TRADE USAGE IN THE COURTS: THE FLAWED CONCEPTUAL AND EVIDENTIARY BASIS OF ARTICLE 2'S INCORPORATION STRATEGY

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INTRODUCTION

The Uniform Commercial Code ("Code") directs courts deciding disputes between merchants to look to usages of trade and other commercial standards and practices to interpret contracts and fill contractual gaps. This so-called incorporation approach[1] was the brainchild of the Code's principal drafter, Karl Llewellyn,[2] and was an important application of legal realist philosophy to commercial

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[1] The term "incorporation approach" refers to the Code's incorporation of course of dealing, usage of trade, and course of performance. This essay, however, focuses solely on the incorporation of trade usage. For a discussion of the reasons why it is undesirable to incorporate course of dealing and course of performance into commercial contracts see Lisa Bernstein, *Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms*, 144 U Pa. L Rev. 1766 (1996) [Hereinafter, *Merchant Law*].

[2] Early drafts of the Code were more sensitive to the procedural and strategic considerations identified in this essay. They contained a provision directing "Merchant Experts on Mercantile Facts," see REPORT AND SECOND DRAFT: THE REVISED UNIFORM SALES ACT 251 (1941), to determine the content of usages relating to a variety of subjects including but not limited to the conformity or nonconformity of goods, whether a nonconformity was substantial, the reasonableness of actions, and other issues within the purview of "special merchant's knowledge rather than general knowledge" *id* at Section 59 p. 254. Llewellyn recognized that these determinations were ill-suited to adversarial litigation in front of lay juries because it "could take three weeks of trial time merely to determine whether a shipment of Textiles were conforming, and that if such matters were left to a jury, representatives of the parties' . . .would be the main witnesses bringing their obvious bias' with them."

law.[3] The incorporation approach was both endorsed and expanded in the most recent proposed revision of Articles 1 and 2 of the Code.[4] It is also at the jurisprudential heart of many of the most important international commercial law statutes,[5] including the recently completed Common European Sales Law.[6]

The Code's incorporation strategy has been in operation in US courts for over seventy years and has had a significant influence on commercial law around the world; yet the justifications for the strategy have always been predominantly theoretical. The conceptual model underlying the strategy has never been tested or even evaluated against the reality of the way that its trade usage component operates in practice. This essay presents a detailed study of all of the sales-related trade usage cases digested under the Code's trade usage provision from 1970-2007. It then draws on the study's findings to reevaluate the core justification for the strategy, namely that as compared to a more formalist (agreement-centric) approach to interpretation, incorporation decreases specification costs without unduly increasing interpretive error costs.[7]

Subject to the usual methodological limitations of studies based on reported cases, the study reveals that the trade usage component of the incorporation strategy works very differently in practice from the way that it has long been assumed to work in theory. The study demonstrates that interpretive error costs are

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[3] See WILLIAM TWINING, KARL LLEWELLYN AND THE REALIST MOVEMENT (Cambridge Univ. Press 1993)[hereinafter *Realist Movement*] (describing the realist jurisprudential bent of the Code, but noting that no realist style social scientific research was done to justify its adjudicative approach).

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

[5] See e.g., UNITED NATIONS CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS Art. 9, para. 2.

[6] See European Commission, REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL ON A COMMON EUROPEAN SALES LAWS (2012).

[7] Kraus and Walt, *In Defense of the Incorporation Strategy, IN* JODY S. KRAUS AND STEVEN D. WALT, THE JURISPRUDENTIAL FOUNDATIONS OF CORPORATE AND COMMERCIAL LAW (Cambridge, 2000); Clayton P. Gillette, *Harmony and Stasis in Trade Usages for International Sales,* 39 Va. J. Int'l Law 707 [hereinafter "*Harmony and Stasis"]* 707-7099 (1999) ("The commercial law literature contains a somewhat traditional story about the efficient incorporation of trade usage into commercial contracts . . . Commercial parties, unable to specify every contingency with precision, can reduce transactions costs by incorporating default rules into their contracts; total contracting costs are minimized to the extent that those defaults reflect risk allocations that most parties would have adopted had they negotiated explicitly about the term," and suggesting that "usages of trade. . .provide an alternative source of majoritarian defaults" that may be desirable for any of a number of reasons among them the fact that the application of even nonperfectly efficient custom "does serve the function of reducing the costs of contracting."). See also, Steven Shavell, *On the Writing and the Interpretation of Contracts,* 22 J. Law, Econ. & Org. 289 (2005) (putting forth a specification cost saving justification for looking to usage that is based on a stylized model of contracting that does not take into account error costs or strategic behavior costs.).

likely to be higher than theorists assume since the types of "objective" evidence of trade usages that incorporation's defenders suggest will minimize the risk of interpretive errors[8]-- such as expert witness testimony, trade codes, and statistical evidence—are not routinely introduced in sales-related litigation. Rather, in a majority of cases, the existence and content of usages was proven solely through the testimony/affidavits of the parties and/or their employees, a type of testimony that may be both deliberately and subconsciously self-serving. In addition, parties rarely introduced any objective evidence (or data) that the alleged usage was regularly observed. The study also suggests, though by no means proves, that given the weak evidentiary basis of trade usage determinations, the Code's permissive parol evidence rule, and the ways that courts have interpreted the Code's hierarchy of authority, the incorporation strategy is unlikely to reduce (and may even increase) specification costs in many transactional contexts.

In light of these and other findings about the incorporation strategy's effect on motions for summary judgment, transactors' ability to engage in litigation-related strategic behavior, and the interaction of the strategy and the policies governing the internal operation of multi-agent firms, the essay concludes that at least in transactions between large business entities the background interpretive presumptions of American commercial law should be shifted in the more formalist/agreement centric direction of the New York common law.

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

[8] Steven Walt, *State of the Debate*, at 274 ("A finding of a business norm requires some objective evidence; a pattern of behavior in the relevant trade.").

commercial law in a more formalist direction at least for business-to-business transactions. It also suggests some smaller changes to the Code that would be desirable if (as is likely to be the case) wholesale revision of the statute proves politically infeasible. Part VI concludes by identifying the issues that need to be empirically investigated before the desirability of incorporation can be definitively assessed from a purely empirical perspective, something that may not (at least at present) be possible to accomplish.

I. THE STATUTORY AND DOCTRINAL FRAMEWORK

Articles 1 and 2 of the Uniform Commercial Code and their Official Comments require or permit courts to look to usages of trade in deciding contract disputes. A usage is defined as "any practice or method of dealing having such regularity of observance in a place, vocation or trade as to justify an expectation that it will be observed with respect to the transaction in question."[9] Usages are considered part of the transactors' legally enforceable agreement,[10] which the Code defines as "the bargain of the parties in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance."[11]

Under the Code usages are relevant to interpreting contract terms; filling contractual gaps; determining the reasonable time for the taking of an action when the written contract is silent;[12] determining if a contract or a contract provision is unconscionable; [13] defining the contours of the actions that can be taken by a party given an option to act at his discretion,[14] defining the meaning of commercial unit;[15] determining when it is reasonable to conclude that the tender of non-conforming goods with a price adjustment will be acceptable;[16] determining the extent to which the opportunity to cure can be disclaimed; creating or excluding implied

[9] UCC § 1-205(2).

[10] UCC § 1-201(3)

[11] See UCC.

[12] UCC § 2-309 cmt. 1 (noting that the "criteria as to reasonable time," depend upon commercial standards and that an agreement to a "definite time" may be implied by "usage of trade").

[13] See e.g. *Adcock v. Ramtreat Metal Tech., Inc.*, 44 UCC Rep. Serv. 2d 1026, 1032[unpublished] (2001) ("A party defending a limitation of liability clause may prove it is conscionable regardless of the surrounding circumstances if the general commercial setting indicates a prior course of dealing or reasonable usage of trade as to the exclusionary clause.")

[14] See UCC.

[15] See UCC.

[16] See UCC § 2-508(2) cmt. 2 (noting that "reasonable grounds to believe," that non-conforming goods would be acceptable with a price adjustment, can be found in "usage of trade.").

warranties;[17] excluding consequential damages;[18] defining conforming tender;[19] and fleshing out the contours of the implied warranty of merchantability.[20] Usages are also relevant to discerning the terms of a contract concluded under UCC 2-207(3) and to determining which so-called "different" or "additional terms" in a battle-of-the-forms situation are included in a contract formed under UCC 2-207(2)(b).[21]

The concept of trade usage is also at the heart of the Code's non-disclaimable duty of "reasonableness"[22] and its non-waiveable merchant's duty of good faith that includes "the observance of reasonable commercial standards of fair dealing in the trade."[23] Usages of trade are not considered parol evidence. It is therefore unnecessary to demonstrate an ambiguity in a contract's written terms before usage evidence can be properly introduced.[24] As the Official Comments explain, "writings are to be read on the assumption that . . . usages of trade were taken for granted when the document was phrased."[25]

The Code's hierarchy of authority nominally gives express terms priority over inconsistent usages. It provides that "the express terms of an agreement and an applicable . . . usage of trade shall be construed whenever reasonable as consistent with one another but when such construction is unreasonable express terms control . . . usage of trade."[26] In implementing this provision, courts (in cases

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[17] See UCC § 2-316 (3)(c) ("[A]n implied warranty can also be excluded or modified by. . .usage of trade.").

[18] See UCC.

[19] See UCC.

[20] See UCC.

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

[22] UCC § 1-102 & cmt. 2.

[23] See UCC.

[24] See UCC § 2-202 cmt. 1("This section definitely rejects . . . The requirement that a condition precedent to the admissibility of the type of evidence specified in paragraph (a) is an original determination by the court that the language used is ambiguous.").

[25] UCC § 2-202 cmt. 2.

[26] See UCC § 1-205(4).

decided by published opinion) incline towards finding adequately established usages to be consistent with even seemingly contradictory express terms.[27] Under the relevant case law, a usage is considered to be "consistent" with an express term unless the usage is deemed to "totally negate" the express term. As one court observed, "in making this determination, it must be borne in mind that to be inconsistent the terms must contradict or negate a term of the written agreement; and a term which has a lesser effect is deemed to be a consistant term."[28] More generally, as another court 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."[29] This approach to interpretation, while in seemingly in tension with the statutory language, finds support in the Official Comments as well as the overall jurisprudential bent of the Code, which reject the idea that even a seemingly clear express contractual provision can have a meaning independent of the commercial context in which it is used.[30]

The usage component of the incorporation strategy is not a

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[27] See Table X infra at __ and accompanying text (setting out the contract provisions and the alleged usage-based meanings that courts found to be consistant with one another in the study group cases that went to trial), and Table Y infra at __and accompanying text (setting out the contract provisions and alleged usage-based meanings that courts implicitly found to be consistant with one another in the study group cases involving a motion for summary judgment on an interpretation issue).

[28] *Shiavone,* 312 F.3d at 804. See also *Modine* (same); *Campbell Farms v. Wald*, 578 NW2d 96 (N.D. 1998) ("In cases governed by the Uniform Commercial Code, the courts have regarded the established practices and usages within a particular trade or industry as a more reliable indicator of the true intentions of the parties than the sometimes imperfect and often incomplete language of the written contract. The court 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"*); Nanakuli* (noting that "the delineation by thoughtful commentators of the degree of consistency demanded between express terms and usage is that a usage should be allowed to modify the apparent agreement, as seen in the written terms, as long as it does not totally negate it.")

[29] *American Machine and Tool Co. v. Strite Anderson Mfg. Co.,* 353 N.W.2d 592 (Minn. Ct. App. 1984).

[30] See UCC 1-205 cmt 1 ("This Act rejects . . .the "lay dictionary". . . reading of a commercial agreement. Instead the meaning of the agreement of the parties is to be determined by the language used by them and by their action, *read and interpreted in light of commercial practices and other surrounding circumstances.* The measure and background for interpretation are set by the commercial context, which may explain and supplement even the language of a formal or final writing.") [emphasis added]. See also *Columbia Nitrogen, supra note __at __*(noting that "[i]ndeed the Code's Official commentators urge that overly simplistic and overly legalistic interpretation of a contract should be shunned"); and Roger W. Kirst, *Usage of Trade and Course of Dealing: Subversion of UCC Theory*, 1977 L. Forum 811 (discussing the ways that the Code rejects the idea of plain meaning and elevates the search for meaning to a search for intent)

pure default rule. Particular usages can reliably be excluded from consideration if they are "carefully negated."[31] However, simply including a detailed clause covering a subject is insufficient to negate seemingly inconsistent usages. The enforceability and effectiveness of a general clause opting out of all trade usages is at best unclear.[32] Such a clause might keep some usages out.[33] It is unlikely, however, that the influence of trade usage on contract interpretation can be completely excluded given the central role usage plays, not only in the Code's overall jurisprudence, but also in defining the contours of the non-waiveable duties of good faith and reasonableness.[34] In practice, the usage component of the incorporation strategy lies somewhere between a pure mandatory rule and a pure default rule.[35]

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[31] UCC § 2-202 cmt. 2. Quinn, a leading form book, suggests that to exclude a usage, transactors should include a version of the following clause for each usage they wish to exclude: "**Specific Trade Usages Negated** This Contract was written with the understanding that the following usage of the trade would not affect the content, interpretation or performance of this Contract and is hereby expressly excluded. The trade usage excluded would normally require [Describe normal effect.] In substitution, the parties have agreed to the following [Describe alternate procedures or allocation of rights adopted]." Form 4, p 1-28.

[32] See LEXSTAT 5-1 FORMS & PROCEDURES UNDER THE UCC P 21.06: Forms and Procedures under the UCC (Matthew Bender & Company, 2010) **(**"The structure of Section 2-202 appears to allow the admission of course of dealing, course of performance and trade usage even when a merger clause is effective to totally integrate the agreement. Indeed, some doubt exists of the ability of the parties to exclude parol evidence of a course of dealing, usage of the trade or course of performance."); David V. Snyder, *Language and Formalities in Commercial Contracts: A Defense of Custom and Conduct,* 54 S.M.U L. Rev. 617, at 635-36 (2001) ("As custom and conduct are part of the agreement not only by the fiat of the UCC definition but also as a practical matter, the parties will have a rough time banishing them generally.") Courts do, however, sometimes mention the absence of a clause opting out of usages as an additional justification for giving great weight to usage-related evidence, See e.g., *Columbia Nitrogen v. Royster*. In one case, the court found that the Code did not apply, but noted in dicta that if the Code applied, it would have enforced a provision in the contract which stated that "No terms, conditions, prior course of dealings, course of performance, *usage of trade*, understandings, purchase orders, or agreement purporting to modify, vary, supplement or explain any provision of this Agreement shall be effective unless in writing, signed by representatives of both parties" *Madison Ind. v. Eastman Kodak Co,* 13 UCC Rep. Serv. 2d 325 (N.J. Super. Ct. 1990). In another case, a clause excluding usages was included in the written contract, but did not even merit mention in the court's opinion. See e.g., *Leighton Indus., Inc. v. Valley Steel Prods. Co. Tubular Steel, Inc.*, 41 UCC Rep. Serv. 2d 1128 (N.D. Ill. 1991) (denying the plaintiff's motion for summary judgment and explaining that "whether usage of trade in the pipe industry excluded the implied warranty of merchantability is a genuine issue of material fact," despite both a standard integration clause and a clause in the contract stating that "no course of prior dealing between the parties and no usage of the trade shall be relevant to supplement or explain any term used in this agreement.").

[33] Some courts have suggested in dicta that the absence of a clause excluding usages from interpretation is relevant to their decision to admit certain usage evidence, but there are also cases where despite the presence of such clauses (even independent of an integration clause) in the relevant contract is not even mentioned by courts.

[34] The Code permits transactors to particularize the "standards by which the performance of such obligations [of good faith and reasonableness] is to be measured," subject to the constraint that such attempts at particularization must not be "manifestly unreasonable," a concept that is also given content, at least in part, by reference to usages of trade. See UCC[].

[35] Incorporationists note that even if the strategy were a pure default rule, the choice of default

Despite the centrality of the concept of trade usage to the Code's jurisprudence, the statute provides little guidance on how the "existence and scope" of usages are to be proven. It requires only that a party seeking to introduce usage evidence give the other party notice[36] and that "the existence and scope of . . .a usage are to be proved as facts."[37] The Official Comments provide some elaboration. They reject the strict English and common law standards for establishing the existence of a custom, create a presumption that usages that are commercially accepted are reasonable, and make the question of whether an extant usage has been incorporated one for the trier of fact.[38] The comments also note that "[i]n cases of a well established line of usage. . . where the precise amount of the variation has not been worked out into a single standard the party relying on the usage is entitled, in any event, to the minimum variation demonstrated."[39] Courts have provided little additional doctrinal guidance on how usages should be demonstrated, although they have recognized that usage evidence is somewhat unique in that " testimony of trade custom is testimony to a conclusion; and though all evidence . . . is inferential to a degree . . . the chain of inference is longer when the fact testified to is the existence of a trade custom than when it is the color of the defendant's hair."[40]

The Code and the Comments are both silent on the question of who has the burden of proving the existence and scope of a usage. The leading Code treatise and the case law suggest that the burden of proof rests (at least in the gap filling and interpretation contexts) on the party attempting to prove the usage exists.[41] However, in

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would have important implications for commercial contracting. See Walt, *State of the Debate*__.

[36] UCC § 1-205(6).

[37] UCC § 1-205(2).

[38] UCC § 1-205 cmt. 9.

[39] UCC § 1-205 cmt. 9.

[40] *W. Indus., Inc. v. Newcor Canada Ltd.*, 739 F.2d 1198, 1202 (7th Cir. 1984) accord *Rich Prod. Corp. v. Kemutec, Inc.*, 66 F. Supp. 2d 937, 965 (E.D. Wis. 1999) (reiterating the "liberal 'chain of inference' accorded to testimony on matter of trade usage"); *Tutor Time Learning Centers, LLC v. Larzak, Inc.*, 2007 WL 2025214 at *8 (N.D. Ind. 2007) (interpreting testimony of trade custom in the child care industry with a liberal "chain of inference").

[41] See White and Summers, supra n. 43 at 128 ("Generally the party who asserts the existence of a trade usage or the like and benefits from its proof has the burden of proving it.") In some UCC § 2-207(b) cases, if the additional term in an acceptance is not the type of term that the comments designate as a per se material alteration, a party who wants to exclude the term bears the burden of proving that it was a "material alteration." See *Bayway Refining Co. v. Oxygenated Mktg. and Trading A.G.*, 215 F.3d 219 (2d Cir. 2000) (holding that the party who opposes the inclusion of an additional term found in a confirmatory memorandum has the burden of proving that it is a material alteration, and such proof can lie in a demonstration that its inclusion is not a usage of trade.").

cases arising under 2-207(b)(2) the party attempting to demonstrate that an additional term is "material alteration" may have the burden of demonstrating that its inclusion is not customary in the trade.

Drawing on these statutory requirements, incorporation's defenders ("Incorporationists") have developed a fairly well-articulated view of the type and quantum of "objective" evidence that they assume will be submitted to establish the existence, scope, and content of a usage. They maintain that "[u]nder Article 2, there are two principal methods of demonstrating the existence of an observable regularity of conduct," namely "expert testimony and evidence about statistical regularity."[42] They surmise that "much of the evidence of commercial norms might consist simply in the presentation of evidence of statistic norms—mere frequencies of a given behavior in the trade."[43] The leading Code treatise takes the position that "to prove [a usage of trade], a party must usually call on an expert."[44] A leading practice manual presumes the same.[45]

Despite their legal realist roots incorporation's defenders have never explored the types of trade usage issues that arise in litigation or the ways that trade usages are *actually* established in court. Rather, they have been content to simply assume that transactors have been taking advantage of the specification cost savings the strategy affords by leaving contractual gaps, ignoring remote contingencies, and including large numbers of vague and standard-like clauses, or industry terms of art, in their contracts. They have also simply assumed that transactors prove usages by introducing objective evidence and that the courts interpreting sales contracts have been following the directives of the Code as written, including its hierarchy of authority. As a leading Code commentator put it, "without a thorough analysis of a large group of cases, why should we believe that courts are systematically ignoring or misapplying

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

[43] Kraus & Walt, *In Defense*, supra note __at 213. See also Clayton P. Gillette, *Institutional Design and International Usages under the CISG*, 5 Chi. J. Int'l L.157 (2004) ("The contextual significance of trade usage requires adjudicators to discover the alleged usage, define its scope, and determine its application to the issue at hand.").

[44] White and Summers, *Treatise, supra note* _ at 140. See also, E. ALLEN FARNSWORTH, CONTRACTS (2004) at 41 (Under the UCC, "[a] party commonly shows a usage by producing expert witnesses who are familiar with the activity or place in which the usage is observed.").

[45] 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").

these clear and direct commands?"[46]

The next section takes up the challenge of looking at just such a large group of cases. It presents a study of the digested cases decided between 1970 and 2007 in which a trade usage argument was raised in an Article 2 sales dispute. Its goal is to provide data that can be used to begin to evaluate both the claim and the theoretical arguments behind the claim that the incorporation strategy decreases specification costs without creating a large increase in interpretive error costs.

II. USAGE IN THE COURTS

In an effort to explore how the trade usage provision operates in practice, a data set of cases was constructed. It consists of information about all Article 2 sale of goods cases decided between 1970 and 2007 that are digested in Callahan's UCC Digest under the relevant sections of the Code's trade usage provision.[47] The cases were coded to explore the types of situations where trade usage arguments are made, the type and quantum of usage evidence that parties introduced, and the type and amount of evidence that was required to either establish the existence of a usage at trial or raise a genuine issue of material fact and thereby defeat a motion for summary judgment.

To obtain detailed information about as many of the 173 cases as possible,[48] a letter was sent to at least one attorney involved in each

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[46] Robert A. Hillman, Comment: *More in Defense of UCC Methodology*, 62 La. L. Rev. 1153, 1157 (2002).

[47] The cases were drawn from the UCC Case Digest (formerly Callahan's now West) under the para.1205 "Course of Dealing and Usage of Trade," omitting 1205.1(6) "As to security interests;" 1205.1(10) "As to acceleration;" 1-205.1 (11) "As to Ownership or Title" 1-205.1 (12) "As to banking practices;" 1205.2(3)-(7) "Bank Transactions;" 1205.3 (all) "Course of dealing;" 1205.4(1)(b) "Course of Dealing;" 1205.4(3)(a) "motor vehicles course of dealing;" 1205.4(7)(a)-(c) "Banking;" 1205.4(8)(b) "Clothing and fabric: Course of Dealing;" 1205.4(9)(b) "Construction materials: Course of Dealing;" 1205.4 (11) "Security interests;" 1205.4(12)(b) "Other: Course of dealing;" 1205.5 (1)(b) "Express terms of agreement control: Course of dealing;" 1205.5(1)(d) "Express terms of agreement control: Course of performance;" 1205.5(3)(b) "Machinery and equipment: Course of Dealing;" 1-205(4)(a)-(c) "Security agreements;" 1-205(5) (a)-(b) "Banking and lending;" 1205.6(2) (all) "Course of dealing;" 1205.8 (all)." In addition __of the __ cases that were included in the relevant sections of the digest were nonetheless omitted for reasons noted individually in Appendix A. The most common reasons for exclusion were that the case did not deal with sales, that the case either made no mention of usage, or the court, in remanding or ruling, simply mentioned usage or the possibility of introducing usage evidence in passing. Individual cases dealing with warranty of title were also omitted regardless of where in the digest they appeared.

[48] The number of cases in the digest seems strikingly small in light of the Code's pervasive reliance on trade usage. The reasons for this are unclear. It might be that trade usage plays only a minor role in Article 2 commercial disputes (perhaps because lawyer's consulting treatises and form books would be told that they cannot prove a usage without an expert witness). Alternatively, the small number of

case.[49] The letter asked for case documents relevant to the trade usage issues. The documents obtained were supplemented with case documents downloaded from Lexis and Westlaw. Additional information was also obtained from court files where this could be done at a cost under $150 per case.[50]

Using these methods of data collection, a significant portion of the trade usage-related litigation record was obtained for 63 cases (the "detail group").[51] Another group of 40 cases (the "opinion-only group") was coded using information gleaned solely from opinions available on Lexis and Westlaw.[52] The remaining 70 cases in the digest were ones in which the opinion did not discuss the types of usage evidence that were introduced. These cases were coded separately and only to determine the type of trade usage issue they involved (the "issue only group").[53]

A. Case Characteristics

The cases in the "detail" and "opinion only" groups [hereinafter the "Study Group"] came from a variety of industries. The only notable concentration in any one area (36%) dealt with agriculture—defined to include: farming, animals, seeds, and agricultural chemicals.[54]

Across the Study Group 46.6% of the cases were in federal court[55]

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published decisions may be due to the fact that the sorts of cases where usage issues are likely to arise are unlikely to result in published opinions. For example, cases that pit one asserted usage against another, or cases where one party introduces evidence to prove and the other party introduces evidence to disprove, a usage are unlikely to result in written state trial court published opinion (as these are rare) or an appeal since they turn on factual findings that are unlikely to be reversed on appeal. Similarly, denials of summary judgment in state courts are not typically published, so it is possible that usages are being used to defeat such motions in numbers the study would not pick up.

[49] There were some cases in which the lawyers could not be located in Martindale-Hubble.

[50] There were several cases where the case file turned out to be more expensive either because court personnel misestimated the cost, or because additional documents relevant to the issue had to be requested.

[51] For a list of cases included in the "detail group" and the documents obtained and reviewed for each see Appendix B.

[52] Cases were included in the "opinion-only" group where the opinion made explicit reference to the type of usage information introduced. To rule out the possibility that cases in this group under reported trade usage evidence a two sided Fischer's exact test was run comparing the frequency with which key types of evidence appeared in the "opinion only" and "detail" groups. It found no statistically significant differences between them.

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

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

[55] 60.4% of the federal court opinions were trial court decisions and 39.6% were appeals

and 53.4% in state court.[56] 58.8% of these cases involved trials or appeals from a trial judgment, 32.4% motions for summary judgment, 2.9% motions to stay or compel arbitration and the rest other procedural postures.[57]

The amounts at stake varied widely: 3% involved less than $10,000 (in 2012 dollars), 22% involved $10,000-$50,000, 15.3% between $50,000 and $100,000 and the remaining 59.7% had over $100,000 at stake.[58]

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

B. The Types of Issues That Arose

The study sought to identify the type of issue the usage was introduced to address. Its findings are set out in Figure 1 below.[60]

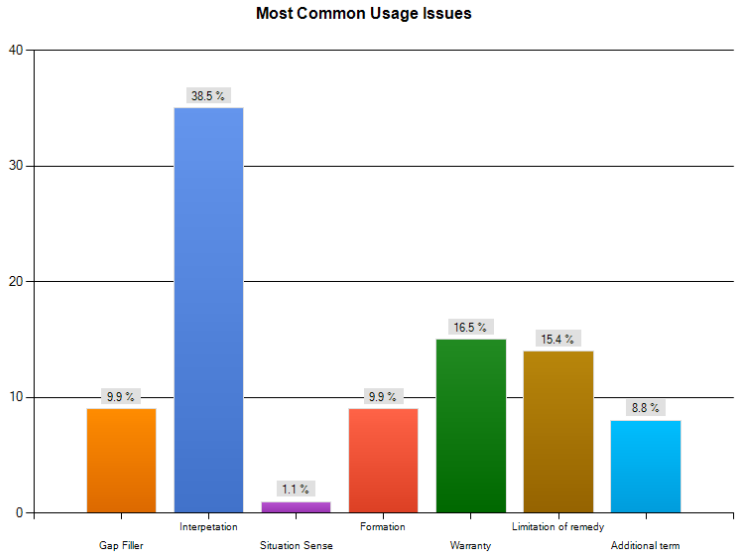
Figure 1

[56] 10.9% of the state court opinions were trial court decisions and 89.1% were appeals.

[57] See *Figgie Int'l, Inc. v. Destilleria Serralles, Inc.,* 925 F. Supp. 411 and 190 F.3d. 252 (D. S.C. 1996) (motion for a declaratory judgment); *Bureau Serv. Co. inc v. King,* 721 N.E.2d 9150 (Ill. App. Ct. 1999)(motion for an involuntary dismissal and an appeal from a denial of a motion to amend a complaint); *Southland Farms, Inc. v. Ciba-Geigy Corp*, 14 UCC Rep. Serv. 2d 404 (Ala. 1991), 930 F2d. 21 (1991), 12 UCC Rep. Serv. 2d 644 (1990) (a certified question to the state supreme court).

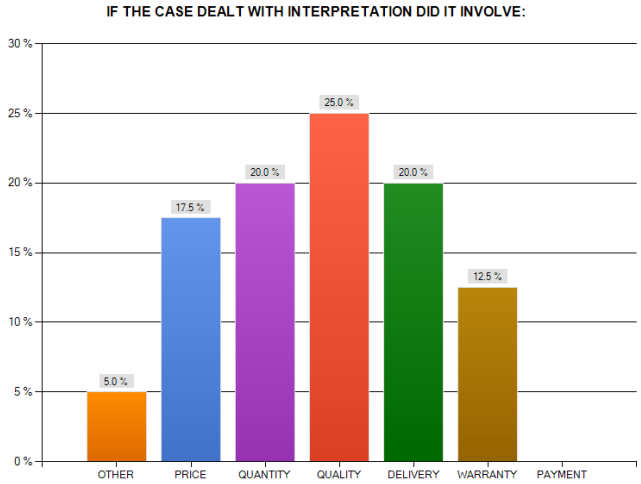
[58] The amounts at stake percentages are calculated on the basis of the 72 cases for which this information could be obtained.

[60] Under the Coding protocol used, a case was coded as involving gap-filling if the written contract in question was silent on the issue the usage purported to cover. Technically, under the Code, usages are part of the transactors' legally enforceable agreement so the nomenclature of referring to a gap filled by a usage is inconsistent with the jurisprudential foundation of the Code. The study defined a remote contingency as a low probability event that did not relate to the core terms of the deal.



Across the interpretation cases, the study also sought to identify the subject matter of the usage related issue. Its findings are set out in Figure 2 below which shows that almost all of the usage-related interpretation cases dealt with the core dickered aspects of most deals--price, quantity, quality, delivery, warranty, and payment.

Figure 2



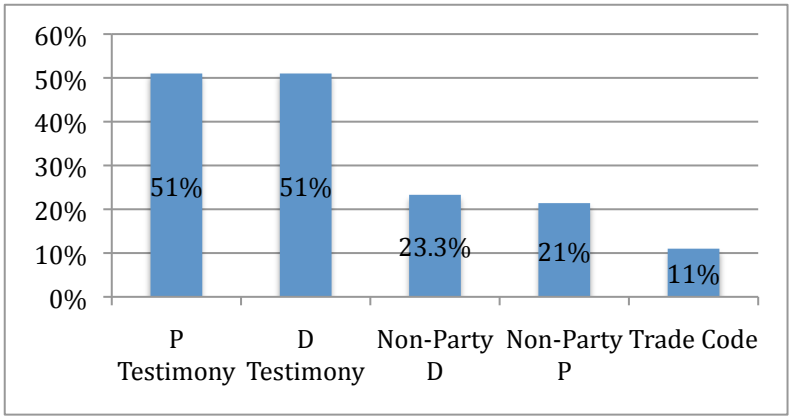
C. The Types of Evidence Introduced

The chart below provides the percentage of cases in the Study Group in which the following types of evidence were introduced:

(1) testimony of plaintiffs or their employees; (2) testimony of defendants or their employees; (3) non-party testimony offered by defendant; (4) non-party testimony offered by plaintiff and trade codes.

Figure 3

TYPES OF EVIDENCE INTRODUCED IN USAGE-RELATED CASES



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

1. Trial

Party or Party Employee Evidence Across the study group cases that went to trial, the most common type of usage evidence introduced (or that was sought to be introduced) was the testimony of a party or a party's own employee.[61] In the cases where a trial was held[62] and usage evidence was admitted, Plaintiffs and/or their employees ("plaintiffs") testified in 66% of the cases, while defendants and/or their employees ("defendants") did so in 45.8%. In 63.15% of the cases it was the only usage-related evidence introduced. Even in cases where a *usage was found to exist*, this party testimony was the only usage-related testimony introduced in 68.4% of the cases.

Expert Witness Evidence The study sought to examine how often expert testimony was introduced. However, it was often impossible

[61] Former employees of a party were coded as employees of a party.

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

to determine whether a particular witness was a fact witness, a lay opinion witness, or an expert witness, even in cases for which full transcripts were available. Given this limitation, all non-party or non-party-employed witnesses were coded together as non-party witnesses.

Across the Study Group cases where a trial was held and the court admitted usage evidence, only 20.8% of plaintiffs and 22.9% of defendants introduced nonparty testimony.[63] Even in cases in which a trial was held *and a usage was found to exist*, only 31.5% involved the introduction of nonparty witness testimony.[64] Since only some of the nonparty witnesses would have qualified as experts, this data permits the conclusion that the introduction of non-party expert witness testimony is not required to establish the existence of a usage.[65]

Interestingly, there were no statistically significant differences in the likelihood that a usage would be found to exist between the cases that went to trial with only party evidence on usage, and cases that went to trial with nonparty witness testimony and/or Trade Code related usage evidence.[66]

Trade Codes and Similar Writings Parties attempted to introduce Trade Codes and other trade association publications in 11% of the cases,[67] but the evidence was admitted in only 6%. In three of the five cases where the trade code was admitted a usage was found to exist.

Regularity of Observance The doctrinal requirement that to qualify as a usage a practice must be "regularly observed" was typically met (to the extent that it was addressed at all) by a mere assertion by a witness that a practice was common or that they had never seen things done differently.[68] Across the gap filling and interpretation

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[63] There was no statistically significant difference (using a two sided Fisher's exact test) between the detail and opinion only groups in terms of the rates with which plaintiffs or defendants introduced non-party witness testimony. This test was conducted to explore the possibility that opinions might not faithfully recount all of the evidence introduced.

[64] In these cases 15.8% of plaintiff's and 21% of defendants introduced nonparty witness testimony.

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

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

[67] The relative infrequency with which Trade Codes were introduced may be due, in part, to the fact that a large number of the industries that produce Trade Codes and association drafted contracts also provide arbitration services to those who contract under them.

[68] To get a feel for the types of evidence that courts accept as fulfilling the statutory requirement

cases in the Study Group, there was not a single instance of a party trying to prove "regularity of observance" using statistical *data* about the frequency with which a practice is observed. Even in the cases with the largest stakes, the best lawyers, and the testimony of witnesses with traditional expert qualifications, proof of statistical regularity was still a matter of assertion and opinion.

Battle-of-the-form cases were the only type of cases in which parties introduced evidence that claimed usage had actually been observed in *any* specific transactions. In six of these cases, the party seeking to have an additional term in its acceptance included in a contract introduced a few contracts drafted by others in their industry in an effort to establish that there were at least some specific instances where similar *written* terms were used.[69] There were, however, no cases where the proffered evidence came close to establishing the frequency with which the practice was observed in a place, vocation, or trade.

2. Summary Judgment

Across the Study Group, 30% the cases involved motions for summary judgment on a usage-related issue.[70] In 65% of these cases (seventeen cases), the usage argument was raised by the non-movant in an effort to defeat the motion.[71] This tactic was successful 70.6% of the time. In the other 34% of the cases (nine cases), the movant asserted the existence of a usage and was granted summary

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that the usage be regularly observed, consider the testimony that was actually introduced in the following cases where a trial was held and the court found the claimed usage to exist. In *Spurgeon v. Jamison Motors*, 521 P.2d 924 (Mont. 1974) two of the defendant's employees testified as to the usage of the used farm machinery trade. Ingeman Svendson testified that he had worked with farm machinery for 40 years. When asked whether it was customary to warrant used combines, he said "no." That was the extent of his testimony on the scope of the usage. *Id.*, Transcript of Testimony, C.A. No. 6985 p. 41. Keith Jamison also testified to Jamison Motor's policy of sharing repair costs 50-50 on newer used models and providing no additional warranties. He was then asked if this was "pretty much standard throughout the business in your trade." He replied that it was. Id. at. 79.

[69] *M.A. Mortenson Co., Inc. v. Timberline Software*, 37 UCC Rep. Serv. 2d 892 (Wash. Ct. App. 1999); 998 P.2d 305 (2000) (where in a high profile case that attracted an amicus brief from the Business Software Alliance because it had huge potential ramifications for the software industry, the defendant introduced fifteen "true copies of personal software license agreements from 15 well known software developers," that included the provision it claimed was a usage).

[70] In most jurisdictions a denial of summary judgment is not a final order and is hence not appealable. As a consequence, these decisions are less likely to show up in digested opinions. It is therefore not possible to know how frequently usage arguments are used to defeat motions for summary judgment. In addition, although courts sometimes publish opinions on this issue, there is no data available on the frequency of this practice.

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

judgment on the usage-related issue 88.9% of the time.[72]

In 83.3% of the cases where a usage argument defeated a motion for summary judgment,[73] the only evidence of the usage introduced by the non-movant was an affidavit of one of its employees.[74] This strongly suggests that courts do not, as a doctrinal matter, require the party asserting a usage to defeat a motion for summary judgment, to produce a great deal of evidence supporting their claim.[75]

In cases where the party moving for summary judgment introduced a usage argument in support of its claim, summary judgment on the usage-related issue was granted 88.9% of the time (eight cases). However, it is not possible to determine from these cases the type or amount usage evidence that courts require to grant summary judgment on a usage related issue. In 75% of the cases where the motion was granted (six of eight cases), the usage-related issue was whether or not an additional *written* term in a variant acceptance was customary in the relevant industry.[76] In all of these

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[72] 37% of these cases were at the trial level and 62.5% at the appellate level.

[73] In three of the five cases where a usage argument did not defeat a motion for summary judgment, the non-movant introduced only its own or its employees testimony. In one of these cases, the court explicitly noted that it was inappropriate to rely on the on testimony of a party or a party's employees to defeat a motion for summary judgment, see *CoreStar Int'l v. LPB Commc'ns, Inc.*, 513 F. Supp. 2d 107 (D. N.J. 2007). In the remaining two cases, the parties sought to introduce additional types of evidence but the court excluded the evidence. See *Golden Peanut Co. v. Hunt,* 18 UCC Rep. Serv. 2d 26 (Ga. App. Ct. 1992) (noting that while the defendant had submitted affidavits from an employee and a non-employee as to the content of an alleged usage, the evidence was inadmissible as it contradicted an express term of the contract); *Crescent Oil and Shipping Serv., Ltd. v. Philbro Energy, Inc.*, 929 F.2d 49 (2d Cir. 1991) (where the non-movant sought to introduce many maritime documents bearing on the usage it sought to allege, but the evidence was excluded by the lower court and considered and rejected by the appeals courts as being insufficient to establish a usage).

[74] To get feel for how thin the evidence of custom can be, while still be sufficient to defeat a motion for summary judgment, consider the evidence introduced in the eight cases in the detail group where this occurred. [insert note].

[75] 50% were primary court decisions and 50% were appeals from a grant of summary judgment or a denial of summary judgment (one case on interlocutory appeal by leave of court).

[76] See *Bayway*, 215 F.3d at 219 (where the movant-plaintiff introduced the testimony of two expert witnesses, and five industry contracts containing the disputed clause); *M.A. Mortenson*, 970 P.2d at 1228(where the defendant movant introduced two expert witnesses and copies of personal software license agreements from 15 well known software suppliers); *Gooch v. E.I. Du Pont De Nemours & Co.*, 40 F. Supp. 2d. 863 (D. Ky. 1999) (where movant-defendant introduced the deposition of the plaintiff's employee which included eleven other herbicide contracts for products he purchased which also included the clause at issue and the court noted that similar clauses had been upheld in other agricultural chemical cases); *Stirn v. E.I. Du Pont De Nemours & Co.*, 21 UCC Rep. Serv. 2d 979 (1993) (where an attachment to the movant-defendant employee's affidavit contained six labels from other chemical products produced by DuPont and others containing a similar limitation of remedy clause); *Suzy Philips Originals, Inc. v. Coville, Inc.*, 939 F. Supp. 1012 (E.D. N.Y. 1996) aff'd 1997 U.S. App. Lexis 41389 (1997) (where the movant-defendant introduced the Worth Street Textile Rules to argue that a limitation of remedy clause in an acceptance was not a material alteration as it was standard in the textile industry and had been included in numerous previous contracts between the parties); *Adacock*, 44 UCC Rep. Serv. 2d at 1032 (where the contract at issue was a trade association standard-form contract

cases the movant introduced evidence other than party and party employee testimony and the non-movant opposed the evidence only with legal arguments. In the remaining two cases, the court granted summary judgment based solely on the testimony of the parties or their employees. In neither of these cases did the party opposing the motion introduce any usage evidence of its own.[77]

There were only two cases where the parties presented conflicting evidence of usage. The court denied summary judgment in both of them.[78]

In sum, while Code commentators and academics have long expressed concern that courts might impose too high a requirement for establishing a trade usage, "for it is likely to be confused with 'custom' and the law has long encumbered proof of custom with stringent requirements,"[79] precisely the opposite seems to be the case both in cases that go to trial and in motions for summary judgment.[80]

D. The Code's Hierarchy of Authority

Across the cases in the study group, courts applying the Code's hierarchy of authority seemed strongly inclined to view usage-based meanings as being consistent with express terms. Table 1 below sets out the contract provisions and the usages asserted to explain them in the six interpretation cases that went to trial and pitted a plain meaning against a usage-based meaning. In all but one case, the court the court accepted (or suggested that on remand the lower court accept) the usage-based meaning over the plain meaning. In

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with a limitation of remedy provision that the plaintiff claimed was unconscionable, the defendant introduced an affidavit of a trade association executive that the term was commonly used and was granted summary judgment in its favor).

[77] *Graaf v. Bakker Bros. of Idaho, Inc.*, 934 P.2d 1228 (Wash Ct. App. 1997) (where the court granted the defendant's motion for summary judgment, finding the usage it asserted to exist, based only on an affidavit supplied by one of its employees); *B/R Sales Co. v. Krantor Corp.*, 226 A.D.2d 328 (N.Y. App. Div. 1996) (where the court granted summary judgment for the plaintiff, finding that the defendant had not rejected the goods within a reasonable time, which the plaintiff's employee testified was 48 hours under a usage of the trade).

[78] See *Carter Barron Drilling v. Excel Energy Corp.*, 581 F. Supp. 592 (D. Colo. 1984) and *Rich Prods. Corp. v. Kemutec, Inc.*, 66 F. Supp. 2d 937 (E.D. Wis. 1999).

[79] White and Summers, Treatise, 3-3 at 127 3rd ed. Hornbook student series .

[80] See William Hoffman, *On the Use and Abuse of Custom and Usage in Reinsurance Contracts,* 33 Tort and Ins. L. J. 1 (1997) (finding that in reinsurance litigation under the common law, courts find reinsurance customs to exist on the basis of evidence the author characterize as thin, explaining that "a review of the growing number of reinsurance usage cases. . .suggests that counsel asserting a reinsurance usage often do not present nor do the courts require the evidence necessary [per the common law] to support a finding that reinsurance usage affects the meaning of a contract. Further, the published opinions . . . in these cases often lack any reference whatsoever to the applicable rules for poof 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.)

the remaining case, the court admitted the usage evidence but gave a jury instruction (an erroneous one under the Code) that it was only to be considered if the meaning of the contract was unclear. The jury found the contract to be clear. [81]

Table 1: Contract Provisions v. Usage-Based Meaning In Cases that Went to Trial

Contract Provision	Usage
"Shell's posted price at the time and place of delivery"[82]	"Shell's price at the time the buyer bid a job"
"Cooling capacity shall not be less than indicated"[83]	Reasonable variation in cooling capacity is acceptable
"All cotton produced on 400 acres"[84]	400 acres of cotton
"Shipment September-October"[85]	"Delivery November-December"
A minimum of 31,000 tons of phosphate a year[86]	All quantity statements are estimates
Two contracts to deliver a total of 100,000cwt sacks of potatoes[87]	All quantity statements are estimates

The study group cases also included nine cases in which motions for summary judgment turned on an interpretation issue.[88] In all of

[81] *Loeb and Co., Inc. v. D.L. Martin*, 349 So.2d 11 (Ala. 1977)(where the court (erroneously) instructed the jury that if they found the contract term ("All cotton produced on 400 acres") to be clear, they could not look to the usage to explain it.

[82] *Nanakuli Paving and Rock Co. v. Shell Oil Co., Inc.*, 664 F.2d 772, 778 (9th Cir. 1981).

[83] *Modine Mfg. Co. v. Ne. Indep. School District*, 503 S.W.2d. 833 (Civ. App. Tex. 1974) (holding that although a contract for the sale of air conditioners stated that cooling "capacities shall not be less than indicated," the trial court should have nonetheless admitted evidence of a trade usage that "reasonable variations in cooling capacity are considered to comply with the specification" because such an understanding would not be inconsistent with the contracts express terms, as "to be inconsistent the terms must contradict or negate a term of the written agreement; and a term [such as the one alleged here] which has a lesser effect is deemed to be a consistant term.") .

[84] *Loeb and Co., Inc. v. D.L. Martin*, 349 So.2d 11, 12 (Ala. 1977).

[85] *Harlow & Jones, Inc. v. Am. Steel Co.*, 424 F. Supp. 770, 771 (E.D. Mich. 1976).

[86] *Columbia Nitrogen*, 451 F.2d at 6 *Columbia Nitrogen*, 451 F. 2d at 3 (1971) (where the court held that although the contract had a quantity provision that set out minimum tonnages that had to be ordered each year, evidence that under a trade usage all quantity statements were estimates and that the minimums were not binding should have been admitted as it was nowise inconsistent with the contracts provisions).

[87] *Heggablade-Marguelas*, 19 UCC Rep. Serv. at 1070.

[88] There was one additional case that could arguably have been added to this group but was not, namely *Steel & Wire Corp. v. Thyssen, Inc.*, 20 UCC Rep. Serv. 892 (E.D. Mich. 1976) in which the contract had a notice provision, which the defendant said was trumped by usage, and the court found that the length of time the defendant took to give notice was unreasonable under 2-607 without any need for recourse to usage evidence which the court said was relevant to the interpretation of contracts, but not

these cases the non-movant alleged a usage-based meaning as against a plain meaning in an effort to defeat the motion. In two of these cases the court refused to consider the usage on the grounds that it was prohibited by the parties' contract;[89] in two cases the court refused to consider the usage on the grounds that it had not been adequately proven;[90] and in one case the court refused to consider the usage both because it had not been proven and because even if established it would have conflicted with the terms of the written agreement.[91] In the remaining four cases, set out in Table Y below, the court denied the motion for summary judgment, and did not note any inconsistency between the asserted usage and the express terms.

Table 2: Contract Provisions v. Usage-Based Meanings in Summary Judgment Cases

Contract Provision	Usage
"500 gross ton" [92]	Up to 500 gross ton
"March Delivery" [93]	Delivery in late spring
"operator shall pay the contractor," [94]	Operator shall pay contractor only when paid by the owner

to the interpretation of the Codes gap-filling provisions.

[89] See *Golden Peanut Co. V. Hunt*, 416 S.E.2d (App. Ct. 1992)(where the court refused to consider usage evidence on the meaning of the contract term "bona fide offer" on the grounds that the contract provided that "no parol evidence shall be relevant to supplement or explain this agreement," overlooking the fact that usage evidence is not subject to the parol evidence rule under the code.); and *Madison Indus., Inc. v. Eastman Kodak Co.*, 581 A.2d. 85 (N.J. 1990) (where the court found a contract for the sale of goods not to exist, and hence that the uniform Commercial did not apply, yet in so holding excluded proof of a usage on the ground that reference to such evidence was precluded in one of the writings exchanged by the parties which stated that…. And that it conflicted with the plain meaning of the phrase "right of first refusal").

[90] *Corestar Int'l Pte. Ltd. v. LBP Commc'ns, Inc.*, 513 F. Supp. 2d 107 (Dist. Ct. N.J. 2007) (where the contract had a fixed delivery date that was not met, and the defendant claimed (through the assertions of one of his employees) that per a usage the dates were mere estimates, the court nonetheless granted the plaintiff summary judgment, saying the defendant had not provided enough evidence of the usage); *Oil and Shipping Serv., Ltd. v. Phibro Energy, Inc.*, 929 F.2d 49 (2d Cir. 1991)(where the court granted summary judgment for the plaintiff based on the plain meaning of the term "discharge port," in a pricing term, explaining that the evidence of usage tendered, was insufficient to establish the usage).

[91] See *Bib Audio v. Herold Marketing*, 517 N.W.2d 68 (1994)(where the court granted summary judgment on the contracts plain meaning finding that the usage offered to defeat the motion was not proven and that evidence of it should have been inadmissible as it contradicted the contracts plain meaning).

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

[93] *Dreyfus Co., Inc. v. Royster Co.*, 501 F. Supp. 1169 (D. Ark. 1980).

[94] *Carter Baron Drilling v. Excel Energy Corp.*, 581 F. Supp. 592 (D. Colo. 1984).

The bull being sold is an "active breeder," whose semen should be tested at the "beginning of the season," [95]	Bull should be tested later than beginning of the season so he can mature

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

E. Methodological Issues

Before considering the implications of this data, it is important to note that the usage study has certain methodological limitations. Most importantly, its findings may have been influenced by the types of selection effects that are present in research that relies on cases decided by reported opinions.[96]

First, given the origin of the data, a selection effect of the classic Priest-Klein[97] variety may have introduced bias into some of the results relating to the types and quantum of evidence introduced. The study therefore cannot definitively rule out the possibility that more or different trade usage evidence was introduced in the cases that were decided without an opinion. However, there are several considerations that suggest that the selection effect problem does not entirely undermine the study's findings.

Across the appellate cases in the Study Group, only 13.4% of

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[95] *Campbell Farms v. Wald,* 578 N.W.2d 96 (N.D. 1998).

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

[97] See George Priest and Benjamin Klein, *The Selection of Disputes for Resolution,* 13 J. Legal Stud. 1 (1984).

the cases involved an appeal of a usage issue standing alone; most cases involved the appeal of multiple issues—22.4% involved 2 issues, 29.9% involved 3 issues, and 34.3% involved 4 or more issues. These data suggest that any selection effect related to the quantum of usage evidence introduced is likely to be quite noisy. In addition, only a small percentage of the cases (for reasons discussed further below) were cases where the court was faced with one party's evidence that the usage was A and another party's evidence that the usage was B, and had to decide between them. This is a classic situation in which the Priest-Klein selection effect with respect to the strength and quantum of evidence introduced would be the greatest. Rather, in approximately 75% of the cases in the Study Group, one party submitted evidence of usage while the other party claimed that the usage was inadmissible based on a legal argument other than that the evidence submitted was insufficient to meet the burden of proof. In these cases, there is no reason to think that a selection effect is operating to make cases with weaker evidence go to appeal. In fact, for cases in some postures, the selection effect might well lead to a bias in favor of cases with stronger evidence of usage making it into the published reports.[98]

Second, the study's results about the types of issues (gap filling, warranty, etc) that arise may have been affected by a factual issue-

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

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

In an effort to explore the possibility that this type of fact-issue based selection bias is responsible for the infrequency of these types of cases, a data set was constructed that looked at the Westlaw Court Document Data base for Illinois State and Federal Court Filings.[99] A search of the term "usage of trade" turned up 170 hits for the years 1999-2010, a total of 104 independent cases. After excluding the types of cases that the large study excluded,[100] and cases that merely cited statutory language referring to usage, without asserting that a usage existed or suggesting that a usage-based argument was in the offing, 24 cases remained. Of these cases, one (4.2%) involved gap filling in the context of a contract by conduct, one (4.2%) involved filling a gap in a written contract, and one (4.2%) involved making a general clause more specific. These findings echo the results of the case study in terms of the type of trade usage issues that wind up in courts. Whether or not gap-filling or giving meaning to standard-like provisions by usage is occurring in the shadow of the law (or in the shadow of extralegal understandings) in disputes that arise, but do not result in legal filings, cannot be determined.

With these methodological limitations in mind, the next sections examine the core theoretical arguments used to justify the incorporation of trade usages and other commercial practices in light of the study's findings.

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[99] The database is IL-FILING-ALL and according to Westlaw it includes "documents filed with Illinois state and federal trial courts. Documents include the following **civil trial court** filings: pleadings, motions, memorandum, trial briefs, non-expert depositions and discovery, non-expert affidavits, proposed orders, agreements, verdicts, settlements and other trial filings." See: web2.westlaw.com/scope/default.aspx?db=IL%2DFILING%2DALL&RP=/scope/default.wl&RS=WLW11.07&VR=2.0&SV=Split&FN=_top&MT=208&MST=.

[100] See supra note _

II. REVISITING INCORPORATION ON ITS OWN TERMS

This section integrates the study's findings into the theoretical debates over the desirability of the incorporation strategy by revisiting the claim that the strategy will decrease specification costs without unduly increasing interpretive error costs. It begins by discussing the implications of the data for interpretive error costs, the component of the incorporation debate that the empirical study was designed to explore. It then considers how this data, together with the study's findings about the types of cases that arise, the ways that courts interpret and apply the Code's hierarchy of authority, and the ways that information about contract terms is transmitted through large multi-agent firms, bear on incorporationists' claim (which has never been supported by any empirical evidence) that the strategy is likely to reduce specification costs.

A. Interpretive Error Costs

1. Evidence on Interpretive Error Costs

Incorporationists recognize that the incorporation strategy may slightly increase interpretive error costs.[101] However, they maintain that the magnitude of any increase in such costs is likely to be insignificant because a party seeking to establish the existence and scope of a usage, will have to introduce "objective evidence of . . . a business norm,"[102] such as expert witness testimony, industry trade codes, statistical evidence that a practice is regularly observed, or, at a minimum, some examples of *actual* commercial transactions in which the practice was followed.[103]

The study demonstrated, however, that the types of "objective" usage-related evidence the strategy relies on to keep interpretive error costs within acceptable limits, were neither commonly introduced, nor required by courts to establish the existence of a usage. Across the Study Group "objective evidence," in the form of nonparty testimony or a written Trade Code, was introduced (or sought to be introduced) in only 39.8% of the cases. Even among the cases that went to trial and found a usage to exist, objective evidence was introduced in only 38.4% of them. On

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[101] Interpretive error costs include the costs of courts mistakenly finding usages to exist when they do not, the costs of courts making errors in defining the scope and content of usages, and the cost of courts mistakenly incorporating extralegal understandings into legally enforceable contracts.

[102] Walt, *The State of the Debate*, at 277.

[103] Id. at __

motions for summary judgment, objective evidence was introduced only 16% of the cases where a usage-based argument succeeded in defeating the motion.[104] And, even more notably, there was not a single case in the Study Group where the regularity of observance was established by data rather than mere witness assertion and only six cases where either party introduced any evidence that the usage had been observed in actual transactions other than those between the parties to the dispute. In the main, the Study confirmed Llewellyn's prediction that in the absence of a merchant jury provision, disputes over the content of trade usage would turn primarily on the word of the buyer's man and the seller's man.

Although the Code could, in theory, be amended to require parties seeking to establish the existence of a usage to introduce particular types of evidence such as expert witness testimony, trade codes[105] or data showing that a practice is, in fact, widely observed, as discussed further below, even if such a change were adopted, practical and conceptual concerns suggest that interpretive error costs would remain significant.

2. Practical and Conceptual Problems in Proving Usages

Even if the Code were amended to require the submission of statistical information about "regularity of observance," there are significant practical barriers to the compilation of such evidence. Most businesses are reluctant to share information about their contracting relationships (indeed confidentiality provisions are common in large supply contracts) and businesses are likely to fear that inquiring into the contracting practices of their competitors

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[104] Across all motions for summary judgment, parties attempted to introduce objective evidence in 30.3%.

[105] Given that the theory behind incorporating unwritten usages is that they arise from the competitive selection of rules and practices and are presumptively efficient and reasonable given their wide-spread use by merchants, looking to trade codes and standard form contracts as proxies for usage is conceptually problematic. Although associations whose members are buyers one day and sellers the next and that also have well-constructed committee structures and voting rules may generate the types of trade rules and standard-form contract provisions that come close to meeting these criteria, see e.g., Lisa Bernstein, The NGFA Arbitration System at Work, *nationalaglawcenter.org /assets/ linkstorage/ - ngfa.pdf*, most associations will not. Many trade associations represent only buyers or only sellers and some trade associations that run private legal systems govern transactions between members who play a fixed role in the chain of production and distribution, making rent-seeking in Trade Rules and standard-form contract creation a serious potential issue. As a consequence, in order to determine which association rules and standard form contract provisions should be incorporated as substitutes for unwritten usages that evolve over time, courts would need to engage in a detailed game theoretic analysis of the associations' rules-creation process, an inquiry that is likely to exceed the limits of their institutional competence. See Robert Cooter, *Structural Adjudication and the New Law Merchant: A Model of Decentralized Law,* 14 Int'l Rev. L. and Econ, Vol. 2 p. 215 (1994).

could be viewed as anti-competitive. Moreover, even if these and other practical barriers to obtaining this type of statistical information were overcome, the introduction of this type of evidence would not necessarily enable courts to identify "such regularity of observance in a place, vocation or trade, as to justify an expectation that it will be observed," in any *particular* transaction. To see why consider the following two examples.

Consider first a contract for the supply of electronic components in the computer industry where there is a highly variable demand for the computer manufacturer's end product. In such contexts, the manufacturer's procurement department often adopts a portfolio approach to quantity management.[106] It enters into one contract for a fixed-quantity of the component based on the relatively certain part of the forecasted demand for the company's end product. It then enters into a variable quantity contract (valid over a specified range of quantities) with either the same or a different component supplier. Any additional components needed are purchased on the spot market. The price differential between a fixed and a flexible quantity components contracts can be large. For example, at Hewlett Packard, this price differential is estimated to be 15%; yet the company still purchases significant quantities of most components through flexible quantity contracts.[107] If one were simply to look at contracting behavior under contracts in this industry, one might well see variations in the quantity delivered under a majority of the contracts, yet such an observation, even if accurate, would not tell us whether in a fixed quantity contract there is really a usage to vary the quantity.

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

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[106] *See* Venu Nagali, et al, "Procurement Risk Management (PRM) at Hewlett-Packard Company" (2006).

[107] Id. at 9.

The conceptual problems with demonstrating usage, however, go beyond the need for data that will almost never be available. To better understand why interpreting even good data on behavioral regularities might not yield an accurate picture of the existence or nonexistence of a trade usage even if all of the underlying contracts in the market were identical, consider a contract for the delivery of one hundred bales of hay on the first of the month over the calendar year 2011 for a price of $50 per bale.[108] Suppose that the price of hay suddenly increased on April 20, 2011 and that the seller delivered only eighty-five bales, claiming that there was a usage in the hay business that quantity statements in contracts were only estimates or that delivering any amount plus or minus twenty bales was considered acceptable under a usage of trade.[109] Suppose further that to establish that usage the seller introduced a study which found that in one hundred contracts that called for the delivery of one hundred bales of hay on the first of the month, under one-third of the contracts eighty bales were tendered and accepted, under another third one hundred bales were tendered and accepted, and under the final third one hundred and twenty bales were tendered and accepted. If courts looked at this data through the lens of the Code and the Official Comments, they would likely conclude that it established a usage that when a contract says one hundred bales, one hundred bales plus or minus twenty bales is considered proper or customary tender.

Given the structure and operation of the hay trade, however, a more accurate interpretation of this behavior is that the one hundred contractual relations observed were among transactors who trusted one another and dealt with one another on a repeat basis, so that within any individual relationship where eighty were accepted one month, a look at the next month's tender would show one hundred and twenty were tendered. Among parties who trust one another and have sufficient inventory, it might be much cheaper to take the level of precaution that results in an average of one hundred bales per month being delivered, rather than the level of precaution associated with delivering exactly one hundred bales each time. Yet if relations between these parties broke down and they did not

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[108] See *H & W Indus., Inc. v. Occidental Chem. Corp.,* 911 F.2d 1118 (5th Cir. 1990) (explicitly noting that in seeking to introduce trade usage evidence the defendant had not produced sufficient evidence of regularity of observance).

[109] [insert case]

anticipate dealing with one another in the future, and one party delivered eighty-five at a time when the price had gone way above the contract price, to excuse delivery of the additional fifteen bales on the basis of a usage would be far from implementing the parties' intent.[110]

As this example illustrates, courts face interpretive difficulties in these situations because transactors' willingness to make the types of adjustments that look on their surface like behavioral regularities often depends on the existence or non-existence of conditions that are observable to them but are not verifiable by a court. These include: the degree of trust they have in one another, the expected benefit of future dealings, and the likelihood that the difference will be made up in a future deal even if the market price makes it non-advantageous to do so. As a consequence, when courts incorporate behavioral regularities into contracts as trade usages, some of the regularities they incorporate are likely to be the types of norms that transactors are willing to follow when they want to preserve their relationship (a "relationship preserving" or "informal norm"), but that they would have been unwilling to promise to follow in their written agreement for any of a number of reasons.[111] When courts incorporate informal norms into commercial agreements, they may well be acting directly contrary to the parties' intent and may therefore be creating large interpretive error costs.

Incorporationists view the incorporation of informal norms as "simply another potential source of interpretive error costs."[112] However, the consequences for efficient contracting of courts routinely incorporating informal norms into commercial contracts are more significant than the consequences of their making occasional errors in filling gaps or determining the meaning of written contractual provisions. In contexts where both formal and informal norms are common, and nonlegal sanctions (including termination of dealing) are sufficiently strong, transactors will often find it beneficial to structure their contracting relationship using a mix of legally enforceable promises that condition on verifiable

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[110] See Alan Schwartz, *Karl Llewellyn and the Origins of Contract Theory*, in Kraus and Walt, ed. The Jurisprudence of Contract and Commercial Law, at 12 (noting that Llewellyn's academic writing explicitly recognized this possibility).

[111] For a comprehensive discussion of the ways that relationship preserving norms and end game norms impact commercial behavior and the consequences of confusing them in adjudication, see Bernstein, *Merchant Law*, supra note __.

[112] Kraus and Walt, *In Defense, supra note __at 209.*

information, and informal agreements (both express and tacit) that condition on information that may only be observable. However, the incorporation strategy transforms all of the transactors' commitments reflected in both formal and informal norms into legally enforceable contract obligations, thereby making it very difficult (if not impossible) for transactors to fully realize the significant efficiency gains that this two-tiered contractual structure may offer. Transactors must either bear the interpretive error costs that come with the mis-incorporation of informal norms, or structure their relationship using a set of second-best terms that they are willing to follow in their work-a-day interactions and have courts enforce in the event of a dispute.

Incorporationists maintain that any problems introduced by the incorporation of informal norms are likely to be insignificant given their "speculation" (which is unsupported by any data), "that observable patterns of commercial behavior more often than not reflect formal rather than informal norms,"[113] and their belief that Code does not require courts to take informal norms into account. However, there is no sound a priori reason to believe that most commercial norms are informal[114] and there is nothing in the Code or its Official Comments to suggest that courts have the authority to distinguish between formal and informal norms. The Code defines the existence of a trade usage by the regularity of its observance and the reasonableness of the expectation that it will be *observed* in a particular contracting relationship. Applying these criteria, informal norms are often indistinguishable from formal norms,[115] because

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[113] Kraus and Walt, *In Defense, supra note __at__*.

[114] In defending this position, incorporationists explain that because "informal norms are more likely to develop in the context of relational rather than discrete contracts . . .and [m]any, perhaps a majority of the transactions governed by Article 2 are discrete," informal norms will not be common in contracting relationships governed by the Code. However, the data show that a significant proportion of the interpretation cases arising under the Code involve transactors who have dealt with one another before, often over an extended period of time. Across the cases that went to trial on an interpretation issue, 47.9% involved transactors who had dealt with previous occasions. More, importantly, however, incorporationists overlook the fact that the existence or non-existence of the type of informal norms that will appear to be behavioral regularities across a market or industry, is not determined only by the characteristics of the parties to a particular dispute, but also by structural and interpersonal features of the relevant market. These sorts of norms are likely to arise when many transactions in the market are repeat and the same types of adjustments and/or contractual flexibility will benefit a large number of transactors. In such contexts, if a case goes to court, the regularity of behavior in the market, the supposed predicate for finding a usage, is independent of whether the case at bar is a dispute between transactors with a longstanding relationship, or transactors who have never dealt with one another before. As a consequence the number of discrete or repeat relationships that wind up in court is a poor proxy for the risk that informal norms will be mistakenly incorporated.

[115] In markets where such norms are common, they are often backed by an array of non-legal sanctions that make them, in effect, self-enforcing over a range of typical market conditions. It is

transactors (particularly those in repeat-dealing relationships) fully expect one another to abide by informal norms.

Moreover, even if the Code were interpreted, or explicitly amended, to give courts the authority to incorporate only formal norms, such a rule would be difficult to implement. Although incorporationists suggest that "the paradigm evidence of an informal norm [can be] provided by trade-wide testimony that a practice is not intended to be given legal effect,"[116] and any transactor in the relevant market could be called to testify about their own subjective beliefs about whether a usage was meant to be enforced in court, it is unclear how, absent the type of social scientific survey that would be prohibitively expensive to conduct, it would be possible to reliably prove the general subjective understanding of transactors across the relevant market.

In sum, the conceptual difficulties in proving usages indentified above, suggest that the interpretive error costs occasioned by the strategy cannot, as incorporationists suggest, be reduced to an acceptable level through mere procedural and evidentiary changes in how usages must be demonstrated.[117] Even if the Code were explicitly amended to require the introduction of the types of objective usage evidence incorporationist envision, the conceptual problems with the interpretation of this type of evidence identified here would remain. Moreover, as discussed further below, such changes would also fail to eliminate the negative effect that usage-based arguments and evidence have on the outcomes of motions for summary judgment.

3. Interpretive Error Costs and Motions for Summary Judgment

The conceptual debate over the magnitude of the interpretive error costs introduced by the incorporation strategy has largely ignored the effect of the strategy on motions for summary judgment. As the study demonstrated, however, a party opposing a motion for summary judgment can assert the existence of a usage based on nothing more than a cursory affidavit supplied by one of its own employees (an affidavit that is simply attached to the moving papers

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therefore quite likely that they will, in fact, be observed by a majority of transactors most of the time.

[116] Kraus and Walt, *In Defense*, supra note __at __.

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

so the affiant's assertions are not subject to cross examination). Indeed, in 83.3% of the cases where the party raising the usage issue succeeded in defeating a motion for summary judgment, an affidavit from a party and or its employees was the only usage-related evidence introduced. This finding suggests that summary judgment determinations may be subject to significant interpretive error costs, and may enable transactors to more easily engage in potentially costly strategic behavior by falsely asserting the existence of a usage to defeat summary judgment and thereby obtain a more favorable settlement.

4. Conclusion

The empirical study's central finding—that trade usages are not typically proven through the introduction of either "objective" evidence or statistical norms--might even give pause to incorporation's strongest defenders, who have taken the position that "an analysis counts as an interpretation of custom only if it adequately fits relevant commercial behavior and attitudes [demonstrated through actual instances of commercial behavior]. . .otherwise, the analysis is not an interpretation of anything. It instead serves as a recommended decision rule."[118] Indeed, taken together, the cases in the study suggest that usage evidence (along with the economic/business rationales proffered to explain it) may, in practice, be serving as just such a "recommended decision rule." Understood in this light the incorporation of usages might be defended as providing courts with contextual information that helps them decide cases in a commercially sensible way. However, to conclude that the types of usage evidence introduced in typical Article 2 cases frequently establish a "usage of trade," as that term is defined in the Code, is in practice a legal fiction.

B. Specification Costs

Given the study's findings about the interpretive error and uncertainty costs created by the incorporation strategy, it is useful to revisit the core theoretical defense of the strategy, namely that its "chief virtue" lies in its "promise" to reduce specification costs in its shadow.[119] Recognizing that the interpretive error costs created by the strategy may well be significant and that courts do not strictly

[118] Kraus and Walt, supra note
[119] Kraus and Walt, *In Defense*, supra note __ at 193.

follow the Code's hierarchy of authority, suggests that while incorporationists view specification costs and interpretive error costs as independent variables to be compared in a cost-benefit type of analysis,[120] these costs are actually interrelated in a *dynamic* way. Higher interpretive error costs create incentives for transactors to enter into more detailed and specific contracts (as well as to fortify the terms of these contracts) in an effort to constrain the range of meanings a court might attribute to their agreement, thereby increasing specification costs.

1. The Theory and Limited Empirical Evidence on Specification Costs

The incorporationist claim that the incorporation strategy reduces specification costs starts from the assumption (an assumption that is not only empirically unsubstantiated, but also goes against the weight of the limited empirical evidence available) that a majority of merchant transactors want their contracts to be given their usage-based meaning.[122] Incorporationists speculate that when transactors know that courts will look to usages to fill gaps and interpret their agreements, they will ignore remote contingencies, leave more contractual gaps, and choose to forgo drafting complex (and expensive) written provisions, in favor of either standard-like provisions that are inexpensive to draft, or provisions that include terse industry-specific short-hand phrases that implicitly reference complex "terms that have a domain specific meaning"[123] or reflect inchoate understandings that "carry with them an array of implications that might be difficult even to bring to mind let alone commit to paper."[124] Together, these drafting choices are said to significantly reduce specification costs.

Although the data set does not (and was not designed to) directly test the strategy's effect on specification costs,[125] it is notable that its

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[120] See Walt, *State of the Debate* at 263 (noting that while there "is an inevitable tradeoff between specification and error costs, incorporation reduces specification costs significantly more than it decreases error and administrative costs. . [H]olding contract behavior constant, the total costs associated with incorporation are lower than under formalism.")

[122] See infra nn __and accompanying text

[123] Kraus and Walt, *In Defense*, supra note __at __.

[124] If courts do incorporate usages of this description, these usages are in effect mandatory rules. Because these understandings cannot, by definition, be written down, they also cannot be specifically negated in commercial agreements. See Quinn, supra note __at __(noting that a contract provision that seeks to specifically negate a usage should include a statement describing the usage to be negated).

[125] The incorporationists, themselves, explicitly acknowledge that there is no "direct survey or experimental evidence," about the size of these specification cost savings and that any estimates must necessarily be "indirect, based on inferences from other data." Walt, *State of the Debate* supra note __at 278.

findings are strikingly inconsistent with what one would expect to find if transactors were taking advantage of the specification cost savings the strategy might afford.[126] If the strategy were influencing drafting choices in the ways incorporationists suggest (and assuming the study cases are representative of the underlying population),[127] a significant number of trade usage cases should deal with gap-filling, allocating risks arising from remote contingencies, giving meaning to standard-like provisions, incorporating unarticulable usages, and discerning the complex meanings attached to short-hand industry terms of art. However, this is not, for the most part, what the study found.

Across the Study Group only 9.9% of the cases involved gap filling and none dealt with remote contingencies. These findings are confirmed (albeit weakly due to the small number of cases) by the pilot study of the usage-related issues raised in Illinois case filings. In addition, there were no cases in the detail group in which usage evidence was introduced to give meaning to a standard-like term. Most of these cases involved usages that were introduced to "interpret" a clear, detailed or highly specific clause embedded in a detailed agreement. And, while it is impossible to rule out the possibility that transactors were trying to establish the existence of complex customs that could only be articulated ex-post, none of the usages alleged in any of the cases seemed as if they would have been very complex or difficult to articulate at the time of contracting.

The only incorporationist prediction that was borne out was that usages were commonly introduced to give meaning to industry-specific terms of art. This was done in 32% of the interpretation cases

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

[127] See Supra text accompany notes __-__ (discussing the limitations of the data and the small-scale examination of Illinois filings which suggests, though does not prove that the selection effect does not undermine the validity of the findings in this respect.)

that went to trial and 11% of interpretation cases that involved motions for summary judgment. Although the use of these clauses likely reduced specification costs, a comparison of the terms of art invoked and the usages proffered to give them meaning (set out in Table 3 below) suggests that the magnitude of the specification cost reduction realized through the invocation of these terms of art may be less significant than incorporationists suggest. First, it is notable that at least a third of these contracts (and likely more) were standard form contracts so that any costs of specifying the meaning of the terms would likely have been prorated over many contracts. Second, most of the definitions at issue were simple to state concisely and all related to the core terms of any agreement, with 67% relating to definitions of quality.

Table 3: Contract Provision v. Usage-Based Meaning in SJ Cases

Contract Provision	**Usage-based Meaning**
"High Quality SEW Pig"[128]	Pig must cut out at 51% lean
"First Quality"[129]	No flaws versus 3%-5% flawed
"Slaw Cabbage"[130]	Big cabbage versus any cabbage that can be made into Cole Slaw
"Scotch Mint Roots of Good Solid Stand"[131]	Maximum 10% contamination
"Barren"[132]	Barren doesn't mean a horse that conceived and aborted
"85% Chemically Lean"[133]	Excludes BCVL quality designation
"Agricultural Grade CAN"[134]	CAN that is granular
"Acres"[135]	Acres with every row planted

In thinking about the implications of Table 3 for the magnitude of specification costs more generally, however, it is important to recognize that firm conclusions about ex-ante specification cost savings cannot be made solely on the basis of ex-post data. It is possible that in the absence of the strategy transactors would have

[128] *Trumm v. Feeder's Supply, Inc.*, 49 UCC Rep. Serv. 2d 44 (Ct. App. Iowa 2002).
[129] *Foxco Indus. Ltd. v. Fabric World, Inc.*, 595 F.2d 976 (5th Cir. 1979).
[130] *Williams v. Curtin*, 807 F.2d 1046 (D.C. Cir. 1986).
[131] *Moore v. Schinman*, 700 P2d 754,700 P2d 754 (1985)
[132] *Keck v.Wacker*, 413 F. Supp. 1377 (E.D. Ky. 1976).
[133] *A.J. Cunningham Packing Corp. v. Florence Beef Co.*, 785 F.2d 348 (1st Cir. 1986)
[134] *Ind. Farm Bureau Coop. Assoc., Inc. v. S.S. Sovereign Faylenne*, 1978 AMC 1514 (S.D. N.Y. 1977).
[135] Morgan v. Stokely-Van Camp, Inc., 663 P.2d 1384 (Wash. App. 1983).

chosen to spell out the meaning of the clause at issue under a variety of conditions other than the one that arose in the particular case, and would also have elected to include detailed definitions of numerous other terms as well, thereby increasing specification costs.

The small number of cases involving gap filling and the absence of cases involving the interpretation of standard-like provisions might also be viewed as an indication that the incorporation strategy is functioning extraordinarily well. It might be enabling transactors to avoid litigation by encouraging them to look to usages to cooperatively fill gaps and/or give meaning to any under-specified provisions in their agreements.[136] This explanation, however, is hard to reconcile with the large number of cases where parties are arguing about the existence, content, and admissibility of usages that are alleged to be relevant to interpreting industry quality specifications like "healthy, high-quality SEW pigs"[137] or industry short-hand terms relating to core terms of the contract. That is, to believe that the shadow effect of the strategy was working so perfectly, it would be necessary to explain why the usage-based meaning of written trade terms, is less clear to the parties than the usage meaning of similar types of terms that are not written down.

2. Specification Costs and the Code's Hierarchy of Authority

Although the debate over incorporation has long focused on the specification cost savings the strategy might create, it has failed to explore the possibility that given the ways that courts have implemented the Code's hierarchy of authority[138] (which in practice privileges usages over express terms unless doing so would result in a "total negation," of the express term), and the relatively thin evidence that is required to establish a usage, the incorporation strategy might actually increase specification costs.

When transactors want to control the meaning of their contract through express terms and are drafting in the shadow of the incorporation strategy as it operates in practice rather than in theory,

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

[137] *Trumm v. Feeders Supply, Inc.*, 49 UCC Rep. Serv. 2d 44 (Iowa Ct. App. 2002).

[138] UCC § 1-205(4).

they will have to include additional detail and/or additional provisions to fortify their contract's terms against usage-based interpretation. As a leading form-book explains, to ensure usages cannot be used to interpret a contract, the contract should include a provision specifically setting out, negating, and replacing each usage-based interpretation that the transactors wish to exclude.[139]

A simple example based on elements of decided cases can be used to get a feel for the specification costs that might be required to fortify even a simple transaction against incorporationist interpretation. Consider a contract for the sale of two hundred tons of fertilizer with a 22% nitrogen content to be delivered FOB seller's place of business on March 1st for a price of $X. Suppose that the price of fertilizer rose after the contract had been signed, and the seller delivered one hundred and eighty tons of fertilizer with a 16% nitrogen content on March 7th. If the buyer sued for breach of contract and these facts were undisputed, he might nevertheless be unable to prevail on either a motion for summary judgment or at trial. The seller could claim there was a usage that quantities were mere estimates,[140] or that any quantity within twenty tons of the promised amount was considered good tender under a usage of trade. The seller might also claim that although the contract called for 22% nitrogen content, there was a usage that any nitrogen percentage within eight percent of the promised amount was considered good tender.[141] The seller could also assert that the delivery dates were mere estimates or any of a number of other usages under which its late delivery would be considered acceptable. The seller might also claim either that the buyer was in breach as he failed to add sales tax to his payment,[142] or that the time for cure should be extended because the usages outlined above made it reasonable for him to conclude that the nonconforming fertilizer would be accepted with a price adjustment.[143] Conversely, the buyer too could potentially make a number of usage-based claims. For

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[139] See Quinn, supra note _ (providing template clause for opting out of a trade usage).

[140] See *Columbia Nitrogen*, 415 F.2d at 1; *Heggblade-Marguleas-Tenneco v. Sunshine Biscuit,* 19 UCC Rep. Serv. 1067 (Ct. App. Cal. 1976)(where a contract for delivery of a fixed number of bushels of potatoes, was interpreted as being a contract for an estimated number of potatoes due to a usage of the potato processing industry).

[141] *Modine,*14 UCC Rep. Serv. at 317 (Where the contract provided that the cooling capacity of an air conditioner "shall not be less than indicated," the court said a usage that 6% variation in cooling capacity was admissible as it did not contradict the contract).

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

[143] [insert cite]

example, if the price of fertilizer fell, the buyer might reject a portion of the delivery claiming that the two hundred ton number was merely an estimate or an upper bound.[144] She might also claim that the stated price was merely an estimate. As a consequence, to ensure that this simple agreement would be given its plain meaning, it would have include provisions reciting and negating all of the above mentioned usages as well as all of the usages that either of the transactors might be able to plausibly assert in the event of a dispute.

Although incorporationists claim that parties do not have to take steps to protect their writing,[145] as the example above illustrates, and the data in the study confirm, transactors who want the written terms of their contract to be enforced as written, may have to incur significant specification costs to fortify their contract, given the court's definition of "conflict" and the relatively thin evidence that is commonly accepted as establishing a usage. The need to incur these fortification costs is likely to have undesirable effects on contractual innovation—transactors seeking to change common contractual provisions, usage-based understandings, or commonly used contractual structures, will have to incur greater costs to do so than they would in a regime that enforced contracts as written. The effects on incremental innovation may be especially large. When courts are faced with a new clause that slightly changes an old term and a demonstrated usage reflecting the old term, they are likely to interpret the new term giving weight to the usage, creating a "regression to the usage" effect that may well retard the gradual evolution of value creating contract provisions.

In defending the merits of the Code Llewellyn suggested that over time, as courts found usages to exist and identified their content, tailored sets of industry specific default rules would emerge and would provide transactors in particular trade with a set of stock terms on which they could rely, thereby reducing the costs of contracting. Had this occurred, it would have provided an additional reason to favor incorporation; yet no such industry specific sets of terms have indeed emerged from courts trade usage rulings. Whether this is due to the fact that usages are not consistent from place-to-place and change too much over time, or merely to the fact that State courts and Federal courts do not issue published opinions

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[144] *Michael Schiavone & Sons v. Securalloy Co.*, 312 F.Supp 801 (1970).
[145] See Hillman, supra note __at __

after trials with enough regularity is unclear, but the fact remains that no such industry specific sets of stock rules have emerged, forcing most parties to litigate the meaning of particular usages anew in each case.

3. Specification Costs in the Modern Economy

Even if the incorporation strategy influenced transactors' drafting decisions in the way that incorporationists theorize, its effect on the content of commercial contracts, particularly in contexts where transactors are not part of close-knit geographically concentrated commercial communities, or are large entities engaged in multiple complex outsourcing transactions, might be much weaker than they anticipate.

In contexts where transactors do not know one another well and are not part of a geographically localized or well-organized market, they are unlikely to know whether a potential contracting party shares their understanding of trade usages. In the absence of such information, transactors will have to either bear the cost of investigating their contracting partner's understanding of the scope and meaning of trade usages in the relevant market/s and/or locations, or will need to memorialize more aspects of their deal in writing. Although in any given transaction it is difficult to predict whether the cost of investigation or the cost of drafting more detailed contracts will be higher, the cost of investigation will have to be borne every time a new contracting partner is chosen (and, unlike drafting, will not make disputes more amenable to resolution on a motion for summary judgment), whereas the cost of drafting provisions reflecting the relevant usages will be incurred only once. Thereafter, the provisions can be used in subsequent transactions at little or no cost. Transactors, particularly those who enter into many contracts for the sale of a particular good or set of goods, are therefore likely to find it advantageous to incur the one-time cost of memorializing usages in contract provisions (which they will implicitly prorate over all the future contracts in which they anticipate their use), rather than bearing the significant future costs of investigating the usage-related knowledge of all of their future contracting partners.

The benefits of memorializing any usage-based understandings they want to include in their agreements (while including clauses that attempt to negate any usages that are not explicitly mentioned)

may be particularly large for transactors who sell their goods on click-to-buy websites.[146] In these situations, sellers typically do not know the identity, location, or business of their putative buyers, making it especially important to specify all parameters of the deal in advance.[147] Indeed, language attempting to exclude usages is very common in the boilerplate of click-to-by websites, both those that market directly to consumers and those that market primarily to other businesses.

Similar considerations affect the drafting choices of large manufacturing concerns that outsource the production of many components of the goods they produce. These companies typically use one standard master agreement that is posted on their supplier portal for the vast majority of their supplier contracts. The suppliers they deal with are located around the world and the transactions they enter into involve numerous discrete markets. In these transactions, the cost to buyers of learning the usages in all of their suppliers' markets would be prohibitively high, and, even if these usages were widely known, the cost to buyer-firms of adjusting their operations to the usages of multiple individual markets would eliminate many of the cost savings associated with outsourcing and/or the adoption of standardized internal operating procedures. Perhaps this is why the Master agreements adopted by these firms contain broad entire agreement clauses (clauses that the contract managers view as "productive in supporting successful relationships"[148]) as well as many additional provisions (provisions whose enforceability is by no means clear under the Code) that attempt limit or to opt out of the Code's contextualist and incorporationist jurisprudence.[149]

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

[147] These clauses could also be included in contracts with contracting partners who are either in different trades, or located in different localities that may or may not have different usages, thereby facilitating the creation of new contracting relationships.

[148] See IACCM, 2012 Top Terms in Negotiation (2012) at 11-12.

[149] See Lisa Bernstein, Merchant Law for a Modern Economy, (noting that in that these provisions include "clauses making clear that no courses of dealing, courses of performance, actions, inactions or trade usages, are to be construed as waivers or modifications of the agreement's written terms; provisions negating the applicability of usages and industry standards to interpretation of the contract; provisions making clear that any terms in purchase orders or commitments made (either orally or in writing) during the life of the parties contracting relationship are unenforceable unless memorialized in a signed amendment to the Master Agreement; and, . . . a variety of merger, integration, and entire agreement clauses that are not mere boilerplate but rather vary considerably in their specificity and seek to exclude from consideration not only pre-contract considerations, but some post-contract ones as well," as well as a wide variety of clauses that seek to ensure exact conformity with the contracts

There are also several additional reasons, rooted in the steps that large multi-agent firms take to originate and operationalize their contracts that suggest that they are unlikely to take advantage of the potential specification cost savings the incorporation strategy might afford them.

In large multi-divisional firms the department that needs the goods (the "internal customer") will typically provide the purchasing department with a detailed set of written specifications describing the item to be purchased, the range of acceptable quality parameters, required delivery dates, and the quantity or range of quantities needed. This information is then used by the procurement department to both determine which suppliers are eligible to bid for the contract and to draft the bid solicitation documents. When the deal is finalized these specifications are simply included in or annexed to the contract with no additional specification costs, making it unlikely a firm would opt to omit them.

Moreover, taking into consideration the post-formation writings and information sharing activities undertaken by these firms (on both the buyer and seller side) to operationalize their contracts, suggests that relying on usages is unlikely to produce a meaningful reduction in deal-rated specification costs. When these firms enter into contracts, the team that negotiates them must hand them off to the team that will implement them. This process usually involves a half a day of meetings as well as the preparation of a detailed contract summary form that captures all relevant operational and financial aspects of the deal.[150] To the extent that usages or other aspects of the negotiating or contracting context inform the meaning

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quality, quantity and delivery specifications, regardless of industry practices).

[150] See e.g., IACCM, Contract Briefing Template (Version 7 July 2011) at 1 (Discussing the handoff process and noting that the summary should include: "Goals of the Customer (summarise the outcomes sought from this deal). . . Goals of supplier (summarise the outcomes sought from this deal) . . . Scope- (what is in, anything specific that is out (but could be a source of confusion) . . . Beneficiaries (i.e. 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.)

of, or add provisions to, these agreements, they will have to be memorialized in writing in these hand-off documents. As a consequence, anticipating these costs, firms will likely choose to memorize them in their contracts, since the marginal cost of doing so is small, and doing so will enable them to both reduce uncertainty and increase the likelihood that any disputes reaching a court can be resolved on summary judgment. Together, the ex-ante sunk costs of the writings produced as part of the procurement process and the ex-post writings needed to operationalize complex contracts, make it unlikely that these types of large commercial transactors will realize specification costs savings from the availability of the incorporation strategy.

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

4. *Considerations Relevant to the Future Desirability of the Incorporation Strategy*

In drafting the Code, Llewellyn's goal (as reflected in the statute's Official Comments) was to create a semi-permanent piece of legislation whose structure and interpretive methodology would ensure that it could be adapted to "unforeseen and new circumstances and practices"[153] as well as other changes in the structure, operation and organization of trade. Indeed, Llewellyn viewed the incorporation of trade usage as one of the main ways the Code would be able to adapt itself to changes in commerce. As suggested above, however, the Code's incorporation strategy is not well suited to the changes in trade that have occurred over the last several decades – including the increasingly complex structure of multi-agent firms, the rise of out sourcing and the widespread

[152] Matthew C. Jennejohn, *Contract Adjudication in a Collaborative Economy*, 5 Va. L. Bus. Rev 173 (2010).

[153] UCC § 1-102(b) and cmt. 1.

adoption of just in time inventory methods, the lowering of barriers impeding international exchange, the rise of collaborative contracting for innovation, and the increase in the volume of transactions consummated over the internet. All of these changes have made usages less likely to emerge, more expensive for firms to learn, and therefore less likely to be in the contemplation of contracting parties, particularly when they transact using detailed lawyer-drafted contracts, whether standard-form or specifically negotiated. In sum, the uncertainty introduced by the incorporation strategy and, as discussed below, the potential it creates for strategic behavior, suggest that whatever the merits of the strategy were in 1940, they may be far less significant today. [154]

IV. THE INCORPORATION STRATEGY AND STRATEGIC BEHAVIOR

Neoformalist scholars have pointed out that the incorporation of usages encourages strategic behavior by enabling a transactor disadvantaged by a contract's plain meaning to argue ex-post that the contract was actually written in a "private language" consisting of usage-based meanings that favor his legal position.[155] The Study confirmed that that transactors do, in fact, make these types of claims and that courts (at least in cases decided by published opinion) are inclined to find usage-based meanings to be consistent even with seemingly contradictory express terms, both at trial and on motions for summary judgment.[156]

Although the Code opens the door to private language-based and other types of strategic behavior, it is nonetheless quite difficult to determine whether or not strategic behavior was actually taking place in the decided cases. A party asserting that a seemingly clear contract provision has a private usage-based meaning may simply be making a good-faith attempt to demonstrate the parties' true intent at the time of contracting. Alternatively, he may be acting strategically in any of a number of ways. First, he might be falsely asserting the existence of a nonexistent usage in an attempt to

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[154] See Lisa Bernstein, Merchant Law in a Modern Economy, supra note __ (providing a through discussion of the mismatch between the Code and the needs of transactors in the modern economy).

[155] Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 Yale L.J. 541 (2003) (arguing that the Code's interpretive approach leads to strategic behavior); Alan Schwartz and Robert Scott, *Contract Interpretation Redux*, 119 Yale L.J. 936 (2010) (extending and clarifying arguments that the Code's interpretive approach leads to strategic behavior).

[156] See supra text accompanying note _-__(explaining the reasons why the data cannot give meaningful insight into how frequently courts permit a usage-based meaning to trump a plain meaning).

override the plain meaning of an express term or defeat a motion for summary judgment. Second, he might be attempting to override a clear provision that was actually intended to change an extant usage. Third, he might be falsely arguing that a practice that transactors sometimes opt to follow on an occurrence-by-occurrence basis, must actually be followed all of the time. Finally, he may be arguing that a usage that exists under certain market conditions (such as stable prices) should be applied in a situation where conditions are very different (such as a time of price volatility).

Unfortunately, the data do not provide the information needed to assess the prevalence of strategic behavior and the number of cases that went all the way to trial on a plain meaning versus usage-based meaning is too small to draw any firm conclusions. However, a closer look at these cases suggests that there are reasons to be concerned (and some reasons to be mildly comforted) about the prevalence of various types of usage-based strategic behavior.

In all of the six cases that went to trial on a plain meaning versus usage based meaning there were large potential gains to be had from strategic behavior. In all six cases the usage-related issue was outcome-determinative. Five of the cases involved claims over 100,000 and the remaining case involved a small farmer and a claim of over $50,000 dollars. 83.3% of the claims arose in a context with a large price movement in the relevant market, whereas only 36.8% of the other cases that went to trial on a usage-related issue involved large price movements. Together, these considerations suggest that strategic behavior might well have been afoot. On the other hand, objective evidence that the usage existed was introduced in 83% of the cases where a plain meaning was pitted against a usage-based meaning (as compared to 47% of all other cases that went to trial on an interpretation issue)[157] and in 50% of them the alleged usage was also confirmed by a course of dealing or course of performance.

Although the amount of usage-related evidence introduced in the plain meaning versus usage-based meaning cases, provides some reasons to be comforted that parties were not simply fabricating usages out of the blue, the introduction of usage-based private language evidence may still have been strategic as the clarity of the

[157] Although the numbers are too small to provide conclusive inferences, the difference in the frequency with which objective evidence was admitted in the two groups of cases was statistically significant using a one sided fisher exact test (p=.0493)

contract provisions at issue suggests that the provisions may well have been included in the contract to negate any usages relating to the subject matter of the clause. In addition, a closer look at the facts of the decided cases suggests that parties were likely engaging in other types of strategic behavior, most notably claiming that adjustments that were sometimes made on an occurrence-by-occurrence basis were actually usages, or claiming that practices that were generally followed in stable market conditions should be followed at times of great market volatility.

For example, *Columbia Nitrogen* and *Heggeblade* each dealt with claims that fixed quantity contracts were actually flexible with regard to quantity. In both cases the price of the good fell dramatically and buyers argued that they did not have to take the quantity or minimum quantity specified, as quantity statements were mere estimates. While adjusting these contracts for overages and underages in a stable market (such as existed in both markets prior to the events at issue) is something parties allegedly did in *Columbia Nitrogen* or would likely have done in *Heggeblade* (as it involved an agricultural buyer who purchased from numerous small farmers), there is no reason to assume that they would want this practice applied in cases where (as it in fact turned out) a huge price movement occurred. Applying the usage in this context would undermine one of the main goals commodity contracts are designed to achieve, namely the allocation of the risk of a large price fluctuations. Moreover, in both cases the buyer who claimed the benefit of the usage had drafted the contract and both contracts were very detailed. The contract in *Heggblade* was a standard-form contract with a fill in the blank for quantity. It had several detailed provisions dealing with shortfalls in quality; yet apart from a standard force majeure provision it did not mention adjustment of quantity. If all quantities were estimates as the buyer asserted at trial, its form could have easily said estimated quantity. In *Columbia Nitrogen*, the contract was heavily negotiated, had detailed minimum and maximum quantity provisions, price adjustment clauses that applied in particular market conditions, and a term that was three times longer than the standard industry contract, considerations which suggest that the contract was designed in contemplation of market changes and undermine the buyer's claim that quantity provisions in these types of contracts were essentially

meaningless.[158] Together these considerations strongly suggest (though do not prove) that the buyers in both of these cases may well have been behaving strategically.

Similar considerations seemed to have been at play in *Nanakuli*. The Nanakuli-Sell contract stated that the price was to be "Shell's posted price at the time and place of delivery," yet the court accepted a usage that Shell was to price protect Nanakuli on all projects (of particular types) in which it had submitted irrevocable bids, charging Nanakuli the price posted at the time of the bid. Although Shell had in fact price protected Nanakuli on several prior deals (which suggests that the usage was not simply fabricated), on those occasions the change in the market price had been far smaller. Moreover, on each of these previous occasions there were additional self-serving considerations in terms of Nanakuli's competitive position vis-a-vis the other large asphalt supplier on Oahu, that most likely had led it to do so.

In *Modine* it is also likely that the party claiming the usage-based meaning of a contract provision was attempting to enforce an informal norm that industry transactors often followed, but only when they both agreed to do so at the time the need to invoke the norm arose. The *Modine* contract was for the sale of an air conditioning system. It contained a provision calling for strict compliance with the contract's detailed cooling specifications; yet at trial the seller claimed that a reasonable variation around the specified capacity specified (within 6% by his account) was permitted per a usage of the trade. Although there was testimony in the case that variations in cooling capacity were commonly accepted, this was typically only after the project engineer had signed off on them (which was not done in this case), suggesting that such variations, while common, were an accommodation buyer's sometimes offered seller's rather than an obligatory usage. Alternatively, even if variations in cooling capacity were in fact an accepted and unconditional usage, the fact that this contract had several strict compliance provisions, may suggest that the transactors had sought to change the usage at the time of contracting and that the seller was now engaging in private-language based strategic behavior.

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[158] For a detailed discussion of this perspective on the case see Victor Goldberg, FRAMING CONTRACT LAW (2012).

Another case in which it seems likely that a party was strategically invoking a usage that was often followed in a stable market in the context of a volatile market was *Advance Steel*.[159] This case involved the exchange of standard-form contracts each of which contained a provision stating that shipment was to be "September-October." At trial the parties agreed that: the shipment was not made until mid-November, it had arrived at the end of November, and the buyer had repudiated the contract at the end of October. The court ruled for the seller, accepting his assertion that per a usage of trade the trade a term calling for shipment "September-October" meant delivery in October or November which had, in fact, occurred. However, in reaching this conclusion the court appeared to be influenced by the fact that the contract had a CIF delivery term, and that under 2-504, a delay in putting goods in a carriers hands is only a breach if "material delay or loss occurs," something that was absent in this case as the goods actually arrived on time. Moreover, at the time the buyer repudiated the contract on the last day of October for failure to ship, the market had moved against him, which might in fact have been the actual motivation for his actions. Nevertheless it is unclear whether the buyer was in fact being opportunistic as his form contract contained many provisions calling for strict compliance with the contract's timing provisions.

The final case pitting a plain meaning against a usage-based meaning was *Loeb v. Martin*. In this case a small local farmer agreed to sell "400 acres" of cotton to a large out of state buyer. That year the farmer planted much of his cotton in a skip row pattern that produced a lower yield per acre than cotton planted in the traditional way. At the time for delivery, the price of cotton had doubled, making the contract highly disadvantageous for the farmer-seller. He claimed that he was only obliged to deliver the cotton that was in fact grown on 400 of his acres, even if it was planted skip row. The buyer, in contrast, argued that it was a usage that 400 acres of cotton meant cotton planted on 400 acres with every row being used. The court instructed the jury that if it found the meaning of the term "400" acres clear it need not consider the usage. The jury found for the farmer. Given the price change in the market, it seems on the facts of the case that it was the farmer claiming plain meaning rather than the large buyer claiming the usage who was

[159] *Harlow & Jones, Inc. v. Advance Steel*, 424 F. Supp 770 (1976).

being opportunistic, but it is hard to know for sure.

In sum, looking at the plain meaning versus usage-based private meaning cases that went to trial, suggests that while it is difficult to establish whether opportunism was talking place, and, if so precisely what type of opportunism was afoot, it is clear that the Code and the case law open the door to several different types of strategic behavior and that there are no effective checks in place to prevent it despite incorporationists' claim that the Code's hierarchy of authority together with the assumed requirement that "objective" evidence of the usage is required, will operate to reduce strategic behavior/interpretive error in these and other sorts of cases.

V. REFORMING COMMERCIAL LAW

1. The Argument for Large Scale Legal Reform

In response to the problems created by Code's trade usage provisions and other aspects of its highly contextualized and quasi-mandatory approach to adjudication, neo-formalist scholars[160] have suggested that in transactions between businesses, the Code's interpretive approach should be replaced with a formalist/agreement-centric interpretive default rule that would also permit transactors to opt ex-ante for more contextualized interpretation of either their contract as a whole or of specific provisions of it.[161] They explain that such a change would reflect the preferences of a majority of business transactors, thereby transforming the Code's quasi-mandatory interpretive approach into the type of majoritarian default rule the law generally favors.

The shift to a more formalist default rule would give those transactors who elected to be governed by an agreement centric approach a way to largely avoid some of the most significant costs

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[160] Alan Schwartz & Robert E. Scott, Contract Theory and the Limits of Contract Law, 113 Yale L.J. 541 (2003); Bernstein, *Merchant Law for a Modern Economy*, supra note __ (demonstrating that supply contracts entered into by Big Bog retailers and other firms with highly outsourced production processes often include numerous provisions attempting to opt out of the Code's incorporationist jurisprudence).

[161] This proposal could be altered to only permit parties to opt into an incorporationist adjudicatory regime provided that their contract appoints an expert arbitrator to make binding determinations about the content of usages, and specifies the location and industry whose usages are supposed to be incorporated. Such a rule, if properly structured, could have desirable information forcing effects that may largely eliminate commonly litigated issues such as whether the parties are merchants (which they will have to recite or will be considered to have stipulated to by virtue of the opt in), whether they are part of the same commercial community, and, if not, which communities usages should govern (a choice of usage clause), and whether they should have been aware of relevant usages (their opt in would constitute their consent to be bound.

associated with the Code's incorporationist interpretive approach. Among other things, it would enable transactors to draft contracts that would be more amenable to summary judgment-based adjudication, permit businesses to select adjudication on a truncated evidentiary base (something they would arguably desirable in many transactional contexts),[162] and would reduce the internal firm information transmittal costs occasioned by the strategy. In addition, if combined with a change that also permitted the parties to opt out of the Code's course of dealing, course of performance, and waiver provisions, it would also reduce the intra-firm agency costs the strategy creates and enable parties to capture the benefits of using a two tiered contractual structure consisting of both legal and extra-terms. Moreover, as discussed further below such a shift in default rules would be likely to significantly reduce--though not entirely eliminate--the types of private language related strategic behavior discussed above. It would also have the benefit of increasing the returns to careful drafting, a change that would encourage contractual innovation, decrease the social cost of disputing (as fewer disputes reach the legal system) and facilitate the maintenance of cooperative contracting relationships.

2. The Limited Evidence on Majoritarian Preferences

The assumption that transactors want their contracts to be given their usage-based meaning is deeply woven into both the Code and its Official comments; yet there is no empirical evidence that business transactors actually prefer contextualist adjudication. Indeed, the limited available evidence suggests that certain types of merchants and most large corporate contracting entities prefer more formalist approaches to adjudication.

Studies of contracting and dispute resolution in a number of merchant industries (particularly cash commodities markets) suggest that merchants strongly prefer formalist interpretation. In many of these markets contracts are governed by industry-drafted Trade Rules and are interpreted and enforced in trade-association run arbitration tribunals. Although these tribunals are staffed by expert, industry-participant, arbitrators who would be well-versed in any extant trade usages, the tribunals nonetheless adopt formalistic adjudicative approaches that that look to usage if and only if the

[162] Schwartz and Scott, *Contract Theory*, supra note __at __.

parties' contract, the relevant association's Trade Rules, and the UCC are silent on a particular question, that is, in the case of a true contractual gap.

The best available evidence about the interpretive preferences of large corporate transactors suggests that they too prefer formalistic adjudication. A recent study of choice of law provisions in large commercial (though not exclusively sale of goods) contracts[163] looked at whether transactors preferred to be governed by relatively contextualist California law (which applies a lax parol evidence rule), or relatively formalist/agreement centric New York law (which applies a strong parol evidence rule).[164] It found that transactors had a strong preference for New York law and concluded 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 . . . sophisticated parties prefer formalistic rules of contract law."[165] Similar transactor preferences were revealed by a European study that looked at choice of law provisions in business contracts subject to arbitration at the International Chamber of Commerce. It found that transactors strongly favored British law, the most formalistic of the available EU alternatives.

3. *Reducing Strategic Behavior Costs*

The adoption of the neo-formalists proposed default rule would most likely reduce the incidence of private language related strategic behavior; yet it is unlikely to do so as successfully as some of its proponents have suggested,[166] particularly when transactors opt for contextualized adjudication.

Under the proposed rule, when transactors opt for formalistic adjudication, their ability to claim that there contract was written in a private language will be severely constrained; yet to be effective the change in interpretive default would have to be combined with the adoption of a strong parol evidence rule that treated usage as

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[163] 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).

[164] Geoffrey Miller, *Bargains Bi-Coastal: New Light on Contract Theory*, 31 Cardozo L. Rev. 1475 (2010).

[165] Miller, *Bargains Bicoastal,* supra note __ at __.

[166] Schwartz and Scott (suggesting that the change in default will markedly reduce strategic behavior even when transactors choose contextualism) but see Bernstein, Merchant Law, supra note __ (arguing the opposite)

parol and included the "four corners" presumption of the common law. The study revealed that parties often seek to introduce usage evidence by framing their usage-based argument as a claim that the usage creates an "additional term," or a precondition to the invocation of a clear written term, rather than as a factor to take into account in interpretation.

Some proponents of the proposed rule suggest that it will also significantly reduce strategic behavior even when contextual adjudication is selected. They reason that a party selecting a contextualist default will only be able to play a language game by claiming that the plain meaning of the contract favors his position, something that will occur infrequently and only by happenstance. However, even if the contextualist option requires transactors to specify the industry and locations whose usages they are referencing once it is recognized how easy it is to prove a usage, it becomes clear that while including a clause opting to be governed by, for example, the "swine trade in Iowa" does restrict somewhat the types of "private language" arguments that can plausibly be made, it is likely that a party will be able to find an employee (or itself) to testify to a wide range of meanings of just about any provision, thus reintroducing the opportunity to engage in the types of strategic behavior the change in default rule was designed to eliminate or reduce.[167] Indeed, studies of the content of sales usages from the Middle Ages to the present, document that contrary to incorporationists claims, trade usages, to the limited extent that they exist at all tend to be far less precise and far more local in scope than either the Code or proponents of incorporation typically assume—making the range of usages that can be plausibly asserted extraordinarily broad in most transactional contexts.[168] As a consequence, except for the rare occasions where the private language at issue is codified in a written set of rules--such as the Incoterms, or a trade association Code like the Worth Street Textile Rules--when parties opt for contextualism, the likelihood of strategic behavior is likely to be either slightly reduced or essentially unchanged.

4. Smaller More Politically Feasible Changes

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[167] Bernstein, *Merchant Law for a Modern Economy, supra note_*

[168] For a summary of these studies see id.

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

One way for courts to improve the operation of the Code would be to give full effect to integration clauses that specifically mentioned usages of trade, courses of performance, and courses of dealing. This would transform the Code's adjudicative approach from a quasi-mandatory rule to a true default rule. Another would be for courts to more strictly enforce the Code's hierarchy of authority and to adopt a more robust definition of "conflict" that would make it more difficult to override express terms with usages or alleged usages. Although this proposed change, like the neoformalist proposal for shifting the default rule, would not eliminate strategic behavior and might simply induce parties to assert that usages create additional terms (unless it were accompanied by significant parol evidence rule reform), it would nonetheless greatly increase contracting certainty, increase the returns to careful drafting, and make more contract disputes amenable to resolution on motions for summary judgment.

Other changes that would improve the operation of the Code would require small (yet potentially controversial) amendments to the Code or its Official Comments. One potentially significant small change would be to amend the comments to 2-207 to make limitations on consequential damages, limitations on warranty, and clauses providing for arbitration, as either per se material alterations or nonmaterial alterations. Issues related to these clauses are often litigated and unlike cases where usages are introduced to interpret a contract provision or add an unwritten implicit clause to an agreement, the party seeking to exclude the different additional term

often has the burden of proving that the additional term is not a usage, something that is very expensive and difficult to do.

A final potential improvement that would be more radical in scope, yet consistent with Karl Llewellyn's view of role of usage based evidence, would be to bar usage evidence with respect to the core dickered terms of most deals—namely, price, quantity, and (if not part of boilerplate) quality and delivery. As the comments to early Code drafts explained, "Written bargains, in the days when the rules about them crystallized, were bargains whose detailed terms the two parties had looked over; and the rule was proper, that a signature meant agreement. When, however, parties bargain today, they *think* and *talk* of such matters as price, credit, date of delivery, description and quantity. These are the bargained terms. The unmentioned background is assumed without mention to be the fair and balanced general law and the fair and balanced usage of the particular trade."[169]

V. CONCLUSION

This essay has explored the desirability of the Uniform Commercial Code's interpretive approach on its own terms and on the terms put forth by its most ardent defenders. In doing so it has accepted incorporationists' assumptions that transactors prefer courts to adopt highly contextual interpretive approaches and that usages of trade that are widely known and geographically coincident with the extent of trade or important subsets of it exist. However, as suggested above, the existence of the types of trade usages that the Code looks to has never been demonstrated empirically, nor have business transactors' preferences for highly contextual incorporationist interpretive approaches been documented. Indeed the limited empirical evidence available on both of these questions cuts strongly against the incorporationists' claims.

In light of the best available evidence on these issues, and in the absence of any countervailing evidence, it is time to adopt a formalist default approach to the interpretation of business contracts that also leaves transactors free to opt for contextualism when they find it in their best interest to do so. It is only after an interpretive default rule that is in practice a *pure* default has been adopted that it

[169] REVISED SALES ACT, SECOND DRAFT, *supra* note 29, at 332-33 (Comment to § 1-C). Discussed in Kelley Testy.

will be possible to more quantitatively assess whether contextualism or formalism better reflects majoritarian preferences. And, it is only after research establishes that usages of trade that are widely known and geographically coextensive with the extent of trade (or important subsets of trade) exist and reflect obligations that transactors want courts to enforce (as opposed to "informal" or "relationship preserving" norms), that it will be possible to conclude that the incorporation strategy should even be one of the available interpretive default options—for even if parties desire it, if usages don't actually exist, the increase in the social costs of disputing created by the strategy can no longer be justified.