time and quality are not always specified in a contract, but not saying how they are set); Resp. 031 noting that when transactors dealt on a repeat basis, some quality and delivery terms were not written down); Resp. 84 (sometimes shipping method isn’t written down and is understood); Resp. 036 (sometimes extra charges were added when shipping terms changed, but noting this was varied and local).

<sup>lxvi</sup> See e.g., Macaulay, *supra* note 33.

<sup>lxvii</sup> U.C.C. §1-205 cmt. 4 (2010) (distinguishing the Code’s concept of usage from the common law conception of custom).

<sup>lxviii</sup> Matthew C. Jennejohn, *Contract Adjudication in a Collaborative Economy*, 5 VA. L. & B. REV. 175, nn. 142 (2010)(citing, Charles Goetz & Robert Scott, *The Limits of Expanded Choice: An Analysis of the Interaction Between Express and Implied Contract Terms*, 73 CAL. L. REV. 261, 275-6 (1985).

<sup>lxix</sup> Kraus and Walt, *supra* note 30 at 213.

<sup>lxx</sup> JAMES WHITE & ROBERT SUMMERS, UNIFORM COMMERCIAL CODE 140 (6<sup>th</sup> ed. 2010).

<sup>lxxi</sup> See TRAVALIO, NORDSTROM ON SALES & LEASES OF GOODS, para 3.14[c] at 244 (“[P]resumably expert testimony will be necessary to establish a trade usage”).

<sup>lxxii</sup> See Lisa E. Bernstein, *Trade Usage in the Courts: The Flawed Empirical Basis of Article 2’s Incorporation Strategy* (Manuscript on file with the author) [hereinafter, *Trade Usage*].

<sup>lxxiii</sup> Similar results were found in a recent study of the use of custom and usage in reinsurance litigation, see William Hoffman, *On the Use and Abuse of Custom and Usage in Reinsurances Contracts*, 33 TORT AND INS L. J. (1997) (“[C]ounsel asserting a reinsurance usage often do not present, nor do the courts require, the evidence necessary to support a finding that a



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reinsurance usage affects the meaning of a contract. . . [T]hese cases often lack any reference whatsoever to the applicable rules for proof of a reinsurance usage,” and information about its prevalence in a local market and evidence of actual instances in which it was observed are rarely presented.) .

<sup>lxxiv</sup> See Gillette, *supra* note 30 at 708.

<sup>lxxv</sup> Modern contextualists point to the fact that the Code has not been amended to justify the conclusion that transactors view its adjudicative approach as desirable, explaining that “[I]f, as has been alleged, business lawyers dominate the U.C.C. revision process, one might interpret the reaffirmation of the Code’s approach as a “vote” against a more formal approach by those whose clients are affected by the law.” Woodward, *supra* note 30 at 958; Robert A. Hillman, *More in Defense of U.C.C. Methodology*, 62 LAL. Rev 1153, 1157 (2002) (“I am unaware of any effort by business to overturn the codes use of trade custom”). However, even if business interests were opposed to the Code, business lawyers would not necessarily choose to advocate for their clients’ preferences during the ALI/NCUSSAL law reform process. Article 2 is good for law firm revenue and the ALI process is far from transparent. In addition, the political economy of private legislatures like the ALI, suggests that such groups are strongly inclined to adopt the types of vague standard-like provisions that are so ubiquitous in the Code. See Alan Schwartz and Robert E. Scott, *The Political Economy of Private Legislatures*, 143 U. PA. L. REV. 595 (1995).

<sup>lxxvi</sup> See Lisa Bernstein, *Trade Usage in the Courts*, *supra* note 72 at \_\_; Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 Yale L. J. 541, 585 fn. 84 (2003)[hereinafter *Limits*] (concluding that the Code’s interpretive rules are “quasi-mandatory”).

<sup>lxxvii</sup> See also Alan Schwartz and Robert E. Scott, *Contract Interpretation Redux*, 119 YALE L.J. 926 (2010) (suggesting that the terms of alliance agreements reflect transactors preferences for formalistic adjudication).

<sup>lxxviii</sup> The enforceability of some of these provisions has not been tested, yet a close reading of the Code and its Official Comments suggests that they might not be enforced by a court that sought to follow both the letter and/or the spirit of the Code.

<sup>lxxix</sup> Most of the contracts state that contracts cannot be created verbally, Nordstrom, Cl 2 (“Verbal orders will not be valid unless confirmed with a written or electronic purchase order”), while others go further emphasizing that email orders are also considered invalid and noting that only orders submitted on a signed copy of the buyer’s standard purchase order or through the company’s EDI system will be binding. Most of these agreements also all contain language attempting to contract

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out of the battle of the forms, *see e.g.* Burlington Coat Factory, Express Terms and Conditions, Cl. 2 (“THE TERMS STATED IN THIS ORDER ARE THE ONLY AGREEMENT BETWEEN PURCHASER AND VENDOR RELATING TO THE GOODS AND SHALL NOT BE VARIED BY ANY ADDITIONAL OR INCONSISTENT TERMS CONTAINED IN ANY LATER INVOICE, CONFIRMATION OR OTHER MATERIAL OF VENDOR”); Radio Shack, Terms and Conditions of Purchase, Cl. 1 (“Any document of Seller [that] conflicts with, contradicts or adds to any provision, terms or conditions of this Agreement . . . is hereby rejected (unless specifically agreed to in a separate document executed by the Buyer) and the provisions, terms and conditions of this Agreement and the PO by such acceptance shall constitute the whole contract between the parties. Any statement purporting to make Seller’s acceptance conditional on Buyer’s assent to additional or different terms are hereby rejected and shall be of no effect. Buyer shall have the right to make reasonable changes to any PO from time-to-time . . . To the extent that Buyer and Seller are parties to Buyer’s form of Vendor Agreement and any of the terms and conditions of such Vendor Agreement conflicts with the terms of this Agreement the Vendor Agreement shall govern.”)

<sup>lxxx</sup> See *e.g.* Target Supply Agreement, Conditions of Contract, Partnernonline.com, Cl. 21 and 20b (the “Purchaser’s right to require strict observance of the terms of the Contract shall not be waived by course of dealing” and “The Contract may not be modified by course of dealing, course of performance, or any oral communication between Purchaser and Vendor. The Contract may only be modified by (i) a separate written agreement signed by Vendor and an authorized agent or officer of Purchaser, or (ii) Purchaser providing Vendor, with respect to future Purchase Orders, with advance written or electronic notice”). See also Kohl’s providing that course of dealing may not create a waiver Kohl’s at 20 (“Kohl’s’ rights herein are reserved and may be exercised at any time as long as any breach of any of the terms or conditions hereof shall continue, and shall not be deemed waived by delay or by waiver of such condition or any other condition hereof in previous transactions between the parties.”)

<sup>lxxxi</sup> Radio Shack Corp. Purchase Order Terms and Conditions, Cl. 19, 21 (“No course of dealing or course of performance between Buyer and Seller nor any delay or omission of Buyer to exercise any right or remedy granted under this Agreement shall operate as a waiver of any rights of Buyer,” nor shall any “trade custom or practice, course of dealing or course of performance between Buyer and Seller shall operate as a modification or amendment of this Agreement”)

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lxxxii Clauses opting out of usage for the purpose of interpretation are not uncommon in Supply contracts generally, see Purchase and License Agreement between VLSI Libraries and Eki Electronics, (1996) (“THIS AGREEMENT MAY NOT BE . . . INTERPRETED BY ANY TRADE USAGE OR PRIOR COURSE OF DEALING NOT MADE A PART OF THIS AGREEMENT BY ITS EXPRESS TERMS”); Purchase agreement between Gillette Co. and 123 Systems (2008) at Cl. 12.4.2 (“[N]o trade usage shall be used to explain . . . this AGREEMENT even if either or both PARTIES were aware or should have been aware of such trade usage”); Development and Product Supply Agreement (2000) between S3 Inc and Intellon Corp. cl 7.1 (“ This Agreement shall not be . . . interpreted by any trade usage or prior course of dealing not made a part of this Agreement by its express terms.”); Master Supply Agreement between Berkeley Heartlab Inc. and Diadexus, Inc (April 1, 2009) (“No trade customs, courses of dealing or courses of performance by the parties shall be relevant to . . . explain any term(s) used in this Agreement.”)

lxxxiii Target Contract, *supra* note 80 at Cl 1 (“ Any forecasts, commitments, projections, representation about quantities to be purchased or other estimates provided to Vendor are for planning purposes only and shall not be binding upon Purchaser, and Purchaser shall not be liable for any amounts incurred by Vendor in reliance on such estimates.”)

lxxxiv See e.g., Burlington Coat Factory, Express Terms and Conditions, *supra* note 79 at Cl 1 (“Time of delivery is hereby made of the essence”).

lxxxv See *supra* text accompanying nn 135.

lxxxvi See e.g., Kohl’s Terms and Conditions, *supra* note 80 at Cl 2 (“Seller hereby waives any right to cure improper tender which might otherwise be available under law”).

lxxxvii *Id.* at Cl 21 Courts differ in their treatment of no oral modification clauses. See e.g., A. Sethi, D. Carson, & B. Whitlock, *Boilerplate Provisions*, 44 TEX. J. BUS. L., 153, 159 (2012) (noting the inconsistent positions taken by Texas state courts with respect to clauses limiting modification to written amendments).

lxxxviii Courts approaches to enforcing these clauses vary both across and even within jurisdictions. See Geoffrey P. Miller, *Bargains Bicoastal: New Light on Contract Theory*, 31 CARDOZO L. REV. 1475, 1507-1508 (2010) (noting that merger and integration clauses are “accorded nearly conclusive deference by the New York courts,” while in California, they are “not conclusive but rather considered along with other evidence of contract integration,” and “even if an integration clause is present and respected regarding the original terms of the contract, California recognizes relatively easy modification by course of dealing among the

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parties.”); Schwartz & Scott, *Limits, supra* note 76, at n. 94 nn94 (citing cases that illustrate that courts’ attitudes towards merger clauses and integration clauses vary widely and that such provisions are not automatically enforced without question).

<sup>lxxxix</sup> U.C.C. § 2-202 cmt 4.

<sup>xc</sup> *Id.*

<sup>xc</sup> *See e.g.*, Master Sales Agreement between Telecommunication Systems, Inc and Vonage Network Inc., (2006) Cl. 14 (providing for arbitration and noting that the “arbitrator’s award shall adhere to the plain meaning of this Agreement and to applicable law.”); Supply Agreement between Akorn Inc. and Novadaq Technologies (2002) Cl. 12.9 (providing for arbitration and directing that “arbitrator(s) shall apply first the plain meaning of this Agreement, but in matters not fairly provided for in this Agreement, shall apply the substantive law of the State of Illinois.”). Such “plain meaning” provisions can also be found in smaller contracts, *see e.g.*, Growfoo Vendor Agreement, (2012) (providing for arbitration and requiring that “The arbitrator's decision shall follow the plain meaning of the relevant documents and shall be final and binding.”); Planters Rural Telephone Cooperative, Service Terms and Conditions of Service, [www.planters.net/docs/service\\_terms\\_conditions.pdf](http://www.planters.net/docs/service_terms_conditions.pdf)(same), and are quite common in website statements of their terms and conditions of use.

<sup>xcii</sup> *See* SmartMeter Program Upgrade Supply agreement with Pacific Gas and Electric (“This preamble is intended to provide a general introduction to the Agreement. It is not intended to alter the plain meaning of the Agreement or to expand the scope of the Parties’ express obligations under it. However, to the extent the terms and conditions of the Agreement do not address a particular circumstance or are otherwise unclear or ambiguous, such terms and conditions are to be interpreted and construed so as to give full effect to the provisions of this preamble.”); Master Services Agreement by and Between ACI World Wide and International Machines (same). One lawyer interviewed about this clause noted that his firm had dropped it in IT outsourcing contracts because it was making preambles too difficult to agree on.

<sup>xciii</sup> Smartmeter Agreement *supra* note 92 at Cl. 1.2

<sup>xciv</sup> *See e.g.* The Miniature Garden Shoppe, General Terms and Conditions,

<http://www.miniaturegardenshoppe.com/termsandconditions.html>

(“This agreement may not be explained or supplemented by any prior course of dealings or trade by custom or usage.”); Hauser Packaging, Terms and Conditions, [www.hauserpack.com](http://www.hauserpack.com), (“Trade usage shall neither be applicable nor relevant to this agreement, nor be used in any

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manner whatsoever to explain, qualify or supplement any of the provisions hereof,” and that “In the event of any ambiguity or inconsistency in these terms and conditions of sale, said terms shall be given their literal or intended meaning and will not be strictly construed against or to the detriment of the seller.”); Consolidated Electrical Distributors, Terms and Conditions (“Any representation, promise, course of dealing or trade usage not contained or referred to herein will not be binding on Seller. No modification, amendment, rescission, waiver or other change shall be binding on Seller unless assented to in writing by Seller’s authorized representative.”); Noble Polymers, LLC Standard Terms and Conditions of Sale (“Prior courses of dealing, trade usage and verbal agreements not reduced to a writing signed by Seller, to the extent they differ from, modify, add to or detract from the contract, shall not be binding on Seller.”)

<sup>xcv</sup> Most of these systems opted for formalistic approaches long before the Code was adopted so cannot properly be viewed as a reaction to it.

<sup>xcvi</sup> STATE OF NEW YORK, LAW REVISION COMMISSION, STUDY OF THE UNIFORM COMMERCIAL CODE, 23 (1954).

<sup>xcvii</sup> *Id.* at 25.

<sup>xcviii</sup> *Id.* at 29.

<sup>xcix</sup> 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. 1457 (2009).

<sup>c</sup> Miller, *Bargains Bicoastal*, *supra* note 88 at 1478.

<sup>ci</sup> Stuart Popham, *The View of European Business: Survey Results* (Clifford Chance 2008) at 6.

<sup>cii</sup> International Association of Contract and Commercial Managers, 2012 Top Terms in Negotiation, at 11,12 (noting that the importance attached to these provisions might be due to “the tendency of courts – and in particular regulatory authorities – to view any communication (including social media) as relevant to investigations has impacted sensitivity in this area.”)

<sup>ciii</sup> See Bernstein, *Trade Usage*, *supra* note 72 (exploring the ways that the Code’s interpretive approach induces parties to fortify their contracts with terms that attempt to constrain the courts recourse to contextual considerations in the event of a dispute).

<sup>civ</sup> See Avery Weiner Katz, *The Economics of Form and Substance*, 104 COLUM. L. REV. 496 (2004).

<sup>cv</sup> See Lisa Bernstein, *Social Norms and Default Rules Analysis*, 3 S. CAL. INTERDIS. L.J. 59 (1993).

<sup>cvi</sup> See *supra* note \_\_\_ and accompanying text, See also, Liebert eProcurement Vendor Guide at 9 (Liebert provides suppliers with data

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on historical forecasts and usage, as well a current forecasts on a weekly basis, but noting that “it is not a commitment by Liebert to purchase”); OshKosh, Commercial Terms and Conditions: Commercial Purchase Orders, (2013) Cl 2 (“From time to time, Buyer may, in its sole discretion, deliver non-binding 52-week forecasts to Supplier. Notwithstanding any such forecast delivered by Buyer, all purchases of Products shall be governed by this Purchase Order and Supplier agrees that any such forecast is intended solely to assist in planning Buyer’s production schedules and is not a commitment to purchase any minimum volume of Products from Supplier”).

<sup>cvii</sup> Value creating extralegal promises are not uncommon in commercial relationships. See Scott E. Masten & Edward A. Snyder, *United States Versus United Shoe Machinery Corporation: On the Merits*, 36 J.L. & ECON. 33, 62-63 (1993) (discussing the efficient extralegal promises made by the United Shoe Machine Company to its shoe machine lessees); Lisa Bernstein, *Merchant Law In a Merchant Court: Rethinking the Code’s Search for Immanent Business Norms*, 144 U. PA. L. REV. 1765. 1790-1794 (1996) (providing additional examples of value creating extralegal promises in computer software and commodities sales).

<sup>cviii</sup> See MELVIN A. EISENBERG, FOUNDATIONAL PRINCIPLES OF CONTRACT LAW, (FORTHCOMING) at 13 (observing that commentators who report the “birth of neo-formalism in contract law usually point to the work of only three scholars: Lisa Bernstein, Alan Schwartz, and Robert Scott”)

<sup>cix</sup> Schwartz and Scott, *supra* note \_\_ at \_\_.”

<sup>cx</sup> Schwartz and Scott assume that when contextualism is selected, a party disadvantaged by the private-language meaning of a term, will only engage in ex-post interpretation related strategic behavior in the rare case where a contracts plain meaning (or one of a relatively small number of plain meanings it might be viewed to reference) by mere happenstance turn out to favor the position he wants to espouse ex-post.

<sup>cxii</sup> Bernstein, *Trade Usage*, *supra* note 72 at \_\_.

<sup>cxiii</sup> See Schwartz and Scott, *Limits*, *supra* note 76, and Bernstein, *Trade usage*, *supra* note 72 (exploring the many barriers to effectively opting out of the Code’s contextualized adjudicative approach).

<sup>cxiii</sup> See e.g., Melvin A. Eisenberg, [book] Cf. STEVEN J. BURTON, ELEMENTS OF CONTRACTS INTERPRETATION, (OXFORD, 2009) (presenting the interpretive theory known as objective contextualism).

<sup>cxiv</sup> Bernstein, *Trade Usage*, *supra* note 72 at \_\_.

<sup>cxv</sup> See e.g., *Michael Schiavone & Sons v. Securalloy Co.*, 312 F. Supp. 801 (D. Conn. 1970) (where the contract called for the delivery of 500 tons of steel, the court permitted evidence in the form of testimony by the defendants employee that there was a usage of trade whereby a fixed

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quantity term in a contract, meant an amount up to that quantity, explaining that such a usage did not contradict the term, and that summary judgment was therefore inappropriate.); Heggblade-Marguleas-Tenaco v. Sunshine Biscuit, 59 Cal. App. 3d 948 (Cal. App. 5th Dist. 1976) (where a contract had a fixed quantity provision that was held not to contradict a usage proffered by the plaintiff seller who drafted the contract that all stated quantities were mere estimates); *Crest Ridge Constr. Group v. Newcourt Inc.*, 78 F.3d 146 (5th Cir. Tex. 1996)(contract term “subject to credit department approval,” was held not to contradict a usage giving 45 day credit terms.)

<sup>cxvi</sup> *Campbell Farms v. Wald*, 578 N.W. 2d 96(1998)

<sup>cxvii</sup> *American Machine v. Strite Anderson*, 597 N.W.2d 592 (Minn. Ct. App. 1984).

<sup>cxviii</sup> See Bernstein, Trade Usage, *supra* note 72.

<sup>cxix</sup> See Weiner-Katz, *supra* note 105 (noting that when firms do not have effective internal controls over the actions of their employees, but feel their legal staffs adequately represent their interests, they will prefer relatively formalist types of contract interpretation).

<sup>cxx</sup> U.C.C. § 2-204(1) (2010).

<sup>cxxi</sup> In practice, however, large firms dealing with especially important suppliers (or suppliers with a great deal of bargaining power) will enter into specially negotiated transactions with different terms. These are referred to as exempt transactions.

<sup>cxxii</sup> Dollar General, *Master Supply Agreement*, cl. 4.1.

<sup>cxxiii</sup> When these opt outs are included by buyers they are designed to prevent the acceptance of additional or different terms that might arise when a supplier sends a confirmatory memoranda prior to shipment that the buyer does not object to. Conversely, when used by sellers, they guard against the legal consequences that would otherwise flow from the sellers’ employees shipping against a purchase order with additional or conflicting terms.

<sup>cxxiv</sup> For example, many large firms produce internal policy manuals that set out who may sign particular types of contracts, the maximum length of commitments and/or the total value of commitments certain employees can make, and many other details about the constrained menu of provisions that managers at different levels may include in the agreements they sign. These internal policy documents also commonly set out the authority or lack thereof of particular employees to approve change orders and alterations of existing agreements. In firms that use primarily master agreements, similar constraints are placed on managers charged with negotiating and drafting service level agreements.

<sup>cxxv</sup> footnote on cure see seans earlier memo

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<sup>cxxvi</sup> See IACCM, Contract Briefing Template (Version 7 July 2011) at 1

<sup>cxxvii</sup> *Id.*

<sup>cxxviii</sup> *Id.*

<sup>cxxix</sup> *Id.* The template includes: “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 the bid and negotiation phase [including ‘mitigation/management/allocation assumed when contract signed’] . . . Opportunities noted during bid negotiation phase [and designations for follow through] . . . Useful information discovered concerning customer/supplier organization 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). . .[and] Subcontract details.”)

<sup>cxix</sup> IACCM, *The State of Sales Contract Management* (2011) at 9-10

<sup>cxixi</sup> mel steve burton cited in ss

<sup>cxixii</sup> Even if the contract is clear, evidence of these usages will be admissible to supplement or explain the written terms, as under the Code, trade usages are not parole evidence.

<sup>cxixiii</sup> Target, *supra* note 80, at cl. 13.

<sup>cxixiv</sup> Gilson, et. al, *supra* note 3. In the modern economy many of the even the most straightforward sales transactions have a contracting for innovation component, reflected in the supply chain philosophy of “continuous improvement,” in which vendor and supplies work together to achieve gains “in the form of improved product quality, delivery, part pricing and service.” National Instruments, *NI Supplier Handbook* at 5, available online at [http://www.ni.com/pdf/misc/en/supplier\\_handbook.pdf](http://www.ni.com/pdf/misc/en/supplier_handbook.pdf) (visited June 28, 2013).

<sup>cxixv</sup> Gilson, et al., *supra* note 3, at 435.



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xxxvi *Id.*

xxxvii *Id.* at 492.

xxxviii Jennejohn, *supra* note 68, at 179.

xxxix *Id.* at 207.

cxl *Id.* at 179.

cxli These audit provisions tend to be quite broad and give the buyer the right to inspect the sellers plant, its books and records, its quality control documentation and the like, information that, for the most part, firms do not usually have access to unless they file a suit for breach and obtain the right to conduct discovery. Like the right to demand root cause analysis, see *infra* note \_\_ this provision enables the seller to better understand both whether certain types of breaches have occurred (such as not meeting most favored nation pricing provisions), and why, without the need to file a lawsuit, thereby opening the door (though by no means ensuring) that corrective actions can be taken. These types of provisions also help transactors figure out whether or not a bad outcome is due to opportunism or inadvertent error; they thereby make it less likely that cooperative contracting relationships (once established) will break down.

cxlii "Root cause analysis "is a semi-structured method of determining the cause of a problem in performance. The information generated by this process can be used to maintain cooperation by helping a firm figure out whether a bad outcome should be classified as an act of deliberate defection, or chalked up to an inadvertent mistake, the actions of a rouge agent, or a problem in the seller's production process that it can commit to change. This process is especially important in transactions between entities who have so many agents involved in the execution of a single contract that an entity's intent to cooperate or defect cannot be discerned merely by looking at outcomes or through one entities understanding of the other (as is possible in smaller, more personal contracting relationships).

cxliii See Kadens, *supra* note 16 at \_\_.

Readers with comments should address them to:

Professor Lisa Bernstein  
University of Chicago Law School  
1111 East 60th Street  
Chicago, IL 60637  
[lisa\\_bernstein@law.uchicago.edu](mailto:lisa_bernstein@law.uchicago.edu)

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