THE DEVELOPMENT OF TRADE CUSTOMS IN INTERNATIONAL SALES

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I. Two uses of custom.

A. To provide a standard of performance or enforcement in transactions that law does not reach and where extralegal enforcement, such as reputation, fills the void. These include situations where law is costly because, for instance, compliance with the legal standard is observable to the parties, but not easily verified by a third party, such as a court. Thus, customs are likely to arise in international trade because both transactions costs (negotiation of contracts) and enforcement costs may be high.

1. Examples: Medieval trade customs that evolved in cross-border transactions that were either costly to negotiate or to enforce through traditional legal mechanisms. These are the kinds of customs described by Greif; Milgrom, North, and Weingast.

B. To explain the meaning of positive law that is stated in relatively ambiguous terms. These are the kinds of customs that some commentators (Walt) advocate should be incorporated into the interpretation of positive law. Custom of this sort is also likely to arise in international trade because positive law that implicates parties from different nations, cultures, and economic systems is likely to be drafted at a high level of abstraction.

1. Examples: Understanding what constitutes a "reasonable time" for giving notice of a defective performance, or augmenting the written terms of a contract with widely accepted trade terms, such as INCOTERMS.

II. Sources of customs.

A. Ideally, customs that either fill voids or that provide precise meaning to vague legal provisions will reflect the terms that parties to the transaction would have agreed to had they actually negotiated the terms of a contract. Customs that evolve in this manner are likely to contain relatively efficient allocations of contractual risk or to solve contracting problems that arise because negotiations are too costly, or enforcement costs are too high. Under these circumstances, we would presumably want customs to be enforceable or otherwise to dictate best practices by commercial parties. In short, custom ideally provides a way to reduce transactions costs for parties without formal and costly legal intervention.

1. Example: Greif stories about enforcement of contracts through informal mechanisms; eBay transactions supported by Feedback Forum.

B. But custom in international trade does not necessarily evolve in this way. In theory, customs may instead evolve because one trading partner has sufficient market power to enforce its will on another (a monopoly story). Alternatively, a custom may arise because a particular entity is able to create salience around a particular set of practices that serve the interests of that entity. The entity may be able to accomplish this even though the resulting custom does not necessarily serve the interests of those whose conduct is governed by the custom (a political economy story).

1. Examples: In drafting of the United Nations Convention on Contracts for the International Sale of Goods ("CISG"), some nations expressed concern that customs should not

be incorporated because they would tend to reflect the practices imposed on less developed countries by developed countries. This is a monopoly story. Nevertheless, there is little evidence that customs evolving in this manner have had much effect in international trade. Customs promulgated by organizations, and thus susceptible to political economy explanations, have been abundant. But these customs may reflect the interests of the group that promulgates them rather than the interests of those who are governed by them.

C. Moreover, customs, like laws, may be difficult to change once promulgated. Thus, they suffer from a risk of lock-in because it may not be in the interest of affected parties to alter the custom, even though a superior alternative is available. Under these circumstances, we would want customs to be displaced either by new customs or by positive law.

III. As a matter of institutional design, we would want to retain and give legal support for or deference to customs when they emerge from bargains and are capable of being displaced when they threaten to become locked in. Conversely, we would want to ignore customs that appear to have evolved from less benign sources or that command compliance even though the customs are outmoded.

A. What are the institutional mechanisms, if any, by which we could identify the different sources of customs in international trade and thus incorporate those customs that are deserving of protection while nullifying customs when positive law would better allocate contractual risks? Are courts capable of identifying the conditions under which customs would have positive characteristics and distinguish in which deference to customs would have negative effects?