Virginia Journal of International Law
Spring, 1999

The Fifteenth Sokol Colloquium on Private International Law: Unity and Harmonization in International Commercial Law
Article

***707** HARMONY AND STASIS IN TRADE USAGES FOR INTERNATIONAL SALES

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I. Introduction

The commercial law literature contains a somewhat traditional story about the efficient incorporation of trade usage into commercial contracts, a story that is a straightforward consequence of incomplete contracting. 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. At the same time, defaults can reduce errors in expression and interpretation attributable to more highly tailored contract terms. [FN1] The favored defaults may take the ***708** form of state-supplied contract terms. The Uniform Commercial Code ("UCC") and the United Nations Convention on Contracts for the International Sale of Goods ("CISG") provide basic rules that presumably would be acceptable to most parties whose contracts fall within the scope of those codes. But usages of trade, what I call custom, [FN2] provide an alternative source of majoritarian defaults. Custom allows parties in a particular trade to settle on loss allocation practices that may initially have

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been the subject of explicit bargains, but that have become sufficiently regularized among members of the trade that negotiations are no longer necessary to agree on the term that is the subject of the custom. As with state-supplied defaults, the assumption is that the majority of those members would have achieved the same allocation had costly negotiation occurred. [FN3] Indeed, custom is superior to legal defaults insofar as it provides rules more highly tailored to the requirements of a particular industry and, theoretically, is more susceptible to changes warranted by commercial need than is the process of legislative revision. Hence, custom is seen as the result of an evolutionary process in which suboptimal commercial practices are displaced by superior ones. [FN4]

This story provides a compelling rationale on which to elevate custom to the status of legal rule. Requiring adherence to custom not only protects the expectations of parties who are aware of the practices of the trade and anticipate compliance by others in same trade [FN5]; it also minimizes the risks related to judicial construction of contractual obligations or reliance on state-supplied defaults that ***709** do not fit the needs of specific industries. [FN6] In short, reliance on customs that evolve in accordance with the traditional story facilitates communication both among members of a trade and between those members and third parties.

Nevertheless, the existence of a pattern of behavior in circumstances that arise with sufficient frequency to create a common practice does not necessarily imply that the parties have optimally allocated the risks inherent in those circumstances. Even if parties seek efficient allocations, they may lack the information necessary to achieve that end or may suffer from cognitive errors that preclude its realization. [FN7] The fact that actors within an industry repeat the same error does not transform that error into a desirable result. Nevertheless, application of the custom does serve the function of reducing the costs of contracting, and it is unclear whether any noncustomary default rule would produce greater efficiency, especially if industry members consistently contracted back into the custom. We would anticipate that at least some customs are likely to be efficient when they first materialize, given that parties to contracts internalize significant effects of their bargain. This is particularly true where customs allocate risks that materialize with frequency, so that the propriety of the allocation is consistently tested by market forces. [FN8] The same market pressures suggest that customs can evolve to reflect preferable industry practices. Hence, custom offers a plausible, if not inexorable, basis for interpreting the parties' intent when they use particular terms or for filling gaps in incomplete contracts. At the very least, an opponent of custom should want to offer a superior alternative to the interpretive and gap-filling roles that trade usages can play. [FN9]

***710** It is perhaps for these reasons that custom has become integrated into both domestic law and international law concerning the sale of goods. Although some, most prominently Professor Bernstein, have recently questioned the robustness of customs, their existence is assumed in current doctrine. [FN10] The application of ***711** trade usages to interpret contracts under the UCC is well rehearsed. [FN11] In international sales law, custom becomes part of a contract under Article 9(2) of the CISG and takes precedence over conflicting positive provisions of that treaty. [FN12] Trade usages are similarly recognized by the UNIDROIT principles, although they are not given complete authority, in that their application is excluded where doing otherwise would be "unreasonable." [FN13]

Much of the literature on custom, however, suggests that the traditional story of efficient evolution and application is less compelling than we might initially believe. Customs can be relatively imprecise, so that third-party arbiters are uncertain about the definition of the custom or the conditions under which it operates. If that is the case, custom may provide the least guidance when appeal to its strictures becomes most important, that is, when commercial parties disagree about their obligations. If courts have significant leeway in defining the terms and scope of a custom, and may use that discretion in a manner that deviates substantially from the intent of at least one of the parties, then much of the certainty that custom allegedly offers dissipates.

The discretion that courts have to decipher and apply custom is well understood. [FN14] The absence of uniformity that might result from such discretion might be thought to be exacerbated in the very area that has adopted the most liberal use of custom, international commercial transactions. (Long before attempts to codify international commercial law, commercial actors created a lex mercatoria that comprised commercial regularities.) There is, after all, no international court charged with interpreting commercial***712** custom, so national courts must ultimately subordinate local interests to harmonize interpretations of commercial practices. [FN15] Moreover, there is at least some reason to fear that the judicial role in interpreting international custom interacts with another phenomenon that threatens the veracity of the traditional story. The

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recent literature on network effects and other interrelationships among those within a trade suggests that where a standardized practice or technology provides increasing returns or confers learning benefits, users have disincentives against shifting to a new standard, even one that is demonstrably superior to the status quo. While this literature has developed largely in the context of technological standards, recent applications have extended the theory to legal principles. In a series of articles, Marcel Kahan and Michael Klausner have raised the theoretical possibility that standardized terms in corporate contracts may become locked-in through effects akin to network benefits and learning benefits, [FN16] reinforced by cognitive biases and biases towards conformity that favor the status quo. [FN17] Similarly, Jody Kraus has suggested that the type of social learning that ideally allows transmission of knowledge within a society may be beset by internal defects that impede the development of superior alternatives to current social practices. [FN18] The terms that Kahan and Klausner discuss are explicit terms incorporated directly within a contract, rather than the implied terms that constitute trade usages. Nevertheless, Kahan and Klausner essentially contend that these terms are subject to stasis once they become customary. Thus, the application of the theory of network effects directly to custom itself seems a natural test of their claims.

If lock-in of the type predicted by Kraus or Kahan and Klausner occurs in commercial trade usages, then the story in which custom not only reflects majoritarian preferences, but also evolves efficiently, is suspect. If the locked-in usage reflects a judicial misapplication ***713** of the commercial practice, then the story turns commercial reality on its head. This article, then, investigates whether custom in international sales can, in fact, be defended on the theory that harmonization of practices will reflect a result that would be attained by reasonably informed commercial actors who, in the absence of custom, bargained explicitly about the risk that the custom addresses. I conclude that the risk of judicial misconstruction is real, but less compelling as a reason for ignoring custom than some theory suggests. Similarly, I conclude that while there exists a theoretical possibility that inertia will impede development of efficient international customs, in at least some circumstances international sales transactions may provide a uniquely robust means for avoiding lock-in. Thus, there remains an empirical issue as to whether the traditional story is accurate. My conclusion, however, is not that the mechanisms that avoid inertia necessarily support the traditional story of custom. Indeed, I suggest that the very mechanisms that save custom from one source of inefficiency may provoke another.

I begin with a summary of the doctrine concerning custom in international sales law. I then examine the capacity of courts to decipher and apply custom. In Part V, I discuss the mechanisms available in international sales for overcoming lock-in. I conclude with summary remarks and a brief discussion of the implications of my findings for judicial interpretation.

II. The Doctrine

Commercial actors can, of course, explicitly opt into customary practices. For instance, Article 1 of the Uniform Customs and Practice for Documentary Credits, promulgated by the International Chamber of Commerce to regulate use of documentary credits, provides that its provisions "shall apply to all Documentary Credits . . . where [the provisions] are incorporated into the text of the Credit." [FN19] The CISG similarly binds parties to any trade usages to which they have explicitly agreed. [FN20] But courts have long considered custom as a source for filling contractual gaps or interpreting contractual terms in international transactions even in the absence of explicit contractual or treaty provisions to that effect. ***714** All that body of law known as lex mercatoria is, of course, customary in that it evolves within the practice. The state plays the role of enforcing the agreement within the practice, but not of defining the terms of the agreement. [FN21] Even where legal principles of general application are applied to commercial actors, ambiguities in the parties' dealings have been resolved by reference to trade usage. [FN22] Hence, commercial usages are deemed to constitute "an international body of law, founded on the commercial understandings and contract practices of an international community composed principally of mercantile shipping, insurance, and banking enterprises of all countries." [FN23]

The widespread adoption of the CISG ensures further judicial enforcement of commercial custom in international sales. Article 9(2) provides:

The parties are considered, unless otherwise agreed, to have impliedly made applicable to their contract or its formation a usage of which the parties knew or ought to have known and which in international trade is widely known to, and regularly observed by, parties to contracts of the type involved in the particular trade concerned. [FN24]

On its face, this provision takes an intermediate stand between ignoring custom and imposing it on all parties. Binding

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custom is limited to those situations in which the parties knew or should have known of its existence and to those customs adhered to in international trade among parties in the same industry as the one involved in the dispute to be resolved under Article 9(2). Thus, a purely national custom within the seller's jurisdiction would not apply to a contract concluded with a buyer from another jurisdiction. [FN25] The CISG, however, does not require an entirely subjective understanding of practices. The requirement that custom applies when parties knew or "ought to have known" of its existence means, for instance, that a novice in the trade could be charged ***715** with a custom that existed internationally, notwithstanding personal ignorance of its existence. [FN26] Presumably, the underlying theory is that anyone involved in the trade is obligated to discover the relevant practices or at least to signal ignorance in a manner that negates the ability of other trading partners to assume the novice's knowledge.

The cases that have arisen under the CISG to date indicate a willingness of courts to consider international customs in determining both the existence and terms of commercial contracts. In one case, for instance, an Austrian court determined that the absence of a writing did not preclude the finding of a contract for the sale of natural gas because there was no evidence of a trade usage to the effect that writings were required to create a contract. [FN27] Furthermore, the fact that the parties disagreed on the precise amount of gas to be delivered did not negate the existence of a contract because the use of reasonable approximations was customary in the natural gas industry. Other courts have allowed litigants to collect interest on judgments, notwithstanding contractual silence on the issue, on the theory that payment of interest was an accepted usage of international trade. [FN28]

Adherents to the traditional story of custom should consider the CISG's approach a positive development. The requirement that the custom be known to all parties implies that they were aware of it and thus had incentives to contract out of any custom that did not reflect their implicit bargain. The requirement of internationality suggests that the custom is not simply tailored to local conditions, but enjoys a robust application, evincing a universality that implies majoritarian preferences and, if the evolutionary story of custom is to be believed, efficiency. Presumably, if the practice ***716** did not serve the interests of commercial parties, competing practices would have arisen in some part of the commercial world to challenge the existing practice. And if the efficiency of a practice were heavily dependent on underlying conditions that might vary significantly in different geographical areas or cultures, we would expect to see multiple practices in international trade, none of which was appropriate for universal application. In other words, we would see no custom at all.

III. Defining the Custom

Why, then, should we have any doubts about incorporating custom into international sales? The first concern lies with the ability of courts to define and apply custom in a manner consistent with commercial understanding. Custom is inherently vague--some call it "fuzzy"--so that its formal elaboration by courts (as opposed to informal application through extralegal procedures) is often doomed to misstate the actual practice of transactors. This claim has been a constant source of critique of judicial application in domestic law. Thus, I want here only to summarize the argument and suggest why it may be heightened when the custom arises out of international, rather than domestic, transactions.

Customs arise from a context. When defining the custom in order to determine whether it governs a given set of facts, it is difficult to know how much of the context in which the custom arose is necessary to its subsequent application. Take, for instance, the facts of Dixon, Irmaos & Cia, Ltda. v. Chase National Bank. [FN29] In that case, a Brazilian exporter had contracted to sell cotton to a Belgian purchaser. Chase (at the request of a Belgian bank) had issued two letters of credit on behalf of the purchaser. The terms of the credit required Chase to honor drafts accompanied by specified documents, including "a full set of bills of lading." The seller shipped the goods and received two original bills of lading for each shipment, but only one of the two sets of bills of lading was presented to Chase by the due date. In lieu of the other set, the exporter's New York representative, another New York bank, gave Chase an indemnity agreement against loss. Chase dishonored the drafts on the grounds that both full sets of bills of lading had not been presented. The plaintiff introduced evidence that New York banks that financed international sales with letters of credit customarily ***717** accepted a guaranty in place of a missing document when the letter of credit required a "full set of bills of lading." [FN30] The court found that Chase was bound by the custom, and had failed to follow it in this instance only because the German invasion of Belgium had intervened. Since Chase was a confirming bank, entitled to recover from the purchaser's Belgian bank once it honored the drafts, Chase may have been concerned about its ability to obtain reimbursement rather than with the adequacy of the presented documents. The court, in short, believed that Chase was simply acting opportunistically.

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Constraining opportunism certainly seems to be an appropriate motivation for judicial interpretation of contracts. But the nonopportunistic "custom" stated by the court was not necessarily the custom as practiced among banks. Presumably the custom arose because, where a bank guaranty was given, the probability that the shipment represented by the missing documents would not reach the purchaser was sufficiently low that payment would not prejudice the issuing or confirming bank's customer or jeopardize the right to reimbursement. In these circumstances, the reason for rejecting the guaranty might be thought to involve dissatisfaction with the deal rather than with the seller's performance. But if that was the justification for the custom, then it might not apply in situations where the risk of nonreceipt of goods or nonreimbursement was atypically high. It does not take too much imagination to conclude that such situations include the existence of hostilities in the country of receipt or reimbursement. If the rationale for the custom is more suspect in these circumstances, then the actual scope of the commercial practice may be different from the court's characterization of it. Assume, for instance, that the practice of accepting guaranties had developed during peacetime and had not theretofore been tested during wartime. One might now restate the custom in a variety of equally plausible ways: "a guaranty is to be accepted unless there is reason to believe that nonreceipt or nonreimbursement is a significant risk," or "a guaranty is to be accepted unless the purchaser resides in a country at war," or "a guaranty is to be accepted as long as the issuer's customer does not have a valid reason to object." [FN31] None of these statements of the custom would have required Chase to honor the presentment of ***718** incomplete documents. Furthermore, under none of these formulations does Chase appear to be opportunistic rather than prudent in its procedures. But none of these statements of the custom could be said to be more or less accurate than the broader statement accepted by the court if the custom had not theretofore been applied under conditions where the narrower interpretation would have made a difference. In short, it is difficult to know how much of the context in which the custom initially evolved to impute into its foundational definition. [FN32] This is so even for parties to the custom themselves. Richard Craswell's recent work on custom suggests that even transacting parties may have differing interpretations of the custom they both purport to follow. Customs may take a sufficiently generalized form that, while each party agrees on the definition of the custom, they disagree on its application to the specific facts of their transaction. But if that is the case, then how much confidence will we have in judicial interpretations of disputed trade usages?

The problem of selecting the relevant parts of the context to define the custom becomes greater as the details of that context become more varied. The greater the variation, the richer the background against which the custom develops and thus the harder it is to determine just which elements of that custom are necessary to a statement of its scope. Yet those substantial variations are exactly what characterize international sales. A practice that evolves among parties from countries with similar economic systems, cultures, or levels of development may reflect an agreement very different from one that would be reached with a trading partner from a country with a different background. Yet once the practice evolves among nations that are similarly situated economically, culturally, or developmentally, a court might consider it sufficiently "international" to include it even within contracts involving nationals of countries that have very different socio-economic positions. Indeed, there is some evidence that developing countries resisted the inclusion of custom as an implied term in the CISG ***719** out of concern that it would codify practices imposed on them by developed countries. [FN33]

CISG's Article 9(2) might be considered an attempt to resolve these problems. After all, only those usages that are known or ought to be known are imputed into the contract, and then only if the usage is widely known to and regularly observed by parties to contracts of the type involved and in the particular trade concerned. Thus, one might contend, parties cannot easily be surprised to discover that they are bound by a custom of which they were unaware. They will either be aware explicitly or will be charged with knowledge only because they are participating in an industry characterized by trading rules that include the particular custom. But the limitation of Article 9 to widely understood customs only makes the judicial inquiry more difficult, as it requires not only a qualitative inquiry into the conditions under which the custom applies, but also a quantitative inquiry about the universality of the custom. Assume, for example, a contract for the sale of computers concluded between an American seller and a Mongolian buyer. Assume further that because apparent defects may be due either to manufacturer error or to user misuse, a custom has arisen in which buyers are obligated to inform sellers of nonconformity within two weeks of receipt. This custom, however, has arisen in contracts involving parties from countries with well developed computer capabilities, of which Mongolia is not one. (It is certainly plausible that initial international sales of computer equipment would be among countries with such capabilities, so that a custom that arose in contracts among residents of those countries would reflect sophisticated practices.) The purchaser receives a defective computer, but because it has limited experience with computers, the purchaser believes that the good's misperformance is due to its personal

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inexperience rather than to any defect. As a result, the purchaser does not notify the seller of the defect for several weeks.

Here the CISG would appear to impose the loss on the buyer, as the custom could be used to clarify the CISG's vague mandate that buyers must notify sellers of any nonconformity within a "reasonable time" after buyers ought to have learned of its existence. [FN34] A ***720** court could find that the "custom" of notification within a limited period applied to this buyer, even if it did not have actual knowledge of the custom's existence, because it was involved in the trade (the sale and purchase of computers) in which the custom arose. But the court could also find that not enough shipments to unsophisticated buyers had occurred to say that the notification requirement had achieved international acceptance, as opposed to acceptance within a group of countries with sophisticated computer knowledge. Thus, even though the buyer could be charged with knowledge of the custom, Article 9(2) would not bind the buyer because the requirement of internationality would not be satisfied. Once we grant the fuzziness of custom and the discretion that courts have in defining its scope and application, the certainty allegedly offered by Article 9 appears to deteriorate. Nor does the "knowledge" requirement of Article 9(2) necessarily serve as a leveller, since the objective element of that requirement allows a court to find that a party "ought to know" of practices of the trade in which the party participates.

The problem, then, is that a custom that evolves under conditions consistent with the traditional story may be imposed by courts into situations where the parties never intended it to apply. There may be contexts in which the problem is minimal. Given the reputational constraints within which commercial actors operate, the fuzzy nature of the custom may be tolerable. Those constraints may prevent commercial actors from using custom where it does not belong, at least during periods when there are reasons to preserve the relationship between the parties. [FN35] Courts, however, do not operate under the same constraints and may thus misapply the custom. This possibility seems more likely in the international context in which the range of background conditions is broader.

Nevertheless, there is something anomalous about any conclusion that trade usages are so indeterminate as to render them incoherent. If customs were inherently so vague as to impede their application significantly, the traditional story could have no currency at all. Certainly a robust body of transnational principles governing such complex trading and financing patterns as letters of credit, risk of loss allocations, and the development of principles of negotiability could not have evolved if the underlying concepts ***721** were consistently indefinite. If parties were uncertain of the scope of their custom in ways that precluded retelling the custom to third parties, or relying on those parties or the state to enforce custom, nothing close to a lex mercatoria could have developed, and certainly not one that governed as many aspects of international transactions as we see in the current commercial world. Thus, the lucidity of custom might not be a significant problem after all. Indeed, it may be that the clarity of custom, at least relative to statutory and common law, is simply hidden by selection bias. The occasional judicial decision that makes trade usages generally appear opaque creates the basis on which commentators evaluate all custom. Those cases, however, may be so infrequent or pathological as to hide the fact that most customs are sufficiently clear as to be comprehensible and observable to participants in the trade and verifiable by third parties. Relatively clear customs, however, are unlikely to be the subject of dispute; given reputational constraints, actors who value their standing within the commercial community are unlikely to violate a clear custom. Thus, their amenability to easy implementation is not frequently tested. Add to this possibility the likelihood that courts will at least sometimes define the terms and scope of fuzzy customs in a manner consistent with commercial expectations, and judicial interpretation of custom may seem less threatening than much of the commentary suggests. The result is that courts may indeed suffer many of the faults attributed to them, but the likelihood that those interpretive risks will materialize is sufficiently small that it does not interfere with the theoretical capacity of custom generally to adhere to the traditional story.

IV. The Possibility of Stasis

Judicial construction of a custom, however, may implicate an alternative source of deviation from the traditional story. Indeed (and perhaps counterintuitively), it may be proper judicial articulation of a custom that poses the most significant threat to the evolution of efficient customs. The traditional story suggests that custom, appropriately defined, will reflect superior commercial practices, because parties (who presumably seek to maximize the joint value of the contract) have incentives initially to reach bargains that incorporate these practices and, subsequently, incentives to codify those bargains through trade usage to reduce transactions costs. Developments (for instance, in technology or the sophistication of the average trading partner), however, may cause ***722** a custom that was appropriate when it first emerged to become suboptimal. If the parties nonetheless adhere to the custom (and I will make the case for such a possibility momentarily),

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harmonization through judicial recognition of the custom poses a threat to the traditional story. That story involves natural selection among competing practices, and harmonization necessarily reduces the variety of potential competitors. [FN36] If harmonization impedes development of novel practices, then it is more difficult to conclude that the harmonized custom reflects the result that would be achieved through a deliberative consideration of alternatives, the very assumption that underlies incorporation theory in the first instance.

At first, this claim seems peculiar. If a custom does not reflect the bargain of the parties, why wouldn't they simply contract around it? Article 9(2) of the CISG recognizes this possibility by imposing trade usage on the parties only if they have not "otherwise agreed." This explicit exception only confirms the principle of party autonomy, embodied in Article 6, that permits parties to opt out of any provision of the CISG. Although transactions costs may consume some of the savings that would be realized by negotiating around the default custom, these costs might be thought to be low, since a party who has devised a superior rule should quickly be able to persuade a trading partner to adopt it. Even where such costs are high, they might be worth incurring for a repeat player, who could amortize the costs over numerous contracts. Once the repeat player used an alternative superior practice, the evolutionary assumption of the traditional story suggests that it would enjoy widespread adoption. [FN37]

It is at this point that the analogy to network effects and learning benefits to which I alluded earlier, and that has figured in recent literature on corporate contracting, becomes relevant. [FN38] Both network effects and learning benefits involve the use of similar ***723** contract terms by multiple parties. The distinction between them depends on whether the effects of multiple use occur simultaneously or sequentially. [FN39] Network effects permit simultaneous users to realize greater value from their own use of a good (technology, product, contract term) because participants within the network can interact, and more participants implies more interactions. Learning effects similarly facilitate interactions, but by providing subsequent users with information garnered by the experience of prior users, thus reducing the cost of obtaining information about the costs and benefits of the good. In the commercial context, as parties begin to use identical terms and develop experience about the implications and applications of those terms, the term attains greater comprehension and precision, and there is less need for fully negotiated contract terms to cover the same ground as the custom. As courts begin to interpret the vagaries of such terms, parties can use them with confidence (relative to novel terms) about how they will be construed in both commercial and legal environments.

To explore the significance of these characteristics, begin with network effects. Networks imply interdependence within a technology or practice such that the value of its use increases with each additional user. For example, think of telephones, fax machines, language, and standards for nuts and bolts. Because the capacity of any one member of the network to communicate or transact increases with the size of the network's population, users of the good employed by the network enjoy increasing returns that discourage exit to a nonuniform good. Even if a superior technology becomes available, a member of the network might receive greater rewards from adhering to a suboptimal practice that has been adopted within the network, unless he or she has sufficient assurance that a critical mass of others will also make the transition. Think, for instance, of investing in a facsimile machine that transmits and receives twice as fast as, but that cannot communicate with, current models. A current user of facsimile machines would presumably purchase the new technology only if assured that others would follow in short order. Those assurances would require that the superiority of new technology is highly salient, that there exists a mechanism for informing network members of that superiority, or that early adopters of the new technology receive disproportionate ***724** rewards that compensate for the costs and risks involved in the transition.

Adherence to international custom offers benefits associated with networks by reducing costs related both to transactions between the contracting parties and to enforcement by third parties. Although competition may generate superior standards, [FN40] the variety that competition entails can be costly. In international transactions, variety may increase uncertainty about which law will apply or which interpretation of contract terms will govern. The development of custom that trumps domestic law frees actors in international transactions from concerns about conflicts in domestic regulations and interpretations that would otherwise constrain agreement. Reliance on custom further reduces the need to reduce contractual terms to explicit contract clauses. Explicit contracting in the international arena will be more costly because contract terms are susceptible to difficulties of translation and misunderstanding, given that the parties may be using different languages. Even if explicit contracting provides courts with a more precise indication of the parties' intent than custom, total contracting costs may be reduced by reliance on custom where the costs of drafting explicit clauses is high and the frequency of disputes

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(and hence the benefits gained from providing courts with precise clauses) is relatively low. These conditions are likely to be satisfied in international transactions because language differences will increase contracting costs and the high cost of litigation is likely to diminish incentives for judicial resolution, even where disputes arise. The ability of custom to play these roles, however, depends on widespread acceptance by other members of the industry. Only through use by multiple practitioners can custom become sufficiently certain to permit reliance by those within the trade or accurate judicial enforcement.

The need for multiple practitioners, and hence the analogy to network effects, may be questioned because each party can receive significant gains within its individual contract if it adopts a superior practice. Here, I differ a bit from Steven Walt's paper for this conference, which suggests that there may be insufficient market mechanisms that induce internalization of the benefits of novel contract terms, with the consequence that network externalities could theoretically be a possible barrier to the adoption of novel ***725** terms. [FN41] It is less clear to me that this is the case. Parties who adopt a novel explicit contract term may internalize enough of the benefit of the term within their own contracts that it is worthwhile for them to employ it, even if doing so confers positive externalities on other users of the same term. If the personal benefit of employing a novel term is sufficient, there is little reason, other than envy, that would prevent the originator of the term from using it, even if he or she cannot capture the benefits that accrue to others. Thus, the fact that development of a new term will confer external benefits will not necessarily deter its creation.

But even if Walt is correct with respect to explicit contract terms, something close to network externalities may be more evident in the case of implicit custom. This possibility arises from the conventional nature of custom. Because custom applies in the absence of an explicit contract term, it has binding force insofar as it has been adopted by others within the network, giving rise to expectations of conformity to its dictates among those subject to the custom. That is to say, custom binds even in the absence of an explicit agreement to that effect. Thus, we can think of custom as having force in much the same way that a convention, as that term is defined by Lewis, binds its adherents. [FN42] Custom binds because parties within the trade understand that when circumstances within which the custom operates materialize, (1) almost everyone within the trade conforms to the custom; (2) almost everyone within the trade expects almost everyone else within the trade to conform to the custom; (3) almost everyone within the trade prefers that everyone else conforms to the custom, at least as long as others also conform to the custom under the same circumstances. The last condition holds because custom provides interpretive ***726** benefits only if almost everyone within the trade follows the same practice when the conditions that trigger the custom materialize.

Custom does not entirely fit the definition of a convention insofar as the traditional story is true, because that story assumes that there exists a superior practice that should be followed above others. Conventions, at least under Lewis' definition, arise when almost all parties follow a practice that is followed by almost all other parties, but almost all parties would prefer to follow an alternative practice if almost all other parties followed that practice. [FN43] Thus, in a convention, there is no single superior practice, while the traditional story assumes that such a practice exists. This distinction, however, may be irrelevant for my purposes. What binds the parties to a custom is not the alleged superiority of the practice, but the expectations that others will follow it; and that is the same consequence that accompanies a convention.

Indeed, in one sense the conventional dimensions of custom become stronger the more we adhere to the evolutionary understanding of superior customs. Recall that the traditional story posits that a custom emerges only after terms have been negotiated with sufficient frequency and sufficiently similar results that negotiations become superfluous, since all parties understand the outcome that would obtain after costly negotiations occurred. Subsequently, the need for the agreement disappears and parties essentially follow a practice for no better reason than "we've always done it this way." Note the way in which this process fits Lewis' distinction between conventions formed by agreements and those formed in other ways. Parties may initially agree explicitly to a certain practice and that agreement may itself produce conformity when the conditions that trigger the agreement arise. That initial agreement may therefore begin a process that generates the kind of expectations that define convention. At some point, however, the behavior continues for reasons distinct from the initial agreement:

But to say we act as we do because we once agreed to would be badly misleading. It suggests that our agreement continues to influence our actions directly, just as it did at first; actually its major effect is transmitted through a growing causal chain

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of expectations, actions, expectations, actions, and so on. The direct influence fades away in days, years, or lifetimes. ***727** We forget our agreement. We cease to feel bound by old promises . . . We leave the population, and are replaced by heirs who were not party to the agreement. But the indirect influence of the agreement is constantly renewed and in time it comes to predominate. Then a convention created by agreement is no longer different from one created otherwise: it bears no trace of its origin. [FN44]

The consequence of convention defined in this way is even stronger than the literature imparts to the consequences of network externalities. The assumption of that literature is that rational actors engage in a deliberative process, the result of which is a determination that investment in a new technology is not worth making, even though it would be worth making if all others in the network (or a critical mass of them) simultaneously made the same transition. On this theory, the actor realizes that unless others can be convinced to make the transition, individual change is self-defeating because the gains from the new technology are not worth the costs related to exclusion from the existing technological network.

Postulating a deliberative process, however, assumes two possibilities: (1) that individuals will consider the relative merits of proposed new practices, and (2) that the actor who realizes that an existing practice is suboptimal may persuade others to make the simultaneous shift. The conventional nature of custom, however, means that these deliberative processes never come into play. [FN45] Adherence to the custom is a product of habit rather than deliberation. Hence, the possibility of circumventing custom is never considered. The nature of convention is to lull practitioners into the belief that the current practice is foundational, thus precluding any investigation into alternatives or transition costs in the first instance. The unthinking acceptance of a custom ultimately assumes normative proportions that can freeze custom by making adherence part of the definition of what it means to be a member of the network. Knowledge of and adherence to custom becomes the equivalent of a secret handshake, a signal that serves as a surrogate for more explicit acknowledgment that one is a member of the "club," aware of its traditions and its values. Hence, once a ***728** convention becomes universalized, following the convention may become something that members of the network are supposed to do and penalties may attach for noncompliance. Its origins in a different environment that may no longer pertain are forgotten. Consider here Lewis' example of the norm that the original caller call back and the called party waits when a telephone call is cut off. [FN46] An original recipient of a call who does not comply with the convention and calls back after a disconnection is likely to prevent restoration of the connection (because the original caller is also calling back). But the implications of noncompliance for the iconoclast are more serious. The original caller may guess that the recipient was ignorant of the convention, welcomed the excuse to end the conversation, or was unthinking. In any case, the original caller will think less of the recipient for noncompliance with the convention.

One might suggest that this reasoning is inapplicable to the commercial context. After all, in the context of a convention as Lewis defines it, one may as well comply as not because, by hypothesis, the convention is no worse than its alternative (i.e., we would get the same rate of reconnection if the convention were that the original recipient always called back). In the commercial context, however, the iconoclast presumably has devised a superior practice; hence, actors should be more receptive to noncustomary proposals. But if acceptance of the convention is unthinkingly automatic, then there is no reason to believe that the addressee of the proposal to deviate from the custom will treat it as anything other than a gratuitous attempt at innovation for its own sake or as evidence of ignorance of trade usages that portends other transactional difficulties. This possibility is likely to be more salient in international transactions. Long distance transactions, especially those that occur between strangers, are already fraught with a certain level of mutual distrust about performance, given the inability of each party to obtain easy redress for any defalcation by the other. These parties are unlikely to risk sending warning signals that the ensuing relationship will be problematic. Instead, they will likely want to indicate that they are aware of the mysteries of the "club" and have the requisite knowledge to deal with the minutiae of international trade. If unwillingness to adopt an unquestioned practice is susceptible to construction as ignorance or obstinacy, it may constitute an undesirable and unintended ***729** indication of impending difficulty. Thus, in the commercial context, an actor might accept a suboptimal custom rather than opt for an alternative that signifies iconoclasm and that thus signals that one is a "high maintenance" member of the industry or one who does not understand the basic customs of the trade.

One possibility remains. The actor who concludes that the current custom is inefficient could simply educate the trading partner about the relative efficiency of the new practice. If the proposed term is, in fact, superior, then one would imagine that any costs suffered as a result of iconoclasm could be reduced by the realization that it serves mutual interest. It is at this

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point that learning benefits related to the current practice and biases that favor the status quo enter the equation. Each of these tactics raises the costs of educating trading partners about the superiority of novel practices. Any practice will require users to become familiar with its terms, explore its parameters, and refine ambiguities in its implementation. As a generation of users becomes familiar with the practice, there develops a disincentive to shift to a new technology in which similar matters must be relearned.

Kahan and Klausner define learning benefits within transactional settings to include "(a) drafting efficiency; (b) reduced uncertainty over the meaning and validity of a term due to prior judicial rulings; and (c) familiarity with a term among lawyers, other professionals, and the . . . community [that employs the term]." [FN47] Each of these benefits seems to favor the incorporation of custom in international sales contracts. Leaving matters to custom reduces the need to draft explicit terms, an activity that, again, is uniquely hazardous in multi-language international transactions. Prior judicial rulings will provide content to custom (albeit--as argued above--that content may vary from the commercial understanding of the custom), so that participants in the industry will likely be cognizant of the scope and application of custom. Thus, proponents of a novel practice must convince potential trading partners that acceptance of the proposal will have a long-term payoff that offsets transactions costs. The disincentives against persuading a trading partner that a novel practice would have a positive effect on the transaction (the need for substantial conversation with a distant trading partner, the need to negotiate a mutually acceptable term that incorporates the new practice, and the ***730** increased risk that a court will misinterpret the term [FN48]) increase when the trading partner is from another country with the concomitant costs involved in language, technology, and cultural differences. At the same time, if the custom has not affirmatively failed to allocate risks efficiently, either because it was untested (given that international sales may still be relatively uncommon) or because parties have not recognized a superior alternative, then the potential learning benefits associated with that usage are likely to be high relative to any innovation.

Kahan and Klausner suggest that the ability to make convincing arguments for novelty is further frustrated to the extent that cognitive biases in favor of the status quo discourage trading partners from entertaining the possibility of change. [FN49] These biases appear to be related to the phenomenon of satisficing, which suggests that actors may settle on a practice or decision when it is "good enough," even though comprehensive analysis of all possible alternatives could reveal a superior practice or decision. [FN50] The strength of these biases is likely to depend on the ease with which an actor can identify feasible alternatives to the status quo. A commercial actor who could readily find other trading partners willing to continue the existing custom may be less willing to entertain suggestions for deviation from that custom, while a party who has fewer alternatives may be less concerned that a potential seller or purchaser proposes iconoclastic terms.

Even in the latter situation, however, incentives internal to the firm may create biases against rejecting an entrenched practice. The literature involving managerial reactions to risk and agency costs suggests that managers may seek to avoid blame for significant ***731** losses. [FN51] Managers who have this view may be concerned that they will receive blame should contracts employing novel terms go awry, while simply following the practices endorsed by an industry is unlikely to generate blame even if the custom proves harmful. Failure to innovate will not cause the manager to stick out from the crowd that followed the custom. Here again, we have an analogy to technological network effects: A manager who opts out of a network may incur substantial reputational liability for advocating a new path that no one else pursues. Hence, at least some literature suggests managers will elevate fear of loss over calculations of expected value. [FN52]

Again, internationalization of commercial practice should exacerbate these tendencies. One might imagine that the various conditions under which traders in different countries operate give rise to competing practices. This competition should facilitate development of a superior custom where one can be said to exist. It is also possible that these conditions will vary sufficiently that no efficient custom can properly be said to exist. The effect of Article 9, however, is to recognize and codify existing customs and hence frustrate efforts to develop alternatives. Incentives for commercial actors to adopt existing customs rather than to invest in new ones that might not receive recognition are likely to be reinforced by judicial announcement of accepted customs, even if they reflect commercial practice poorly, because risk averse actors can always point to judicial pronouncement to immunize themselves from charges of poor contract drafting.

Just as in the case of uncertainty in the interpretation of custom, however, it is easy to overstate the case for lock-in. International transactions are likely to go awry (if at all) because of exogenous shocks such as shifts in market price or

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financial instability of one of the parties rather than because the parties contracted out of a customary term. The fact that the parties allocated risks in a novel manner, selected an innovative form of transportation, permitted payments to be made through nontraditional channels, or otherwise adopted a term that they anticipated would increase the joint ***732** value of their agreement rarely will be the cause of contractual disaster. Hence, biases against transition may be less robust than the discussion to this point intimates. In addition, as I argue below, there exist rewards for novelty that may produce risk-preferring managers who, if anything, overinvest in deviating from customary terms. Thus, I do not conclude that any of the biases toward conformity necessarily dominates international transactions. Instead, I next consider the tools that firms and their advisors have to overcome any inertia that may exist.

V. Avoiding Lock-In

The arguments from networks, bias, and convention make the traditional story of custom look pretty fanciful. That pessimistic conclusion may be premature, however. Even brief consideration of common commercial practices indicates that they do evolve in the face of incentives for stasis. Without any mandate from formal law, international sales practices have developed electronic payment mechanisms, [FN53] clarified the meaning of shipment terms, [FN54] and revised the standard for examination of documents submitted under documentary credit transactions. [FN55] Obviously, stagnation is not inevitable. How can we explain these phenomena?

Just as the theory of legal lock-in is derived from the literature on technological lock-in, so may the mechanisms of avoiding legal lock-in be analogous to those that underlie technological innovation. After all, municipalities now light their streets with electricity rather than gas. Compact discs have largely replaced vinyl records (to the consternation of some purists). In short, technologies that exhibit network effects and learning benefits, and that therefore might be considered highly susceptible to lock-in, do evolve. In the remainder of this article, I suggest how this might occur and discuss implications for the traditional story of commercial custom.

Consider three ways that transition might occur. The first occurs where the superiority of the proposed practice or standard is sufficiently observable that there is no need for additional inducements for firms to make the transition. This may occur when ***733** current practice is simply a response to a coordination problem and a superior coordination equilibrium appears. Similarly, Farrell and Saloner model a situation in which there is common knowledge that all firms within the network are identical, all relevant parties have complete information about payoffs, and firms decide sequentially whether to shift to a new technology that would benefit each firm in the network. [FN56] Again, these conditions generate shifting by all firms. These situations, however, operate under such extreme demands for information that they are likely to be rare. Pure coordination games occur infrequently; typically, shifting from the status quo to a new practice is likely to produce some winners and some losers, and the latter are likely to resist the shift. Indeed, even when these situations occur, informational gaps about the alternative may preclude movement to the superior equilibrium. And even when information is available, incentives to shift may not be universally shared, even if doing so would generate net positive gains. Assume that the new equilibrium is superior for some participants, but is neither better nor worse for others. It may be, for instance, that a new practice would make buyers better off, but sellers are indifferent between the status quo and the proposed innovation. Sellers have no incentive to shift to the new practice unless buyers are willing to share with them some part of the surplus, and the negotiation costs about sharing of that surplus could diminish buyers' incentives to make the switch at all. [FN57]

The existence of significant transition costs, however, does suggest a second mechanism for shifting to new standards. An entrepreneur who devises a superior technology and who is able to subsidize transition costs of potential participants in the new network and still capture the surplus created by the superior practice might induce others to shift. This is the familiar story of online providers who give away software or "free" hours in order to induce individuals to shift from other methods of communication to online systems, or of electric utilities that gave away light bulbs to induce switching from gas to electricity. Changes in practices that entail major savings may be of this nature, since the parties to the transaction may save sufficient costs that it is worthwhile to make the shift, even though it removes them from a network. Commercial actors who are repeat players within the industry, and thus can use ***734** innovative practices on numerous occasions, can receive long-term benefits that handsomely reward any short-term costs they must incur, notwithstanding the public goods nature of their efforts. This appears to be the case with commercial parties in international trade, who tend to be repeat players. It is not necessary, however, that repeat play occur with the same players. If one is a repeat player within the same industry and can use the same practice on several occasions, albeit with different trading partners, the savings that accrue from repeat play may

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still warrant a shift to the new practice.

Nevertheless, reliance on the ability of entrepreneurs to capture benefits of overcoming inefficient standards is somewhat suspect. Situations in which repeat play allows amortization of transition costs may be too infrequent to warrant much investment in employing novel terms. Entrepreneurs must not only be certain that their proposal will be used with sufficient frequency to justify incurring transition costs, they must also be sufficiently certain that they will otherwise be denied similar gains. If others adopt the same practice and incur the costs of publicizing it, then, in true chicken game fashion, the actor has no incentive to spearhead the drive for transition as the costs of explicitly contracting for a novel practice may disadvantage early adopters.

Those disincentives could be overcome if there were offsetting benefits to be gained from being an early mover to the new standard. For instance, investment bankers or attorneys who devise novel anti-takeover provisions or attorneys who develop novel causes of action against cigarette manufacturers may be able to attract enough additional clients to make the investment in novelty worthwhile. [FN58] In essence, these parties become the equivalent of entrepreneurs who are able to recover the costs of new technology once they publicize its superiority to potential users. As Lemley and McGowan conclude, "[c]ompetition through innovation may internalize much of the cost of innovation, to some degree overcoming collective action problems that might otherwise block transitions among standards in other circumstances." [FN59] And, notwithstanding what I have said above about agency costs, the literature of managerial risk suggests that there also exist risk-preferring managers who seek novelty in order to capture rewards ***735** unavailable from simply adhering to the status quo. Contracts that employ novel terms and that turn out to be more profitable than contracts with customary terms should be as attractive to these managers as customary terms are to risk averse managers.

Indeed, the possibility of attaining notoriety as a catalyst for change may be sufficient to warrant intervention, even if the entrepreneur receives no direct benefit from the specific change that is proposed. Law professors who propose legal change in their writings may receive little benefit from the substance of their proposals. Instead they receive byproducts of those proposals, such as tenure, or membership in a group specializing in the professor's area of interest, or speaking invitations. Individuals who contribute to joint efforts to effect change, such as participation in the American Law Institute, may gain professional rewards from being known as a "leader" in the field, notwithstanding that they receive insubstantial rewards from the proposals they make. To the extent that they are motivated by these entrepreneurial roles, these parties may effectively subsidize transition costs for those who directly benefit from the change.

The possibility that individuals may internalize the benefits of transition ties into the third mechanism for avoiding stasis. Transactions costs may be dramatically reduced if there exists a standard-setting organization that assumes the task of defining industry customs. If that centralized organization assumes responsibility for the promulgation or dissemination of custom within the trade, it can both indicate authoritatively which practice is to be followed [FN60] and overcome collective action problems that interfere with more decentralized efforts to innovate. If each member of the network anticipates that virtually all other members of the network will adhere to the practice publicized by the central decision maker, then each member has an incentive to shift to a new practice promulgated by the central decision maker, thus alleviating the doubt about mutual transition that impedes superior practices.

These organizations simply pose privatized analogies to the operation of legal rules. Laws that exhibit network effects or that solve coordination problems can evolve effectively precisely because a centralized decision maker--a legislature or court--can obligate all parties within its jurisdiction to adhere to a new standard simultaneously. Even though the dictates of professional organizations ***736** do not have "legal" effect, they may collect information about existing and proposed practices, make determinations about which ones to adopt, and disseminate information about the standards to which industry members are expected to conform. Indeed, some groups may establish private dispute resolution procedures and tribunals that essentially displace "legal" adjudicatory proceedings. Examples include the National Grain and Feed Association dispute system studied by Professor Lisa Bernstein, [FN61] and the International Chamber of Commerce, which publishes industry practices relating to such matters as documentary credits [FN62] and shipping terms. [FN63] In essence, these groups constitute private legislatures that coordinate activities and dictate standards to members. As Michael Bonell says of associations and international organizations involved in international business transactions:

> when of their own initiative they proceed to a formulation or a periodical revision of usages and customs, their function is

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essentially a legislative one; even though they normally confine themselves to "recommending" the use of their own normative creations, leaving it in theory open to the various practitioners to accept or reject them, in practice the usages and customs are imposed upon the latter, as a refusal to adopt them would involve their being excluded from the organized sector or market in question. [FN64]

Bonell was not writing against the background of network effects, but his observation certainly is consistent with the implications of that literature.

Consider, in this respect, current efforts to adapt American practices concerning shipping terms to those promulgated by the International Chamber of Commerce. Current versions of Article 2 assign specific meanings to terms used in transactions involving contracts of carriage, such as FOB and FAS, and assign legal consequences to the use of those terms. [FN65] Those definitions, however, deviate from developed international practices as promulgated by the ICC. The proposed revision of Article 2, in an effort to keep ***737** domestic firms within the network of trading nations, replaces the specific American definitions with instructions to courts to interpret shipment terms in light of applicable usage of trade, presumably as embodied in INCOTERMS. [FN66]

The presence of a centralized entity for collecting and disseminating information, and the implicit or explicit designation of that entity as the arbiter of appropriate practices provides the most promising means for overcoming the inertia created by both network effects and learning effects. As noted above, a centralized entity effectively compels participants in a network to make a simultaneous transition to a new practice, thus eliminating the risk that no one individual will adopt a superior practice for fear of being excluded from the network. It may also overcome learning effects by gathering and disseminating information about new practices, thereby reducing the information costs that tend to entrench the status quo.

Of course, centralized entities will undertake these efforts only if they have incentives to underwrite the evolution of practices, and hence to recognize superior alternatives. There are reasons, however, to believe that these entities will take advantage of their opportunities. Individuals who seek notoriety as professional leaders may best accomplish that objective through participation in an association or organization that serves as a centralized representative of the profession. The individuals who constitute the active members of the organization can internalize many of the benefits related to revision of existing practices. Return to my above example of law professors who can obtain personal gains by advocating legal change. Since they receive some benefit in terms of tenure, fame, or speaking engagements from these proposals, and do not have to incur the costs related to the actual transitions, they face significant incentives to invest (indeed, to overinvest) in transitions. Similarly, individuals who become involved in trade associations or international business associations can achieve a significant level of notoriety only by making changes. To serve on behalf of such an organization without undertaking projects that create significant change is tantamount to being a general without a war. Thus, these organizations not only have the ability to orchestrate change in a manner that overcomes inertia, but also the incentives to search for and correct inefficiencies in existing trade usages. It should not be surprising, therefore, that the examples of ***738** developing custom with which I began this section were all organized by private legislatures that had responsibility for reviewing and promulgating the practices to be followed by members of an industry.

But while the presence of a centralized decision maker may help to avoid lock-in, it does not necessarily do so in a manner that enhances the efficient evolution of trade usage. The very fact that centralized decision makers can dictate terms to an industry suggests that subgroups within the industry have incentives to capture the decision making process, just as interest groups have incentives to capture more traditional public legislatures in order to enact their agenda. [FN67] To the extent that the subgroup does not represent the interests of all those within and affected by the industry, there is little reason to expect that the promulgated practices, and thus the customs that are dictated and adopted, will tend to reflect socially efficient alternatives. [FN68] Indeed, I have previously suggested that a legislature, public or private, that is involved solely in an enterprise of revision, rather than initial promulgation of a set of standards, is more likely to be dominated by groups that do not share the interests of the legislature's constituents generally. [FN69] Unlike in the traditional story, novel practices that arise from private interests may be generated by the exercise of political power rather than through natural selection.

Consider in this light two possible customs. The first is the custom asserted in the Dixon case. [FN70] Assume that we can accurately restate the custom as honoring a presentment of documents accompanied by the guaranty of another prime bank

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regardless of whether the underlying goods are being shipped to a hostile environment. A custom that arises among major actors within the banking industry and that involves the conditions under which drafts should be honored presumably develops because the parties to the custom, the banks themselves, believe that the custom produces ***739** net benefits. The custom would favor guarantying banks and their customers by allowing them to obtain payment, while placing some risk on issuing or confirming banks. But the same banks are likely to play both roles (guarantors and confirmers or issuers) in different transactions. If the custom arose among banks that both enjoy the benefits and suffer the occasional losses generated by the custom, then it is likely that the custom reflects a reasonable accommodation of those interests. Since the banks that promulgated the custom will not know ex ante whether they are more likely to play the role of guarantor or issuer, it seems safe to assume that the custom generated net positive results. Even if the custom had been disseminated by a centralized entity, there would be no reason to doubt its propriety, as long as that entity represented banks that internalized all the effects of the custom.

Compare a custom promulgated by a private legislature controlled by nations within a limited geographical area and culture. Recall, for instance, that early efforts to formulate an international code of sales law foundered in large part on the Western European orientation of the proposals. [FN71] Developing countries believed that the Hague Conventions on the Uniform Law for the International Sale of Goods and the Uniform Law on the Formation of Contracts for the International Sale of Goods favored sellers from industrialized nations. Similarly, the binding effect of custom has been resisted or repudiated by some countries that believed the customs originated from practices imposed by industrial nations on less developed countries. [FN72] The Vienna Convention that promulgated the CISG attempted to remedy the situation by including representatives of less developed countries in the drafting process. Nevertheless, the inclusion of Article 9(2) created significant controversy for the very reason that some nations feared that customs had evolved from a dominant interest group (i.e., more developed nations) rather than as a reflection of efficient practices. [FN73]

Indeed, one might imagine that the very conditions that solve our first problem, the difficulty of judicial construction of custom, ***740** are endemic in our second problem, the possible dominance of custom promulgation by organized groups in centralized decision-making institutions. Those groups will presumably want to ensure that the bargain they strike to advance their interests survives. Hence, they should want to promulgate the custom in as specific form as possible. Vagueness that leaves room for either judicial construction or commercial misapplication of the intended practice will undermine the efforts of the dominant group. Thus, we would expect that dominant interest groups will formulate practices with the level of specificity least susceptible to judicial misinterpretation. That same specificity, however, may be a signal that the custom is intended to serve the limited interests of a single group that participates in the underlying trade.

VI. Conclusion

The motivations for harmonizing international sales law through the incorporation of custom into contracts may be more benign than some commentators suggest. The assumption that courts will misconstrue vague custom may be accurate, but they will still fail to threaten the vitality of custom if judicial intervention is sufficiently rare. The possibility that the development of custom will be impeded by a variety of intra-industry and cognitive effects is also plausible, but subject to correctives in at least a non-trivial set of cases. This analysis suggests that evaluation of custom must be more particularistic than some of the existing literature suggests. It is not enough simply to claim that custom will or will not evolve in an efficient manner. Rather, it is necessary to define the characteristics that would tend to generate efficient evolution and to determine whether those characteristics exist in a given case. I have suggested that some steps in that direction may occur by looking at situations in which centralized organizations are responsible for the promulgation and dissemination of custom and determining whether those organizations sufficiently reflect the interests of parties who are affected by implementation of the custom.

Implicit in this is the question of what judges should do when required to interpret and apply a custom. If we believe that judges can identify the salient characteristics that render custom susceptible to lock-in or that makes it possible for custom to evolve, then we might trust ad hoc determinations by courts concerning the scope of custom. Similarly, if we believe that courts can readily identify those circumstances in which a custom has arisen through ***741** a process in which all parties affected by the custom have participated in its promulgation, we might again trust judicial application. If, on the other hand, we believe that courts will have difficulty in discerning the propriety of custom in a contemporary setting or in tracing its origins, then an active judicial role in interpreting and applying custom is more suspect. Allowing courts broad discretion to

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define the scope of custom would risk substantial error costs as courts would be likely to apply customs that did not reflect the bargain struck by the parties, and might not apply customs that had, in fact, evolved through an implicit bargaining process. Nevertheless, denying courts that discretion risks the wooden application of locked-in custom to situations for which it was not intended.

The difficulty of determining which of these judicial strategies is preferable brings us to the final point. Our conclusions about custom ultimately cannot be viewed in isolation from alternative mechanisms of forming or interpreting contracts among commercial parties involved in international sales. I have been concerned in this paper with an examination of the limitations of custom. But even if we believe that the incorporation of custom into international sales contracts suffers severe limitations, nothing I have suggested recommends displacement of custom as an implicit term or an interpretive aid unless we believe that there is some superior mechanism for drafting or interpreting contracts. Certainly, the costs related to drafting a more precise and complete contract will largely outweigh many of the defects of relying on custom, as long as those defects make a difference in only a small number of cases. And even if application of custom generates significant costs in the form of judicial error, it is unclear that those costs could be avoided by shifting to a presumption that custom does or does not reflect efficient practice in a particular situation.

[FNa1]. Perre Bowen Professor of Law and John V. Ray Research Professor, University of Virginia School of Law. Thanks are due to Michael Klausner, Jody Kraus, George Triantis, and Steven Walt, and to the participants in the Fifteenth Sokol Colloquium on Private International Law for comments on earlier drafts of this paper.

[FN1]. See Charles J. Goetz & Robert E. Scott, The Limits of Expanded Choice: An Analysis of the Interactions Between Express and Implied Contract Terms, 73 Cal. L. Rev. 261 (1985).

[FN2]. The Official Comment to U.C.C § 1-205 notes that the phrase "usage of trade" replaces "custom" to avoid any implication that the regularity of observance that the phrase attempts to capture need not be of long standing. The drafters of the U.C.C. were attempting to avoid any implication that novel usages were excluded. I use the phrase "custom" for economy of expression, and include any regularity, regardless of the length of time that it has been practiced.

[FN3]. Course of performance, as defined in the U.C.C., allows an even more highly tailored arrangement. Prior practice between the specific parties to a contract reveals an implicit bargain to which they agreed, again presumably on the understanding that they would have reached a similar allocation had explicit bargaining occurred. See U.C.C. § § 1-205(1), 2-208(1) (1987).

[FN4]. Goetz & Scott, supra note 1, at 278. For a sustained discussion and attack on the evolutionary principle, see Jody S. Kraus, Legal Design and the Evolution of Commercial Norms, 26 J. Legal Stud. 377 (1997).

[FN5]. The U.C.C. defines usage of trade in terms of parties' expectations. Section 1-205(2) provides: "A usage of trade is 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."

[FN6]. See, e.g., Clive M. Schmitthoff, International Trade Usages 33-34 (1987). For instance, Goetz and Scott suggest that a custom concerning quality tolerances will be better suited to the needs of parties within the industry than general warranty formulations intended to cover the whole terrain of commercial sales. See Goetz & Scott, supra note 1, at 277.

[FN7]. See Larry T. Garvin, Disproportionality and the Law of Consequential Damages: De-
fault Theory and Cognitive Reality, 59 Ohio St. L.J. 339, 389-90 (1998); Clayton P. Gillette, Commercial Relationships and the Selection of Default Rules for Remote Risks, 19 J. Legal Stud. 535, 544 (1990).

[FN8]. This claim may be overstated insofar as it suggests that there is a particular point in
time when the custom first arises. It is in the nature of custom that it arises incrementally, so the notion that there exists a particular point in time when a practice has evolved into a custom may be fanciful.

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[FN9]. The need to compare customs to alternative default rules before passing judgment on the adequacy of custom is developed in Kraus, supra note 4, and in Jody S. Kraus & Steven D. Walt, In Defense of the Incorporation Strategy, in The Jurisprudential Foundations of Corporate and Commercial Law (Jody Kraus & Steven Walt eds., forthcoming 2000).

[FN10]. Professor Bernstein has recently raised questions about the frequency with which commercial customs arise. See Lisa Bernstein, The Questionable Empirical Basis of Article 2's Incorporation Strategy: A Preliminary Study, U. Chi. L. Rev. (forthcoming 1999) (questioning existence of customs in various areas); 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 Bernstein, Merchant Law in a Merchant Court]. I find Professor Bernstein's assertions about the scarcity of custom unconvincing for several reasons. First, in her most recent piece, she infers an absence of custom from evidence that, in the early 20th century, the industries she examined had only localized customs rather than national or international ones. Hence, these industries were drafting explicit trade codes to regulate transactions. Of course, those industries may have had localized customs because the markets within which they operated were highly localized. New codes may have become necessary as new forms of transportation made broader markets possible. If those technological advances occurred quickly, it would not be surprising to discover that interlocal customs had not had an opportunity to evolve. That scenario does not deny the existence of custom in industries where broader markets exist and where custom could evolve over time to play the same harmonizing role as explicit trade codes. See William Mitchell, An Essay on the Early History of the Law Merchant 10-12 (1904). Second, even if some industries did not have customs, that tells us nothing about industries that might have had customs or about Article 2's application to such industries. The drafters of Article 2 certainly intended to allow parties to contract out of its default rules, so an industry that decided not to incorporate custom in their contracts would be able to do so without doing any damage to Article 2's basic structure. Third, some of the work on which Bernstein relies actually supports the evolution of custom. For instance, she cites work by Professors Jack Goldsmith and Eric Posner for the proposition that customary international law does not exist. See Jack L. Goldsmith and Eric A. Posner, A Theory of Customary International Law, U. Chi. L. Rev. (forthcoming 1999); Jack L. Goldsmith & Eric A. Posner, Notes Toward a Theory of Customary International Law, 92 Am. Soc'y Int'l L. Proc. 53 (1998). Actually, Goldsmith and Posner (who are writing about public international law) imply that behavioral regularities with cooperative content (their criteria for custom) are most likely to evolve in precisely the kinds of reiterated bilateral relationships that characterize commercial transactions. Finally, it is easy to point to substantial evidence of custom in commercial law. Notwithstanding Professor Bernstein's efforts to distinguish written and unwritten customs, the existence of such documents as the Uniform Customs and Practice for Documentary Credits and INCOTERMS indicates that customary practices do, in fact, play a significant role in the commercial world. Indeed, given the costs of either drafting complete contracts or leaving significant gaps in contracts, it would be quite remarkable if commercial customs did not evolve to reduce drafting costs or facilitate the filling of contractual gaps. See infra notes 40-41 and accompanying text. None of this is to say, of course, that there is universal agreement on customs, or that they will have the same level of specificity for all relevant actors, or that they are employed by all industries at all times. It is only to say that there are reasons to believe that Llewellyn's initial incorporation theory was based both on commercial reality and a logical application of cost-effective commercial contracting. For additional critique of Professor Bernstein's thesis, see Kraus & Walt, supra note 9.

[FN11]. U.C.C. § 2-202 (1987). See, e.g., Elizabeth Warren, Trade Usage and Parties in the Trade: An Economic Rationale For An Inflexible Rule, 42 U. Pitt. L. Rev. 515 (1981); Bernstein, Merchant Law in a Merchant Court, supra note 10.

[FN12]. See OLG Saarbrucken, 1 U 69/92, (Ger.) (Jan. 13, 1993), full text available on UNILEX: International Case Law & Bibliography on the UN Convention on Contracts for the International Sale of Goods D.1993-2.1 [hereinafter UNILEX].

[FN13]. See International Institute for the Unification of Private Law (UNIDROIT), Principles of International Commercial Contracts, Art. 1.8.2 (1994); Imtyaz M. Sattar, The UNIDROIT Principles of International Commercial Contracts and the WTO: Between an 'International Restatement' and a 'Globalization' of Contract Law?, 5 Ind. J. Global Legal Stud. 375, 382 (1997) (reviewing Michael Joachim Bonell, An International Restatement of Contract Law: The UNIDROIT Principles of International Commercial Contracts (1994)).

[FN14]. See, e.g., Richard Craswell, Do Trade Customs Exist?, in The Jurisprudential Foundations of Corporate and Commercial Law (Jody Kraus & Steven Walt eds., forthcoming 2000).

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[FN15]. Schmitthoff, supra note 6, at 32.

[FN16]. See, e.g., Marcel Kahan & Michael Klausner, Standardization and Innovation in Corporate Contracting (or "The Economics of Boilerplate"), 83 Va. L. Rev. 713 (1997); Michael Klausner, Corporations, Corporate Law, and Networks of Contracts, 81 Va. L. Rev. 757 (1995). For additional extensions of network effects to the legal environment, see Clayton P. Gillette, Lock-In Effects in Law and Norms, 78 B.U. L. Rev. 813 (1998). A more skeptical view of the applicability of the network effects literature to legal principles can be found in Mark A. Lemley & David McGowan, Legal Implications of Network Economic Effects, 86 Cal. L. Rev. 479 (1998).

[FN17]. See Marcel Kahan & Michael Klausner, Path Dependence in Corporate Contracting: Increasing Returns, Herd Behavior and Cognitive Biases, 74 Wash. U. L.Q. 347 (1996).

[FN18]. See Kraus, supra note 4.

[FN19]. Uniform Customs and Practice for Documentary Credits (International Chamber of Commerce Publication No. 500, 1993 Revision) [hereinafter ICC].

[FN20]. See United Nations Convention on Contracts for the International Sale of Goods, Apr. 11, 1980, art. 9(1), U.N. Doc. A/CONF.97/18, Annex I, reprinted in 19 I.L.M. 671 [hereinafter CISG].

[FN21]. See Harold J. Berman & Colin Kaufman, The Law of International Commercial Transactions (Lex Mercatoria), 19 Harv. Int'l L.J. 221, 224
29 (1978); Mitchell, supra note 10, at 10-12.

[FN22]. See, e.g., Frigaliment Importing Co. Ltd. v. B.N.S. International Sales Corp., 190 F. Supp. 116 (S.D.N.Y. 1960).

[FN23]. Berman & Kaufman, supra note 21, at 272-73.

[FN24]. Article 9(1) makes usages to which parties have agreed and practices established between the parties binding.

[FN25]. See, e.g., OLG Frankfurt am Main, 9 U 81/94 (Ger.) (July 5, 1995); UNILEX, D. 1995-17.4.

[FN26]. Where a contract could be concluded under customs incorporated to the domestic law of both buyer and seller, the court was willing to assume that the parties had implicitly made the same custom applicable to the formation of their international contract, even without investigation into the parties' actual knowledge of the custom. See Judgment of Dec. 12, 1992 of Zivilgericht Kanton Basel-Stadt (Switzerland), UNILEX, D.1992-31. Even prior to the CISG, most countries appeared to adopt the objective "ought to have known" position. See Schmitthoff, supra note 6, at 16-17.

[FN27]. OGH, 10 Ob 518/95 (Austria) (Feb. 6, 1996), UNILEX, D. 1996-3.1. With respect to the necessary scope of the custom, the court concluded that the buyer could not be charged with the seller's proposed custom of only entering into written contracts because the buyer was unaware of it. The court, however, may have been concerned only with trade usages to which parties have agreed under Article 9(1).

[FN28]. See, e.g., Juzgado Nacional de Primera Instancia en lo Comerical No. 10 (Argentina) (Oct. 23, 1991), UNILEX, D. 1991-10.1; Juzgado Nacional de Primera Instancia en lo Comerical No. 10 (Argentina) (Oct. 6, 1994), UNILEX, D.1994-24.2.

[FN29]. 144 F.2d 759 (2d Cir. 1944), cert. denied, 324 U.S. 850 (1945). See also Board of Trade of San Francisco v. Swiss Credit Bank, 597 F.2d 146 (9th Cir. 1979).

[FN30]. See id. at 760.

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[FN31]. Berman and Kaufman suggest that when the case arose, it was the universal custom to obtain the consent of the buyer before accepting an offer of indemnity. See Berman & Kaufman, supra note 21, at 263.

[FN32]. For a similar argument about the capacity of courts to interpret trade usages, see Clayton P. Gillette, Cooperation and Convention in Contractual Defaults, 3 S. Cal. Interdisc. L.J. 167, 183-84 (1994). Lisa Bernstein similarly contends that courts are likely to misapply trade usage. Specifically, Bernstein suggests that parties may engage in practices inconsistent with contractual language in order to preserve their relationship, but that courts will impose the obligation to follow these same practices in a significantly different context, i.e., where the relationship has broken down and it is more likely that the parties would want to enforce their contractually negotiated entitlements. See Bernstein, Merchant Law in a Merchant Court, supra note 10, at 1765.

[FN33]. See Fritz Enderlein & Dietrich Maskow, International Sales Law 69 (1992); Albert H. Kritzer, International Contract Manual 108 (1994).

[FN34]. See CISG, supra note 20, art. 39(1). The buyer might be able to claim that it is still entitled to damages for nonconformity if ignorance constitutes a "reasonable excuse" for failure to give the required notice. Id. art. 44(1).

[FN35]. See Southern Concrete Services, Inc. v. Mableton Contractors, Inc., 407 F. Supp. 581 (N.D. Ga. 1975).

[FN36]. See Joseph Farrell & Garth Saloner, Standardization, Compatibility, and Innovation, 16 Rand J. Econ. 70, 71 (1985); Michael L. Katz & Carl Shapiro, Systems Competition and Network Effects, 8 J. Econ. Persp. 93, 106 (1994).

[FN37]. Mechanisms by which this adoption would occur are explored in Kraus, supra note 4, which draws on models of cultural evolution.

[FN38]. I speak of analogy rather than refer to practices as exhibiting network effects primarily because direct networks typically involve complete noncompatibility and thus inoperability with practices outside the network. For instance, one who communicates only through e-mail simply cannot communicate with someone who uses only telephones. One who uses a nonstandard contract term can, of course, continue to contract with those who use standard terms, although additional costs may be incurred.

[FN39]. See Klausner, supra note 16, at 726.

[FN40]. See supra text accompanying note 36.

[FN41]. See Steven Walt, Novelty and the Risks of Uniform Sales Law, 39 Va. J. Int'l. L. 671 (1999). Walt ultimately concludes that network externalities do not pose a serious threat to the adoption of novel terms. He reasons that no such barrier exists because another condition of impediment, that network effects influence the terms of a wide range of international sales contracts, will not hold.

[FN42]. See David K. Lewis, Convention 78 (1969). As I discuss immediately below, this is not to say that trade usage constitutes a convention within the sense that Lewis uses the term. For Lewis, a convention exists only when there are two or more equally valid practices that could be followed in the recurrent situation and the parties coordinate around one of those practices. The traditional story about the evolution of efficient trade usages is that there is one superior practice and that parties will gravitate to that practice. Of course, it is possible, in Lewis's use of the term, that all parties would prefer that all parties engage in the same practice, even though one practice (and not necessarily the one that is selected) is superior on some grounds to its alternatives.

[FN43]. See id.

[FN44]. Id. at 84.

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[FN45]. The extent to which deliberation is unnecessary to an evolutionary process is explored in Armen A. Alchian, Uncertainty, Evolution and Economic Theory, 58 J. Pol. Econ. 211 (1950). See also Gillette, supra note 7, at 574- 77; Kraus, supra note 4.

[FN46]. See Lewis, supra note 42, at 100.

[FN47]. Kahan & Klausner, supra note 16, at 719-20. For a fuller discussion of learning benefits, see id. at 719-25.

[FN48]. The risk of misinterpretation may be further increased in international sales transactions because the court that decides the issues may use a language different than the one in which the contract is written.

[FN49]. See Kahan & Klausner, supra note 17, at 359-62. Experimental data and theoretical treatments concerning a bias for the status quo can be found in Raquel Fernandez & Dani Rodrik, Resistance to Reform: Status Quo Bias in the Presence of Individual-Specific Uncertainty, 81 Am. Econ. Rev. 1146 (1991) (discussing the aversion of political actors to efficiency-enhancing reforms); Daniel Kahneman et al., The Endowment Effect, Loss Aversion, and Status Quo Bias, 5 J. Econ. Persp. 193 (1991); Eric Rasmusen, Managerial Conservatism and Rational Information Acquisition, 1 J. Econ. & Mgmt. Strategy 175 (1992); William Samuelson & Richard Zeckhauser, Status Quo Bias in Decision Making, 1 J. Risk & Uncertainty 7 (1988). For other applications in legal contexts, see Russell Korobkin, The Status Quo Bias and Contract Default Rules, 83 Cornell L. Rev. 608, 630-33 (1998).

[FN50]. See, e.g., James G. March & Herbert A. Simon, Organizations 140
41 (1958); Herbert A. Simon, Rationality as Process and as Product of Thought, 68 Am. Econ. Rev.: Papers & Proc. 1 (1978).

[FN51]. The literature is discussed in Gillette, supra note 7, at 554-56; Kahan & Klausner, supra note 17, at 357-58.

[FN52]. See Kenneth R. Maccrimmon & Donald A. Wehrung, Taking Risks: The Management of Uncertainty 112-13, 271 (1986); Zur Shapira, Risk Taking: A Managerial Perspective 45-46 (1995); James G. March & Zur Shapira, Managerial Perspectives on Risk and Risk Taking, 33 Mgmt. Sci. 1404, 1407 (1987); Zur Shapira, Ambiguity and Risk Taking in Organizations, 7 J. Risk & Uncertainty 89, 92 (1993).

[FN53]. For instance, commercial parties used electronic funds transfers in international transactions long before legal doctrine directly addressed that form of payment in the guise of Article 4A of the UCC. See, e.g., Delbreuck & Co. v. Manufacturers Hanover Trust Co., 609 F.2d 1047 (2d Cir. 1979).

[FN54]. See John A. Spanogle, Incoterms and UCC Article 2--Conflicts and Confusions, 31 Int'l Law. 111, 111-24 (1997) (discussing development of standardized shipping terms).

[FN55]. See ICC, supra note 19, at Art. 13.

[FN56]. See Farrell & Saloner, supra note 36, at 72-74.

[FN57]. See Clayton P. Gillette, Rules and Reversibility, 72 Notre Dame L. Rev. 1415, 1437-38 (1997).

[FN58]. See Clayton P. Gillette, Rules, Standards, and Precautions in Payment Systems, 82 Va. L. Rev. 181, 217-19 (1996); Kahan & Klausner, supra note 16, at 736-40.

[FN59]. Lemley & McGowan, supra note 16, at 578.

[FN60]. See, e.g., Goetz & Scott, supra note 1, at 303-04.

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[FN61]. See Bernstein, Merchant Law in a Merchant Court, supra note 10.

[FN62]. See ICC, supra note 19.

[FN63]. See International Chamber of Commerce, INCOTERMS 1990.

[FN64]. Michael J. Bonell, The Relevance of Courses of Dealing, Usages and Customs in the Interpretation of International Commercial Contracts, in 1 UNIDROIT, New Directions in International Trade Law 109, 115 (1977).

[FN65]. See, e.g., UCC § § 2-319--2-324 (1987); Spanogle, supra note 54, at 111.

[FN66]. See Proposed UCC § 2-309 (Revision Draft of February 1, 1999).

[FN67]. See Alan Schwartz & Robert E. Scott, The Political Economy of Private Legislatures, 143 U. Pa. L. Rev. 595 (1995); Robert E. Scott, The Politics of Article 9, 80 Va. L. Rev. 1783 (1994); Clayton P. Gillette, Politics and Revision: A Comment on Scott, 80 Va. L. Rev. 1853 (1994).

[FN68]. Of course, those who are adversely affected by an inefficient custom may attempt to opt out of its application to their contracts. But that effort implicates all the disincentives against rejecting custom that I have suggested threatens inertia in the development of custom in the first instance.

[FN69]. See Gillette, supra note 67, at 1868-69.

[FN70]. See supra note 29 and accompanying text.

[FN71]. See Peter Schlechtriem, Uniform Sales Law 17-18 (1986); Enderlein & Maskow, supra note 33, at 1-2.

[FN72]. See, e.g., Franco Ferrari, The Relationship Between the UCC and the CISG and the Construction of Uniform Law, 29 Loy. L.A. L. Rev. 1021, 1031 (1996).

[FN73]. See John Honnold, Uniform Law for International Sales 119-20 (1991). I have suggested in the text why the wording of Article 9(2) does not necessarily avoid this difficulty.

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