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Lisa Bernstein

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## THE MYTH OF TRADE USAGES: A TALK

Lisa Bernstein \*

### INTRODUCTION

The Uniform Commercial Code,<sup>1</sup> the Convention for the International Sale of Goods,<sup>2</sup> the proposed Common European Sales Law<sup>3</sup> and many other sets of commercial laws the world over, direct courts to look to unwritten usages of trade to interpret contracts and fill contractual gaps. These laws are built on three core assumptions. First, they assume that unwritten, trade usages exist. Second, they assume that in the event of a dispute the existence and content of these usages can be proven to a court with reasonable accuracy at a cost the parties consider reasonable from an ex-ante perspective. And, third, they assume that merchants want courts to look to usages in interpreting contractual language and filling contractual gaps.

This talk presents highlights from several of my empirical projects that were designed to explore the validity of these long-held and deeply rooted assumptions.<sup>4</sup> Although the evidence that I will share with you casts considerable doubt on these assumptions, it is important to emphasize at the outset that the findings may not be extensive enough (at least not at the moment) to definitively “disprove” these assumptions in the social-scientific sense of disprove. Nevertheless, in thinking about whether the evidence presented is sufficient to prompt a serious reconsideration of the role that trade usage plays in commercial-law systems, it is important to keep in mind that the policy makers and academics who continue to advocate for looking to trade usage in commercial adjudication have put forth little, if any, empirical evidence to suggest that usages exist, that their content can be proven to courts with

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\* Wilson-Dickenson Professor of Law, and Aaron Director Research Scholar, The University of Chicago Law School, and International Research Fellow, Saïd School of Business, The University of Oxford. This talk is based on several of my published research studies, see *infra* note 4. I would like to thank Roger Ford, Emily Kadens, Kate Lindgren, Arlette Slomensky, and participants at the University of Montpellier’s Custom and the Law Workshop.

1. U.C.C. arts. 1, 2 (Am. Law. Inst. & Unif. Law Comm’n 2017).

2. United Nations Convention on Contracts for the International Sale of Goods, April 11, 1980, 1489 U.N.T.S. 3, 19 I.L.M. 671.

3. Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on a Common European Sales Law /\* COM/2011/0635 final - 2011/0284 (COD) \*/.

4. Lisa Bernstein, *The Questionable Empirical Basis of Article 2’s Incorporation Strategy: A Preliminary Study*, 66 U. Chi. L. Rev. 710 (1999) [hereinafter *Questionable Empirical Basis*]; Lisa Bernstein, *Merchant Law in a Merchant Court: Rethinking the Code’s Search for Immanent Business Norms*, 144 U. Pa. L. Rev. 1765 (1996) [hereinafter *Merchant Law*]; Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms, and Institutions*, 99 U. Mich. L. Rev. 1724 (2001) [hereinafter *Creating Cooperation*]; Lisa Bernstein, *An (Un)common Frame of Reference: An American Perspective on the Jurisprudence of the CESL*, 50 COMMON MKT. L. REV. 169 (2013); Lisa Bernstein, *Merchant Law in a Modern Economy*, PHILOSOPHICAL FOUNDATIONS OF CONTRACT LAW (Gregory Klass et. al. eds., 2015) [hereinafter *Modern Economy*]; Lisa Bernstein, *Custom in the Courts*, 110 Nw. U. L. Rev. 63 (2015).

reasonable accuracy at a reasonable price, or that merchants want courts to look to usages in interpreting contracts and filling contractual gaps.

In the main, those who support looking to usages to resolve disputes, have looked to two sources of evidence to support their assertion that usages of trade that are generally known across the relevant community of merchants exist. The first source of evidence is ad hoc examples like the fact that everyone knows that a 2x4 piece of wood is not a piece of wood measuring two inches by four inches.<sup>5</sup> Yet a closer look at the most common examples, reveals either significant disagreement about the term's meaning, or that it was memorialized in a written source.

The second source of support for the proposition that unwritten usages of trade exist, and the one that is invoked the world over, is the *story*, and I do want to emphasize here the word, *story*, of the so-called Law Merchant of the Middle Ages in which unwritten transnational sales-related usages that were widely known among merchants were said to have supported long distance trade.<sup>6</sup>

Yet over the past decade historians like Emily Kadens of Northwestern and Charlie Donahue of Harvard have successfully debunked the myth that transnational usages of trade that dealt with core areas of sales law existed in this period.<sup>7</sup> Their extensive archival research has demonstrated that such usages as existed were either highly local in nature, or very vague in form--amounting to little more than a basic exhortation to act in good faith.

As for the assumptions that courts can find the content of usages and that most merchants want them to do so when interpreting contracts and filling contractual gaps, these too have not been empirically demonstrated by the proponents of usage-based approaches to commercial law. Moreover, the best available empirical evidence suggests that courts have great difficulty determining the content of usages and that merchants have a strong preference for formalist/textualist jurisprudential approaches that eschew inquiries into usage and other elements of the contracting context.

It is against this background that I want to share with you some studies I undertook in the spirit of getting realist about legal realism--that is, to do the kind of work that legal realists themselves would have done before drafting the Uniform Commercial Code had they in fact followed the social-scientific approach to law that, led by Karl Llewellyn himself, they so forcefully advocated in theory.<sup>8</sup>

5. See e.g. Stewart Macaulay, *Relational Contracts Floating on a Sea of Custom? Thoughts about the Ideas of Ian MacNeil and Lisa Bernstein*, 94 Nw. U. L. Rev. 775, 787 (1999–2000).

6. For two canonical recitations of the Law Merchant Story see e.g., Bruce L. Benson, *The Spontaneous Evolution of Commercial Law*, 55 S. ECON. J. 644 (1989); HAROLD BERMAN, *LAW AND REVOLUTION: THE FORMATION OF THE WESTERN LEGAL TRADITION* (1983).

7. See Emily Kadens, *Myth of the Customary Law Merchant*, 90 TEXAS L. REV. 1153 (2012); Emily Kadens, *The Medieval Law Merchant: The Tyranny of a Construct*, 7 J. LEGAL. ANALYSIS 251 (2015); Emily Kadens, *Order within Law, Variety within Custom: The Character of the Medieval Merchant Law*, 5 CHI. J. INT'L LAW 39 (2004); Charles Donahue Jr., *Medieval and Early Modern Lex Mercatoria: An Attempt at the Probatio Diabolica*, 5 CHI. J. INT'L LAW 21 (2004).

8. See WILLIAM TWINING, *KARL LLEWELLYN AND THE REALIST MOVEMENT* (1973).

### I. DO TRADE USAGES EXIST?

Let's begin by returning to the first core assumption underlying the law of trade usages, namely that unwritten, industry-wide usages of trade that are geographically coextensive with the scope of trade exist in merchant communities.

In an effort to explore the validity of this assumption, I began from the generally accepted premise that usages are most likely to arise and endure in situations where transactors interact: on a repeat basis, over a long period of time, in relatively similar transactions. I then identified and studied four merchant industries--hay, grain and feed, textiles, and silk--that were roughly characterized by these conditions in the early 20th Century.<sup>9</sup>

Each of these industries also created a private legal system to arbitrate disputes among its members. And, in an effort to provide a set of rules for their arbitrators to apply, each industry's trade association/s undertook to codify their industry's unwritten customs and usages into written Trade Rules. If the customs and usages of these industries had, in fact, been widely-known and relatively uniform, codifying them should have been a quick and straightforward process.<sup>10</sup> Yet it was not. The rules committees tasked with codification quickly discovered that there was no widespread agreement about either the meaning of industry terms of art or the content of supposedly standard trade practices. The codification process took years for most industries to complete. The deliberations were fraught with contention. Moreover, when industries finally did succeed in producing trading rules, they wound up doing so through a quasi-legislative process in which assertions about the content of usages were but one of dozens of inputs into the rule making process.

To get a sense of just how basic and pervasive these disagreements were, it is useful to look at the hay industry. As their codification process got under way, it soon became clear that there was not even agreement on the meaning of the term "bale" of hay. As one transactor explained:

The large bales of New York and New England means a different bale from the large bale in the Western States, and the same is true of the small bales. In Chicago at present there is a lack of clear definition of small bales.<sup>11</sup>

Moreover, some transactors jumped into the debate claiming that whether or not something was a bale was to be determined by its size, while others maintained that it was to be determined by its weight.

In addition, while the UCC looks to usage to determine the meaning of the reasonable time for the taking of an action, the hay industry debates reveal that there was also a lack of consensus over the meaning of such terms. For example, when an attempt was made to draft a rule relating to when certain freight charges had to be

9. These case studies can be found in *Questionable Empirical Basis*, *supra* note 4.

10. For a discussion of why rent seeking was unlikely to have been a reason for disagreements in this context, see *Questionable Empirical Basis*, *supra* note 4, at 740–44.

11. Bernstein, *Questionable Empirical Basis*, *supra* note 4, at 721.

requested, one transactor proposed a rule requiring them to be requested in a “reasonable time.” This suggestion, however, provoked ridicule and widespread disagreement. As one participant opined, “that ‘reasonable time’ business will not tell anything. You might as well leave it out.” And, in response to a suggestion that a more definite rule be adopted, one transactor proposed “nine months,” another “fifteen days,” and still another, “within ten days after the freight bills have been paid.”<sup>12</sup>

Indeed, this type of disagreement is not surprising. In the debate over the UCC itself, a representative of the Merchants Association of New York opposed including the “observance of reasonable commercial standards,” in the duty of good faith, explaining that:

The usages, customs and practices of business are far from being uniform, and the determination of whether a merchant has conformed to reasonable commercial standards would be difficult.<sup>13</sup>

The type of terminological disagreements observed in the hay industry were not mere artifacts of geographically expanding markets in a temporary state of flux. Similar problems and disagreements arose during the codification efforts undertaken by the relatively close-knit textile industry, which had been centered on a three-block area in lower Manhattan for over thirty years when the codification effort began. The textile merchants were unable to achieve a consensus even about the meaning of everyday terms like “first quality” and “second quality.” Consensus was so difficult to achieve that different sets of rules were eventually developed for many small industry segments. Yet even with this high degree of segmentation, many terms and practices remained uncoded because agreement could not be reached. After eighteen years of infighting, the thirty-nine page Worth Street Textile Trading Rules were promulgated; yet it was another twenty years before disputes over the meaning of key terms of trade, even those defined in the rules, began to abate.

Similar difficulties in codifying customs were also encountered in the grain industry, the silk industry, the cotton industry, the lumber industry and many others. In the lumber industry, for example, merchants could not even agree on a single meaning for the commonly used designation 2x4.<sup>14</sup> As noted above, the fact that everyone knows that a 2x4 is not two inches by four inches is the most commonly mentioned example of an unwritten custom, yet a closer look at the history of the 2x4 reveals that there was not, in fact, a generally accepted usage-based meaning of the term.

Although it was true many people knew that a 2x4 was not a board measuring exactly two inches by four inches, for a very long time there was no agreement on what the measurements of a 2x4 actually were. The term had one meaning in the

12. Bernstein, *Questionable Empirical Basis*, *supra* note 4, at 722.

13. *Questionable Empirical Basis*, *supra* note 4, at 745 (citing Commerce and Industry Association of New York, Inc. *Memorandum of Task Group of the Special Committee of the Commerce and Industry Association of New York, on the Uniform Commercial Code on Article 2, Sales and Article 6, Bulk Transfers*, in *Study of UCC Memoranda* 24, 29, reprinted in State of New York, 1 *Report of the Law Revision Commission for 1954* at 88–93).

14. For a history of the 2x4, see *Modern Economy*, *supra* note 4.

West and one in the South, one for dry wood and one for wet wood, one at the mill and another at the lumber yard, and so on.

Although the industry tried to achieve nation-wide consensus, they were unable to do so. In the end, industry trade associations from across the country joined together and asked the Government to issue a product standard to resolve the disagreement. In 1964, after extensive consideration, a U.S. Product Standard was adopted.

Although one might wonder whether these types of disagreements about usage are an artifact of a bygone era, a study based on a structured survey of unwritten usages in the grain and feed trade conducted in and around Amarillo, Texas in the late 1990s suggests that they are not.<sup>15</sup> Amarillo is a place where all of the preconditions conducive to the emergence of usages were present, yet transactors simply did not agree on the content of usages or the meaning of words.

For example, although transactors agreed that a price adjustment was often an appropriate response to the delivery of non-conforming goods, they differed widely as to how exactly the price difference was to be calculated. Some transactors said it should be negotiated, while others maintained it should be done on the basis of a regional or local price list. Transactors could not even agree on the meaning of the terms like FOB or even what the acronym stood for—“when asked . . . 6 percent said, they did not know, 2 percent said ‘factory on balance,’ 32 percent said ‘fee on board,’ 22 percent said, ‘freight on board,’ 2 percent ‘freight on delivery,’ and 34 percent responded in different ways.”<sup>16</sup>

The study also asked transactors whether there were unwritten usages and practices they expected their contracting partners to follow. Although 72% said there were such usages, not a single transactor was able to give an example. Eventually, after additional question probes were used, 65% gave an example, but among their answers half were practices that were codified in written industry rules, and most of the others were just old-boy rules of thumb like, “Follow the golden rule,” or “My word is my bond.”

Taken together, these studies reveal that even in merchant communities where all of the ideal preconditions for the emergence of robust trade usages were present, transactors did not agree about the content of trade practices or the meaning of industry terms of art. Although the studies did reveal a few vague or highly localized usages, such as that hay should not have a bad odor, they nonetheless suggest that even under these ideal conditions, trade practices did not amount to anything close to the all-pervasive sets of implicit gap-filling provisions and dictionary-type interpretive guides assumed by the Uniform Commercial Code and other usage-friendly commercial law systems.

## II. CAN COURTS FIND USAGES

A common response to the findings of the case studies of these merchant industries is that they must be wrong because transactors prove the content of trade usages

15. For an overview of this study, see Bernstein, *Modern Economy*, *supra* note 4, at 246–249.

16. Bernstein, *Modern Economy*, *supra* note 4, at 57.

in court every day, using expert witness testimony, trade codes, and statistical studies about the prevalence of transacting practices.<sup>17</sup>

This claim, however, turns out to be false. I undertook a study of all the trade usage cases digested under the Code's trade usage provision from 1970 to 2007.<sup>18</sup> For a third of the cases, the study looked not only at the courts' opinions but also at large portions of the record and evidence submitted. It found that:

□ The introduction of non-party witness testimony was far from being the norm. In the cases that went to trial plaintiffs introduced non-party witness testimony 20.8% of the time and defendants did so 22.9% of the time. Since this group includes both expert and all other non-party witnesses, it provides an upper bound for approximating the frequency with which expert witness testimony was introduced.<sup>19</sup>

□ Even in cases where a trial was held and a trade usage was found to exist, expert witness testimony was introduced in at most 31.5% of the cases.<sup>20</sup>

□ Similarly, trade codes or other trade-association publications were offered into evidence in only 11% of cases, and were admitted into evidence in only about 6%.<sup>21</sup>

□ Finally-- perhaps most strikingly-- the study did not uncover a single case in which statistical evidence was introduced to demonstrate the regularity with which a practice was followed.<sup>22</sup> Rather, regularity of observance, to the extent it was mentioned at all, was typically demonstrated through witness assertions like "yeah that's common" not data or even concrete examples of transactions in which the alleged usage was actually followed.<sup>23</sup>

Together, these findings raised the question: How, then, do parties attempt to prove usages? The answer is that parties introduce far less evidence, and far less reliable evidence, than theorists generally assume. More specifically, in practice, the most common type of evidence introduced was simply the testimony of the parties or their employees. In just over 50% of the cases that went to trial and found a custom to exist, this testimony was the only evidence of usage introduced. Similarly, on motions for summary judgment, non-movants successfully defeated summary judgment on the basis of an asserted usage 70% of the time, and in 83% of those cases, the

17. See e.g., Jody S. Kraus & Steven D. Walt, *In Defense of the Incorporation Strategy*, THE JURISPRUDENTIAL FOUNDATIONS OF CORPORATE AND COMMERCIAL LAW 193 (2000).

18. Bernstein, *Custom in the Courts*, supra note 4.

19. Bernstein, *Custom in the Courts*, supra note 4.

20. Bernstein, *Custom in the Courts*, supra note 4, at 79.

21. Bernstein, *Custom in the Courts*, supra note 4, at 79.

22. Bernstein, *Custom in the Courts*, supra note 4, at 79–80.

23. Bernstein, *Custom in the Courts*, supra note 4, at 79–80 and n.64 ("To get a feel for the types of evidence that courts accept as fulfilling the statutory requirement that the usage be regularly observed, consider the testimony that was actually introduced in *Spurgeon v. Jamieson Motors*, 521 P.2d 924 (Mont. 1974) where a trial was held and the court found the claimed usage to exist. In *Spurgeon* two of the defendant's employees testified as to the usage of the used farm machinery trade. Ingeman Svendson testified that he had worked with farm machinery for forty years. When asked whether it was customary to warrant used combines, he said "no." That was the extent of his testimony on the scope of the usage. Transcript of Record at 41, *Spurgeon*, 521 P.2d 924 (on file with author). Keith Jamieson also testified to Jamieson Motors' policy of sharing repair costs 50-50 on newer used models and providing no additional warranties. He was then asked if this was "pretty much standard throughout the business in your trade." He replied that it was. Id. at 79.")

only evidence of the usage submitted was a cursory affidavit by an employee.<sup>24</sup> Indeed, across the data set as a whole, the evidence of usage introduced by the parties was so thin, that I was not able to identify a single alleged usage whose “existence” had been in fact demonstrated to exist in the manner and to the extent assumed in the literature or expected by the Code’s drafter.

In sum, this study suggests that even if usages in fact exist, the types of evidence of them that parties introduce—typically the testimony of themselves and their employees—is unlikely to demonstrate their content with the reliability that legal theorists assume.

### III. DO MERCHANTS WANT COURTS TO LOOK TO TRADE USAGE?

The final assumption underlying the idea that courts should look to trade usages to fill gaps and interpret contracts, is that commercial transactors want them to do so. However, this assumption also turns out to be highly questionable.

Some evidence about merchant preferences in this regard can be found in my studies of:

- The trade rules used in industries with trade association-run private legal systems; and
- My detailed case studies of the jurisprudence of the merchant staffed arbitration tribunals in the grain & feed<sup>25</sup> and cotton industries.<sup>26</sup>

These studies show that even though the arbitration tribunals in these private legal systems are staffed by merchant arbitrators who are participants in the relevant trade and should thus be up to date on any relevant usages, these tribunals only look to usage in the narrowest of circumstances. They do not look to unwritten usages to interpret contractual provisions; and only look to usages to fill contractual gaps when both the contract and the association’s written trade rules are silent. Even then, they do not automatically incorporate usages, but rather look to them as just some evidence of what a good gap-filler might be, with their acceptance turning largely on the business justification given for them.

These findings suggest that merchants do not want adjudicators to look to usage to decide cases in any but the narrowest of circumstances. They are consistent with other more generalized studies of transactor preferences and contracting choices which strongly suggest that business transactors have a strong preference for formalistic adjudication. For example, one study found that business transactors prefer relatively textualist/formalist New York law over very contextualist California law.<sup>27</sup> Similarly, a study of choice-of-law clauses in Europe “that looked at choice of law provisions in business contracts subject to arbitration at the International Chamber

24. Bernstein, *Custom in the Courts*, *supra* note 4, at 80–81.

25. Bernstein, *Merchant Law*, *supra* note 4 (providing a case study of the grain and feed industry).

26. Bernstein, *Creating Cooperation*, *supra* note 4 (providing a case study of the cotton industry).

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

of Commerce. . . found that transactors strongly favored British law, the most formalistic of the available EU alternatives.”<sup>28</sup> Together this and other evidence<sup>29</sup> suggests that commercial contracting parties prefer the meaning of their contracts to be governed more by their written meaning than by elements of the contracting context or broad standard-like legal formulations requiring that things be done: reasonably, seasonably, in good faith or in keeping with the customs and usages of particular trades. In American sales law, these terms are given more precise meaning largely by reference to trade usages.

### CONCLUSION

In closing, I want to suggest that even if unwritten usages exist, are typically known by transactors in the relevant markets, and can be proven to courts with reasonable accuracy at a reasonable cost, there are a number of reasons identified by myself and fellow neo-formalist scholars Alan Schwartz and Robert Scott<sup>30</sup> that these considerations should not be taken into account in filling gaps and interpreting commercial contracts, at least not in business contracts in the United States.

Among the most important reasons that courts deciding business-to-business commercial cases should not look to usages in adjudicating cases, are that the incorporation of usages:

- May increase specification costs--that is, the cost of contract drafting--as transactors strive to fortify their contracts against usage-based interpretation and specifically negate usages they want to exclude;
- May increase interpretive error costs, because the evidence that is accepted as proving a usage is so thin;
- May increase the cost of adjudication;
- May reduce the likelihood that cases can be resolved on motions for summary judgment due to the fact specific nature of the usage inquiry; and
- May encourage various types of strategic behavior.

In addition, and perhaps most importantly, when the law directs courts to incorporate usages into contracts, and in many instances courses of performance and dealing as well, it blurs the line between the legal and nonlegal aspects of parties understandings. It therefore prevents parties from structuring their commercial relationships using their preferred mix of:

- legally enforceable contract provisions backed by legal sanctions, and

28. Bernstein, *Custom in the Courts*, *supra* note 4, at 109 (citing Stuart Popham, Clifford Chance LLP, *The View of European Business: Survey Results*, PowerPoint Presentation (Mar. 14, 2008), [http://denning.law.ox.ac.uk/news/events\\_files/Popham\\_-\\_presentation.PPT](http://denning.law.ox.ac.uk/news/events_files/Popham_-_presentation.PPT)).

29. Commercial contracts often include provisions opting out of trade usage, see *id.* at 178 (“See Network Engines, Inc. & VA Linux Systems, Inc., Supplier Agreement cl. 20.18 (Mar. 1, 2000) (on file with the Northwestern University Law Review) (“This Agreement shall not be modified and/or amended by any course of dealing, course of performance or trade usage.”); Compaq Computer Corp. & Brocade Communications Systems, Inc., Corporate Purchase Agreement cl. 31.6 (Feb. 1, 2000) (on file with the Northwestern University Law Review) (“This Agreement . . . shall not be supplemented or modified by any course of dealing or trade usage. Variance from or addition to the terms and conditions of this Agreement in any Order, or other written notification from Seller will be of no effect.”).”)

30. See Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L.J. 541 (2003).

- Extralegal norms and agreements, backed only by nonlegal sanctions.

Because legal and nonlegal obligations are often well-suited to governing different aspects of commercial agreements, this consideration, even standing alone, suggests that the incorporation of trade usage into commercial agreements may be quite costly to business contracting, even if trade usages exist.