

# The Law Merchant in the Modern Age: Institutional Design and International Usages under the CISG

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Commercial sales contracts typically are imperfectly drafted. They are incomplete over all possible states of the world that might materialize before performance and include terms that can be rendered ambiguous. In the event of dispute, some methodological approach must be employed to fill contractual gaps and resolve alleged uncertainties. In choosing among potential interpretive strategies, commentators who favor an economic perspective on contracts would select a strategy that maximizes the value of the contract, which includes minimizing the sum of all contracting costs. Those comprise specification costs, the costs related to drafting contract terms; administrative costs, the costs related to contract enforcement; and error costs, the costs related to erroneous interpretation of the parties' intended meaning.<sup>1</sup> The primary competitors for the ideal strategy that considers these factors are the plain meaning rule and the incorporation strategy. The former is a highly formalistic strategy that considers common understandings of a contract term's meaning independent of its context. The latter incorporates context and commercial custom in filling gaps and defining terms. In American contract law, plain meaning is more consistent with common law practice, while incorporation is explicitly a part of the Uniform Commercial Code ("UCC"). The debate about the propriety of each strategy entails not only a contest about which of these sources of law has a

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<sup>1</sup> See Charles J. Goetz and 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); Jody S. Kraus and Steven D. Walt, *In Defense of the Incorporation Strategy*, in Jody S. Kraus and Steven D. Walt, eds, *The Jurisprudential Foundations of Corporate and Commercial Law* 193 (Cambridge 2000).

theoretical advantage but also empirical claims about the actual practices of commercial actors.<sup>2</sup>

From the perspective of minimizing contracting costs, the ongoing debate is understandable. Different strategies would reduce different costs. Specification costs would be high under a plain meaning regime, because the use of terms with idiosyncratic meanings, understood within a trade but not by outsiders, would give rise to judicial interpretations not intended by the parties. Reliance on customs allows commercial actors to conclude deals on handshakes or minimal writings without incurring the risk that they will be disabled from introducing evidence of their intentions in the event of transactional breakdown. Administrative and error costs, on the other hand, favor plain meaning. The contextual significance of trade usage requires adjudicators to discover the alleged usage, define its scope, and determine its application to the issue at hand—all in all, a costly and error-prone process.<sup>3</sup> The more we think that commercial actors rely on trade usages to define their legal obligations, the more the costs associated with the incorporation strategy are worth incurring. The more we believe that customs are inherently ambiguous or illusory, the more sensible the plain meaning strategy appears.

The plain meaning/incorporation debate reflects the variability of these calculations. Lisa Bernstein, for instance, claims that legal recognition of custom in the UCC miscomprehends the limited scope of discernible usages and the limited role that commercial actors make of them outside of localized networks.<sup>4</sup> For the most part, she suggests, commercial actors intend their adherence to customs to betoken cooperation, but prefer their legal relations to be governed by strict interpretation of contract language. Advocates of the UCC's incorporation strategy, on the other hand, suggest that custom has broad purchase in commercial environments and that Bernstein has, at most, demonstrated that there are conditions under which incorporation is an inferior strategy.<sup>5</sup>

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<sup>2</sup> Compare Lisa Bernstein, *Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms*, 144 U Pa L Rev 1765 (1996), and Lisa Bernstein, *The Questionable Empirical Basis of Article 2's Incorporation Strategy: A Preliminary Study*, 66 U Chi L Rev 710 (1999), with Christopher R. Drahozal, *Commercial Norms, Commercial Codes and International Commercial Arbitration*, 33 Vand J Transnat L 79 (2000).

<sup>3</sup> These conflicting interests have been recognized since the publication of Goetz and Scott, 73 Cal L Rev at 261 (cited in note 1).

<sup>4</sup> See Bernstein, 66 U Chi L Rev at 710 (cited in note 2). See also Robert E. Scott, *The Case for Formalism in Relational Contract*, 94 Nw U L Rev 847 (2000).

<sup>5</sup> The most thorough rebuttal is found in Kraus and Walt, *In Defense of the Incorporation Strategy* at 193 (cited in note 1). See also Clayton P. Gillette, *Harmony and Stasis in Trade Usages for International Sales*, 39 Va J Int L 707, 710 n 10 (1999).

All participants seem to agree that this debate cannot be resolved on an all-or-nothing basis. Plain meaning will sometimes minimize total contracting costs, as will the incorporation strategy some of the time. It is less clear whether the cases in which one strategy dominates are so pervasive as to warrant its applicability to all cases, lest the costs of discovering exceptions prove too great. What is missing from the debate, however, is a taxonomy of the conditions under which trade usages would be sufficiently precise, observable, and verifiable as to warrant their incorporation. In this Article, I begin that process. In Section I, I describe the circumstances under which customs might materialize to demonstrate that there are cases in which customs would enhance the value of contract and thus should be granted legal recognition. In Section II, I indicate the conditions that would have to exist in order for a trade or industry to adopt a custom entitled to legal recognition. These largely replicate the conditions for the evolution of efficient norms. Section III then addresses administrative and error costs that might make legal incorporation of a custom inappropriate, even if the conditions for the evolution of a legally cognizable custom otherwise existed. In Section IV, I apply the conclusions from the prior sections to an area that doctrinal law counterintuitively implies is appropriate for the application of the incorporation strategy—international sales transactions. The United Nations Convention on Contracts for the International Sale of Goods (“CISG”)<sup>6</sup> explicitly incorporates trade usages into contracts that it governs, permits usages to trump conflicting CISG provisions, and authorizes courts to interpret and complete contracts by reference to usages. The complexity of international sales and diversity of transactors suggests that this is a peculiar arena for the incorporation strategy. Nevertheless, I conclude that the conditions for adoption of trade usages under the CISG are surprisingly ripe, and, as currently applied by courts, the incorporation strategy does not generate the substantial costs attributed to it. I suggest that this occurs, in large part, because adjudicators have tended to entertain claims of custom only where the alleged trade usage conditions on variables that are both observable and verifiable. This may leave a relatively small arena for the kinds of usages subject to incorporation. Nevertheless, it reveals that, consciously or not, institutions involved in the use of international trade usages, both to fill contractual gaps and to define ambiguous contractual terms, act within the limits of their competence, and avoid customs where reliance on the incorporation strategy would risk high adjudication and error costs.

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<sup>6</sup> Convention on Contracts for the International Sale of Goods, annex I, UN Doc A/CONF 97/18, reprinted in 19 ILM 671 (1980) (hereinafter CISG).

## I. CONDITIONS FOR LEGALLY COGNIZABLE USAGES

Trade usages reflect behavioral regularities or conventions that prevail in similar contracts within a trade. They assume that parties respond with a certain pattern of conduct whenever a particular recurring set of conditions materializes. Presumably commercial parties consistently select the pattern because, given the conditions that trigger it, they cannot improve their position by selecting an alternative course of behavior.

We can imagine five ways in which a usage might evolve to become accepted throughout a trade. Not all of these, however, maximize the value of the contract, and some of them can be downright nasty. Thus, it is by no means clear that legal doctrine should always incorporate even clear customs that minimize drafting costs. For instance, the first way in which a behavioral pattern might arise is that it is imposed by monopolists or cartels, and reflects the welfare of those parties, but not practices that would arise in a well-functioning market. Parties injured by these practices might still comply with them because they would fare even worse if they attempted to deviate and others failed to follow.<sup>7</sup>

In the second instance, the usage might not be more efficient than an alternative. Nevertheless, it might be widely accepted in order to solve a coordination problem, such as the selection of a “time when sent” or “time when received” rule to determine when an acceptance of an offer is effective. If everyone follows the same rule, contracting costs are minimized. This type of usage best fits the description of conventional practices, in which parties follow a pattern of behavior simply because others can be expected to do the same.

Third, a custom may evolve because it reflects the result that parties bargaining in a well-operating market would have reached had they taken the time to negotiate. Indeed, the less hypothetical version of this Hayekian story suggests that earlier generations of commercial actors did negotiate about the issue but ceased doing so after repeated explicit bargains generated the same result. Substituting the custom saves those negotiation costs without affecting the substantive risk allocation. This is the explanation for custom that is most closely associated with the incorporation strategy, which implies that customs evolve in ways that internalize the interests of all parties.

Fourth, the practice may evolve as a signal to others within the industry that the party is of a certain type.<sup>8</sup> For instance, most merchants within a trade who have received non-conforming goods may give sellers an additional opportunity to deliver conforming goods, notwithstanding the absence of any

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<sup>7</sup> See Clayton P. Gillette, *Cooperation and Convention in Contractual Defaults*, 3 S Cal Interdiscipl L J 167, 175 (1994).

<sup>8</sup> See Eric A. Posner, *Law and Social Norms* 18–27 (Harvard 2000).

legal obligation to do so, in order to signal an intent to cooperate and thus enhance the probability and quality of future dealings. Usages that arise in this manner present the greatest difficulty for the incorporation strategy because one characteristic of these usages is that they are not intended to displace contract terms. Rather, they exist only as a matter of grace to maintain a relationship.<sup>9</sup> Thus, parties intend to adhere to the usage only under certain conditions, such as when there is no evidence of intentional chiseling, when reciprocity is anticipated, or when alternative avenues of redress for chiseling exist. If the parties intended no legal effect to follow from the practice, then the custom should not be incorporated into the contract. But sometimes the parties do intend these same usages to have legal effect, perhaps to raise costs and therefore prevent “bad” types from mimicking the conduct of “good” types. Third-party adjudicators have difficulty discerning whether the practice was followed out of legal obligation or as an accommodation.

Fifth, the custom might reflect a practice that was generated by an entrepreneur who selected it for self-interested reasons and that became widely adopted, even if it was suboptimal, because it provided a focal point around which others could coalesce without incurring contracting costs required by a superior rule. Customs of this sort are likely to arise in contexts where the entrepreneur can easily publicize the rule to potential adopters and the entrepreneur has some status that induces potential adopters to adopt it as authoritative. Think, for instance, of trade associations that formulate and publicize trade rules to their members. Assuming that the trade association represents all parties affected by the practice, it is likely that the adopted rule will reflect a hypothetical bargain, as in the third case, and the authority of the association facilitates widespread adoption.

Nevertheless, rules that evolve from trade associations may fail to maximize the value of the contract or to reduce contracting costs. First, if those who advocate widespread acceptance of a particular usage have idiosyncratic interests, there is no reason to believe that the adopted usage reflects what would arise from a bargain between any two members of the association. Second, once adopted, trade usages embodied in association rules may be difficult to alter, even if technological or political changes suggest that an alternative would be superior. Some usages will have network effects<sup>10</sup> that make unilateral transitions to new rules costly, and commercial actors may want to avoid proposals to deviate from an established usage if those proposals could be construed by potential trading partners as obstinacy or eccentricity.

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<sup>9</sup> See, for example, Roy Goode, *Usage and Its Reception in Transnational Commercial Law*, in Jacob S. Ziegel, ed, *New Developments in International Commercial and Consumer Law* 3, 10–12 (Hart 1998).

<sup>10</sup> Goods with network effects increase in value with the number of users. Think, for instance, of telephones or fax machines.

Some correctives may minimize these effects. The same organizational structure of trade associations that may threaten rent-seeking efforts to divert public resources to private gain can also facilitate desirable changes when existing usages are outmoded. By publicizing changes, trade associations ensure universal transition to the new norm and thus reduce the risk that usages become stale. Officials of trade associations may want to receive credit for making changes and thus have incentives to revise existing trade rules when (and even when not) necessary.<sup>11</sup> Moreover, the fact that a usage has become locked in does not necessarily mean that the outdated practice should not be enforced. Unlike the first case, in which parties face market constraints, the failure of parties to bargain away from an outdated usage reflects that the contracting costs associated with the prevailing usage are less than those associated with agreeing to a new practice. The existing practice, therefore, may be efficient given the costs of bargaining away from it.

## II. WHEN WOULD LEGALLY COGNIZABLE CONDITIONS ARISE?

Customs that fall within the last four categories would tend to produce relatively efficient practices. From a cost-minimizing perspective, therefore, practices that have their origins in any of these circumstances seem appropriate for legal recognition, even if (as in case four) it is difficult to detect the intent of parties in following the practice. But under what conditions would usages that fit those descriptions materialize and spread sufficiently throughout the trade to achieve conventional status? Insofar as we think of conventions as regularities to which members of the relevant groups ought to conform,<sup>12</sup> the literature on norms becomes relevant. That literature suggests that legally cognizable usages will increasingly arise as the relevant trade possesses more of the following characteristics.

1. *Homogeneity of interests.* Commercial usages that warrant legal recognition necessarily advance the interests of those affected by it. The more homogeneous the interests of those in the group, the easier it will be for a usage to attain widespread adoption. This condition has two implications. First, group size may matter. Homogeneity is more likely within small groups than within large ones. Nevertheless, the literature on norms suggests that customs can cascade widely, so that usages may pervade large populations of similarly interested individuals. Second, given that interests may be affected by geography (for instance, cost-minimizing transportation practices may change where parties are divided by

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<sup>11</sup> See Gillette, 39 Va J Intl L at 732-40 (cited in note 5).

<sup>12</sup> See David Lewis, *Convention: A Philosophical Study* 97-98 (Harvard 1969).

mountains or oceans) and culture, usages are more likely to materialize locally than globally.

2. *Entrepreneurship in articulation of the usage.* Usages that address coordination problems may evolve without the intervention of a third party, simply because it is in the self-interest of each participant to comply with the practice. But given the public goods nature of these solutions, customs can be facilitated if someone publicizes the appropriate focal point. The default rule for tender of goods could occur at either the seller's or buyer's place of business and parties may be substantively indifferent as to the result. A legislature or trade association that disseminates a rule applicable to all participants, however, can eliminate the need to bargain over the issue.

3. *Repeat play.* Repeat play among members of the trade facilitates development of usages in two ways. First, it reinforces the expectation that all members of the trade will follow the practice simply because it becomes salient to group members. Second, where it would otherwise be worthwhile for a member of the trade to defect from the practice, repeat play creates a self-interested incentive to cooperate because the potential defector would otherwise face defection from the other participant on subsequent iterations. Repeat play, moreover, need not be between the same members of the group. It will be sufficient to reinforce the practice or to impose reputational sanctions if group members who may deal with an actor in the future can learn from others about the actor's compliance with the practice.

4. *Observability.* A group member who complies with a usage because she expects that other participants will do the same may wish to confirm the compliance of others and to seek redress against those who fail to comply. Compliance with or defection from the practice must, therefore, be observable, which in turn entails that the parties have information about the practices of others. The need for information also suggests that group size may matter because it will be easier to convey information to fewer persons. Observability may be easily satisfied, such as where the practice involves using well-accepted contract language<sup>13</sup> or giving notice of nonconformity within a specific period after delivery. But observability becomes more complicated in other contexts, such as where the practice involves delivering goods that are of a certain quality or that require following specified manufacturing processes.

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<sup>13</sup> See Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 Va L Rev 757, 775–79 (1995); Marcel Kahan and Michael Klausner, *Path Dependence in Corporate Contracting: Increasing Returns, Herd Behavior and Cognitive Biases*, 74 Wash U L Q 347 (1996); Marcel Kahan and Michael Klausner, *Standardization and Innovation in Corporate Contracting (or "The Economics of Boilerplate")*, 83 Va L Rev 713 (1997).

5. *Means of transmission.* There must be some way in which newcomers to the group become aware of the expected behavior.<sup>14</sup> For instance, a trade association may publicize rules among its members, or participants within a group may share information at conventions or in newsletters.

6. *Enforcement mechanism.* There may be instances in which a member of the group would self-interestedly violate the custom, and thus undermine its conventional benefits, unless there is some deterrent. During the period of evolution, the primary enforcement mechanism will be extralegal, such as shunning within or dismissal from the group. Reputational enforcement may continue after the practice has become entrenched, but may be displaced or augmented by legal enforcement if the legal regime permits recognition of the custom, as under the incorporation strategy. If reputational sanctions are unavailable, legal enforcement becomes more important to induce compliance with the usage.

### III. ADMINISTRATIVE AND ERROR COSTS: THE PROBLEM OF VERIFIABILITY

The incorporation strategy implies that when conditions for the emergence of legally cognizable usages exist, parties will rely on those usages rather than specify contractual obligations. But even where parties are aware of a usage, they would be reluctant to incorporate it into their contract if they believed 1) that the costs of proving the custom to an adjudicator were too high, or 2) that adjudicators were likely to commit errors in their interpretation at such a rate as to outweigh the savings of specification costs.<sup>15</sup> Thus, the incorporation strategy makes sense only where third parties can, at reasonable cost, verify compliance with the custom and apply it with accuracy.

The difficulties of satisfying these conditions seem overwhelming. Where usages or their application depend on idiosyncratic understandings, they may be observable to those within the trade, but difficult to verify to those outside. Arbiters of disputes (by which I mean both courts and other adjudicators, such as arbitration panels) may misdefine the content of the usage. For instance, even optimally precise usages may provide commercial parties with significant discretion. Indeed, that very claim constitutes a cogent retort to the empirical claim among plain meaning advocates that customs do not exist. As Kraus and Walt suggest, a practice that imprecisely defines “carload” is not necessarily less of a custom because it allows satisfaction of contractual obligations by delivering

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<sup>14</sup> See Jody S. Kraus, *Legal Design and the Evolution of Commercial Norms*, 26 *J Legal Studies* 377 (1997).

<sup>15</sup> Eric Posner suggests that commercial parties would still draft a legally enforceable contract in the face of incompetent courts in order to deter opportunism. See Posner, *Law and Social Norms* at 153–60 (cited in note 8). The above does not deny that claim but suggests that parties would still not want to include clauses that were likely to increase the rate of judicial error.



goods within a range of acceptable performance, as long as it excludes performance outside that range.<sup>16</sup> Nevertheless, arbiters as well as commentators may confuse imprecision with the absence of custom. Of course, the opposite may also be true. Imprecision may indicate only an uncoordinated set of behaviors that display too little regularity to guide subsequent behavior or signal implicit agreement. Nevertheless, arbiters may find customary regularity where none was intended.

These errors are most likely where arbiters are generalists whose profession consists of adjudicating rather than experts in the trade at issue. Generalists will have limited capacity to determine whether performance within a range reflects a custom. But even generalists will be able to define and apply customs that emerge in a highly specified form and that condition on variables that require little expertise about the underlying trade. Interpretations of customs that provide for the risk of loss to shift to the buyer when the goods pass the ship's rail are likely to have a different error rate than interpretations of customary definitions of how many impurities can be contained within hay of a specified quality.

Alternatively, arbiters may misdefine the scope of the usage. Usages arise in a context, and it can be difficult to discern which of the factors from that context must exist before application of the custom is appropriate. A usage that is followed without objection in peacetime may be unwarranted in wartime when new and more significant risks change the parties' expectations about rates of nonperformance.<sup>17</sup> A usage allowing deviations from quantity requirements when price fluctuations are within historical parameters may be irrelevant when prices are atypically volatile and the risk of opportunistic demands or deliveries increases. Generalist courts, however, may misperceive the essential conditions of the custom and fail to require that those conditions exist in order to apply it.

Finally, courts may misinterpret the intended effect of a custom. This is especially true with respect to usages that arguably evolve as signals of the actor's type. Courts may transform a usage intended as an accommodation in order to preserve an ongoing relationship into a contractual term that has legal effect, even when it is inconsistent with written terms or default rules that the parties intended to make legally enforceable.<sup>18</sup>

In order to avoid these errors, courts must invest in discovering the origins, scope, and purpose of trade usages. This process will typically entail testimony from competing experts whose credibility must be evaluated. In short, courts

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<sup>16</sup> See Kraus and Walt, *In Defense of the Incorporation Strategy* at 202 (cited in note 1).

<sup>17</sup> See, for example, *Dixon, Irmaos & Cia, Ltda v Chase National Bank of City of New York*, 144 F2d 759 (2d Cir 1944).

<sup>18</sup> See Bernstein, 144 U Pa L Rev at 1816–18 (cited in note 2); Bernstein, 66 U Chi L Rev at 769 (cited in note 2).

will have to become knowledgeable about the operation of the trade whose practices are in question, evaluate evidence about that operation, and apply what they learn to the facts before them. The costs related to that process, of course, will not be equivalent for all alleged customs. Some customs will condition on binary events—either the characteristic exists or it does not. For instance, a commercial party may claim that there is a custom of sending a confirmation letter in order to form a contract within a particular trade. An uninformed arbiter must take testimony and resolve any conflicting evidence about whether such a usage exists. But should the arbiter discover such a custom, the issue of whether it has been satisfied in the particular case conditions on the highly verifiable question of whether a confirmation letter was, in fact, sent.<sup>19</sup>

Those inquiries, however, become far more complicated with respect to other customs. For instance, an alleged custom that notice of defective performance must be given within a certain number of days to satisfy the “reasonable time” requirement under Article 39 of the CISG requires more knowledge of the relevant trade than the binary choice of whether a confirmation letter was sent. Even where courts get those inquiries right, administrative costs may be high. And even if courts incur those costs, the indefinite nature of inquiries into definition, scope, and effect of customs suggests that error rates will be high.

Plain meaning interpretations avoid these costs by rejecting the use of customs to interpret or augment explicit contractual terms. That strategy may appear to increase specification costs, but that conclusion does not necessarily follow. Specification costs may remain low if there exist informal, extralegal mechanisms for enforcing a mutually understood custom. Under those conditions, even parties subject to a plain meaning rule would not have to specify those acts that custom required, while generalist courts could avoid inquiries into the custom’s domain. Parties would adhere to customary understandings, not because they believed that those understandings would be legally enforced against them, but because the same closely connected, reputational network that gave rise to the custom also served to enforce it. This appears to be the context in which Lisa Bernstein has discovered that trade associations embrace a plain meaning rule for their private dispute resolution procedures.<sup>20</sup> Members of those associations do not necessarily adopt that strategy because they deny the existence of customs. Rather they may do so because, in that context, informal enforcement of trade usages reduces the need for more costly formal adjudication.

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<sup>19</sup> Of course, there may be cases in which the presence of a confirmation letter is more complicated. For example, will a scratched-out note satisfy the requirement? Is an e-mail sufficient? But for the most part, the issue presents a binary choice that the letter either was or was not sent.

<sup>20</sup> Bernstein, 66 U Chi L Rev at 745–47 (cited in note 2).

This analysis suggests an answer to a puzzle that is presented by Bernstein's work. Plain meaning rules reduce administrative and error costs because context does not have to be discovered and terms do not have to be interpreted.<sup>21</sup> But the private adjudicatory processes that Bernstein has studied use expert judges rather than generalist panels. These experts should already have knowledge of trade customs. These experts presumably could employ custom without generating high administrative or error costs. Thus, these arenas appear ripe for use of the incorporation strategy. Nevertheless, Bernstein finds that industries that use expert judges eschew any efforts to look beyond written contract terms. Perhaps the explanation for this anomaly is that these industries involve repeat players who have sufficient information about each other to employ extralegal, reputational mechanisms to resolve most disputes. As a result, formal dispute resolution can occur in a perfunctory, inexpensive manner that applies formalistic rules because the "real" work of meting out justice is performed extralegally. In essence, the formalist process does not deny the existence of customs; it merely signals those in the trade to resolve disputes over customary practices informally or through reputational sanctions rather than through more costly third-party enforcement mechanisms.

The negative implication, however, is that plain meaning rules may be less appropriate in contexts not characterized by closely knit trading groups whose members enter highly specified contracts, and who are aware of standardized risks—that is, the contractual setting that Bernstein suggests is indicative of the trades she has examined.<sup>22</sup> There may be contexts in which even significant administrative and error costs are worth incurring in order to obtain the benefits of saved specification costs. I next turn to whether the drafters of the CISG may have erred in implying that the contracts with which they were dealing fall into that category.

#### IV. APPLICATION TO INTERNATIONAL SALES

##### A. SKEPTICISM ABOUT INCORPORATION

At first glance, the criteria for beneficial trade usages appear to have little application to international trade. The broad geographical range of international trade and the variety of participants suggest a heterogeneity in risks, preferences,

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<sup>21</sup> Even Bernstein's most thorough critics acknowledge that she may have demonstrated that there are some cases in which rejection of the incorporation strategy is appropriate. For instance, Kraus and Walt suggest that interpretive error will be less under the plain meaning rule. Since they are concerned about total contracting costs, they imply that if interpretive error is sufficiently low, it may offset any gains from reducing specification costs. See Kraus and Walt, *In Defense of the Incorporation Strategy* at 198 (cited in note 1).

<sup>22</sup> See Bernstein, 144 U Pa L Rev at 1816–18 (cited in note 2); Drahozal, 33 Vand J Transnatl L at 92 (cited in note 2).

and culture antithetical to the existence of homogeneity, reputational networks, transmission of information, and extralegal enforcement that are prerequisites for the incorporation strategy. Even though a great deal of international trade will involve individual repeat players,<sup>23</sup> international networks are likely to be less informed about the relevant parties than their domestic counterparts; greater distances between traders are likely to interfere with observability; and variations in local customs and in their interpretation frustrate efforts to verify, for instance, whether practices are intended to accommodate or to have legal effect.

Nevertheless, the CISG, the dominant source of legal doctrine in international sales, relies heavily on usages to interpret and complete contracts. Article 9(2) provides that parties to a contract are bound by any usage of which they knew or ought to have known, and which in international law is widely known to, and regularly observed by, parties to similar contracts in the particular trade. Article 8(3) instructs those adjudicating claims under the CISG to determine the parties' intent by looking at "all relevant circumstances," including any "usages."<sup>24</sup> From the perspective of minimizing contracting costs, these provisions make sense only if specification costs would outweigh the administrative and error costs of verifying customs to adjudicators. This is a plausible outcome for international sales. The former are incurred in every contract. The latter arise only in the event of dispute. Given the costs of international litigation, the percentage of contracts that result in adjudication may be sufficiently low that parties prefer the lower drafting costs that trade usages entail.

Nevertheless, the same legal, cultural, and linguistic differences that make cross-border adjudication costly also reinforce the intuition that customs are too limited to be helpful in international settings. Indeed, at first glance, the CISG criteria appear to grant legal recognition to usages that are unlikely to minimize contracting costs or maximize contract value. Under Article 9(2), the prerequisites for incorporation of a usage are its actual or imputed knowledge by the parties, its international character, and its observation by parties to similar

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<sup>23</sup> Some commentators suggest that international trade will be dominated by one-shot transactions. See, for example, Richard A. Epstein, *Confusion about Custom: Disentangling Informal Customs from Standard Contractual Provisions*, 66 U Chi L Rev 821, 825 (1999). The cases that arise under the CISG, while difficult to classify, suggest that repeat play is frequent. Indeed, at least one court has implied that repeat play in a foreign country may be sufficiently robust that local customs, as well as international ones, may be used to inform the interpretation and supplementation of the contract. See Oberlandesgericht Graz, No 6 R 194/95 (Nov 9, 1995) (Austria), available at <<http://cisgw3.law.pace.edu/cases/951109a3.html>> (visited Mar 28, 2004).

<sup>24</sup> For the importance of usages in the CISG, see Aleksandar Goldstajn, *Usages of Trade and Other Autonomous Rules of International Trade According to the UN (1980) Sales Convention*, in Petar Sarcevic and Paul Volken, eds, *International Sale of Goods: Dubrovnik Lectures* 55, 71 (Oceana 1986); Stephen Bainbridge, *Trade Usages in International Sales of Goods: An Analysis of the 1964 and 1980 Sales Conventions*, 24 Va J Intl L (1984).

contracts in the trade.<sup>25</sup> If those conditions are satisfied, there is no basis for rejecting the custom on the grounds that it arose other than from a Hayekian bargain. During the drafting of the CISG, Chinese delegates unsuccessfully proposed that only “reasonable” usages would be binding on the parties. While some delegates responded that any usage that attracted the requisite international status would necessarily be reasonable, the conditions for customs discussed earlier suggest how cartelization or path dependence could generate inefficient customs. Thus, socialist countries expressed concern that commercial usages to date “had been formed by a restricted group of countries only whose position did not express worldwide opinion.”<sup>26</sup>

The international nature of the CISG similarly suggests that verification and application of trade usages will involve high administrative and error costs. One of the salient features of the CISG is that it is enforced by national courts; no international tribunal adjudicates disputes, receives appeals from national courts, or otherwise resolves disputes among conflicting national courts. Article 7 directs courts to interpret CISG provisions in light of their “international character,” which implies deference in each signatory country to the precedent of foreign courts concerning custom.<sup>27</sup> But, while databases of decisions increasingly make the outcomes of disputes accessible,<sup>28</sup> reliable translations are still lacking for the vast majority of decisions. Even where courts can obtain foreign decisions, the practical reality of a “homeward bias” is likely to transform some localized customs into “international” ones.<sup>29</sup> The likelihood of this

<sup>25</sup> See CISG art 9(2) (cited in note 6).

<sup>26</sup> See John O. Honnold, *Documentary History of the Uniform Law for International Sales* 484 (Kluwer Law & Tax 1989) (remarks of delegates from Yugoslavia and Czechoslovakia). See also M.J. Bonell, *Art. 9—Usages & Practices*, in C.M. Bianca and M.J. Bonell, *Commentary on the International Sales Law: The 1980 Vienna Sales Convention* 105 (Giuffrè 1987).

<sup>27</sup> See CISG Art 7(1)–(2) (cited in note 6) (establishing interpretive guidelines for disputes over CISG’s meaning). For a skeptical view about the capacity of national courts to defer to the decisions of foreign courts, see Joseph Lookofsky, *CISG Foreign Case Law: How Much Regard Should We Have*, in Franco Ferrari, Harry Flechtner, and Ronald A. Brand, *The Draft UNCITRAL Digest and Beyond: Cases, Analysis and Unresolved Issues in the U.N. Sales Convention* 216 (2003).

<sup>28</sup> See, for example, Pace Law School, *Electronic Library on International Trade Law and the CISG*, available online at <<http://www.cisg.law.pace.edu>> (visited Mar 28, 2004); UNILEX on CISG, available online at <<http://www.unilex.info/dynasite.cfm?dssid=2376&dsmid=14315>> (visited Mar 28, 2004); United Nations Commission on International Trade Law (“UNCITRAL”), *Case Law on UNCITRAL Texts (CLOUT)*, available online at <<http://www.uncitral.org/english/clout>> (visited Mar 28, 2004); Lex Mercatoria: *Private International Commercial Law*, available online at <<http://www.jus.uio.no/lm/private.international.commercial.law/sale.of.goods.html#cisg>> (visited Mar 28, 2004).

<sup>29</sup> See, for example, Harry M. Flechtner, *The Several Texts of the CISG in a Decentralized System: Observations on Translations, Reservations and Other Challenges to the Uniformity Principle in Article 7(1)*, 17 J L & Comm 187 (1997); Franco Ferrari, *Uniform Interpretation of the 1980 Uniform Sales Law*, 24 Ga J Intl & Comp L 183 (1994). Trakman reports that the same phenomenon existed in medieval merchants courts that applied local customs in a manner that undermined the development of

confusion (along with related error costs) is increased because judges of national courts will be generalists. Although much of the dispute resolution under the CISG has occurred through arbitration, the arbitrators also tend to be generalists rather than experts within the trade at issue.<sup>30</sup> Taken together, these factors suggest that international sales law is a peculiar forum for the incorporation strategy.

Some of these concerns have materialized in judicial interpretations of the CISG. The unfortunate system of having national courts decide cases has produced at least occasional homeward bias in defining the content of usages. One need not attribute willfulness or jingoism to judges who exhibit this bias. Rather, national judges who are schooled in a particular set of commercial law doctrines and practices are likely to extrapolate from their domestic experience when interpreting provisions that invoke concepts of “reasonableness” or other standards of behavior.<sup>31</sup> The most noteworthy example of this phenomenon involves a series of German opinions involving the period for reasonable notice of defects. Article 39(1) requires a buyer to notify the seller of any nonconformity in delivered goods within a reasonable time after it is or ought to have been discovered. German courts, following domestic practice, have rejected a flexible standard for giving notice that seems appropriate for an international concept of reasonableness.<sup>32</sup> The consequence is that domestic

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universal principles. See Leon E. Trakman, *The Law Merchant: The Evolution of Commercial Law* 19 (Rothman 1983).

<sup>30</sup> See Drahozol, 33 Vand J Transnatl L at 96 (cited in note 2).

<sup>31</sup> See, for example, John O. Honnold, *Uniform Law for International Sales under the 1980 United Nations Convention* (Kluwer Law Intl 3d ed 1999).

<sup>32</sup> See discussion of the German approach in *Obergericht des Kanton Luzern* (Jan 8, 1997), available online at <<http://cisgw3.law.pace.edu/cases/970108s1.html>> (visited Mar 28, 2004). That decision adopted a strict one-month limit, presumably to accommodate concerns of different jurisdictions rather than because of any inherent reasonableness of such a period in the case before the court. The court reasoned:

The calculation of the time limit in which to give a notice of defect varies. Whereas jurisdictions of the Germanic legal family demand an immediate notice, respectively a notice without delay, in Anglo-American and Dutch law the notification must be given within a “reasonable time” or within an appropriate time after discovery of the defects (*cf.* v.Caemmerer/Schlechtriem, Art. 39 n. 4). It appears to be highly uncertain how to determine the time limit for durable goods in standard cases. German authors tend to apply a limit of eight days. The first German decisions on the CISG also point in this direction. Where, due to a longstanding tradition of the national law, a notice of defect given several months after the discovery of the defect is deemed to be within an appropriate time limit—as is the case in U.S. law—this view is likely to affect the interpretation of the CISG. To avoid too wide a gap in interpretation, a convergence of those points of view seems inevitable. Therefore, an approximate medium time frame of at least one month seems appropriate (*cf.* v.Caemmerer/Schlechtriem, Art. 39 n. 17). Bearing in mind the uncertainty regarding the interpretation of a “reasonable time limit”, which the authors of the v.Caemmerer/Schlechtriem Commentary call to our attention, it seems sensible to adopt their substantiated proposal and regard one month as a reasonable time limit.

customs have been elevated to international status, notwithstanding the admonition of Article 9 to incorporate only those customs with international currency.

### B. WHY ARTICLE 9(2)?

But that conclusion leads to a puzzle. CISG doctrine concerning customs can be traced to the prior efforts to internationalize sales law in the Uniform Law for the International Sale of Goods (“ULIS”)<sup>33</sup> and the Uniform Law on the Formation of Contracts for the International Sale of Goods.<sup>34</sup> After years of discussion by Working Groups, the proposed CISG was presented to and debated by representatives of more than 62 countries and eight international organizations.<sup>35</sup> The results have now been adopted by more than 60 nations. Why would all this have occurred with Article 9(2) intact if trade usages were so ill-fit for international sales law?

The first possible response is simply historical. Contemporary international sales law is assumed to descend from the Law Merchant, which is itself seen as evolving from customs and practices rather than from specified written terms.<sup>36</sup> Second, and related to the first, is a certain path dependency. Each codification of international sales law has built on its predecessors, and each has incorporated commercial practice as an aid to contract interpretation. The ULIS, for instance, incorporated into contracts any usages that “reasonable persons in the same situation usually consider to be to be applicable to their contract,” provided that usages prevailed over conflicting legal provisions, and required adjudicators to interpret contractual provisions according to their meanings in the trade.<sup>37</sup>

Path dependence cannot fully explain acceptance of the incorporation strategy in the CISG, however. The modern law merchant varies from its medieval precursor in important ways that suggest commercial actors can get off an established path when more efficient default rules become apparent. In the historical law merchant, the state conceded to market participants both the function of formulating commercial law and of enforcing it. State-supplied law was primarily suppletive, in that it authorized merchants to promulgate the legal

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<sup>33</sup> Convention Relating to a Uniform Law for the International Sale of Goods, July 1, 1964, annex, 834 UN Treaty Ser 109 (1964), reprinted in 13 Am J Comp L 453, 456 (1964) (hereinafter ULIS).

<sup>34</sup> Convention Relating to a Uniform Law on the Formation of Contracts for the International Sale of Goods, July 1, 1964, annex, 834 UN Treaty Ser 123 (1964), reprinted in 13 Am J Comp L 453, 472 (1964).

<sup>35</sup> See Honnold, *Uniform Law for International Sales* at 5–10 (cited in note 31).

<sup>36</sup> See, for example, Trakman, *The Law Merchant* at 7–21 (cited in note 29). For a challenge to this traditional story, see Charles Donahue Jr., *Medieval and Early Modern Lex mercatoria: An Attempt at the probatio diabolica*, 5 Chi J Intl L 21 (2004).

<sup>37</sup> ULIS art 9 (cited in note 33).

rules that governed their contracts. Merchant courts rather than state agencies of general jurisdiction enforced the rules that they had promulgated. This system permitted parties familiar with the trade to evaluate contractual performance and thereby minimized difficulties that might exist if state agencies applied their own interpretive methodologies or substantive rules.

The CISG continues the first element of medieval practice, at least insofar as it recognizes trade usages and permits them to trump conflicting state-supplied defaults. But it deviates from historical roots insofar as it assigns the enforcement function to generalists. To the extent that these adjudicative bodies are less competent to identify and interpret trade usages, and have less incentive to perform those inquiries in a manner consistent with merchant understandings, adjudicative and error costs will be higher; commercial parties, less certain of their capacity to enforce custom, will thus invest more in specifying their obligations in order to signal meaning to third parties. Path dependence explanations for the incorporation strategy cannot account for why those who altered the adjudication mechanism could not simultaneously have changed to a plain meaning rule that would be easier to enforce, reduce interpretive error, and allow greater predictability about the construction of contract terms.

An alternative explanation for the inclusion of an inappropriate incorporation strategy is that those who drafted the CISG were neither in business nor practicing attorneys who represented business clients. Instead, drafting sessions were dominated by law professors, government officials, and parties interested in “uniform law” projects. Arguably, delegates to the Convention desired primarily to produce a document that would be acceptable to legislatures in a wide array of political, economic, and legal systems, rather than optimal for the businesses that would be regulated by it.<sup>38</sup> “Compromise” was therefore the byword of the meetings that generated the CISG.<sup>39</sup> The consequence was to promulgate vague standards susceptible to multiple interpretations and thus avoid disappointing any legislative interest in a particular outcome.<sup>40</sup> Invocation of trade usages, rather than setting trade rules, arguably postpones difficult and controversial risk allocations and places the obligation to promulgate trade rules on courts rather than on legislators who might, in the process, alienate constituents. Thus, in the debate about Article 9(2), delegates at

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<sup>38</sup> See, for example, Goode, *Usage and Its Reception in Transnational Commercial Law* at 23 (cited in note 9) (noting that conventions are made by states, not by merchants, and thus are not formulated “by the members of the community whose usages they are supposed to embody”).

<sup>39</sup> See, for example, M.J. Bonell, *Introduction*, in Bianca and Bonell, *Commentary on the International Sales Law* 1, 13 (cited in note 26); Goldstajn, *Usages of Trade and Other Autonomous Rules* at 58, 76 (cited in note 24).

<sup>40</sup> See Alan Schwartz and Robert E. Scott, *The Political Economy of Private Legislatures*, 143 U Pa L Rev 595 (1995).



least initially had concerns about the imperialism of customs and the extent to which incorporation of usages impinged on national sovereignty, rather than on the efficiency or utility of practices that had wide support within a trade.<sup>41</sup>

But political economy stories also fail to explain the centrality of usages in the CISG. Representatives of some business organizations, such as the International Chamber of Commerce, attended the Working Group sessions that drafted the CISG and the Diplomatic Conference that approved it.<sup>42</sup> Although they had status only as “observers,” they could use that position to lobby for provisions that would serve their members’ interests. In addition, it is anomalous to say that representatives were concerned about adoption of the CISG by different domestic legislatures rather than by business interests. Within the most important commercial nations, such as the United States, business interests would constitute an important voice in the legislature’s decision about whether to adopt the CISG. If the CISG’s provisions created a threat to those interests, the CISG would stand little chance of adoption.

## V. TRADE USAGES AND INSTITUTIONAL COMPETENCE

There remains, therefore, a puzzle about why doctrinal law concerning international sales should assign such primacy to trade usages. In this Part, I suggest that international trade tends to generate only usages that are worthy of legal recognition and that condition on events with low administrative and error costs. Concomitantly, I conclude that the cases decided under Article 9(2) to date reveal a tendency for arbiters to recognize only usages that satisfy those requirements, because the customs are readily identifiable as having evolved from processes that internalize the effects of the usage and that can be defined and applied with little exercise of discretion by generalist arbiters.

Consider first whether the usages that are likely to apply under Article 9(2) will tend to be value-enhancing. The fear of imperialist customs essentially replicates the concern that monopolists or cartels could impose value-reducing customs on contracting parties. That concern, however, does not appear to have materialized, perhaps because of the requirement of “internationality” that was inserted in Article 9(2) as a remedial device. None of the cases that have arisen to this point under Article 9 has involved a claim that the alleged custom should not be enforced because it was imposed under circumstances that deprived the contracting party of an opportunity to bargain for or around it.

Instead, the cases that have arisen under Article 9 have been dominated by either of two situations in which usages plausibly reduce contracting costs. The

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<sup>41</sup> See Goldstajn, *Usages of Trade and Other Autonomous Rules* at 77–83 (cited in note 24); Honnold, *Uniform Law for International Sales* at 127 (cited in note 31).

<sup>42</sup> See Honnold, *Documentary History for the Uniform Law of International Sales* at 26, 63–64 (cited in note 26).

usages that courts have recognized to date emerge either out of international mercantile associations or from unwritten practices that condition on readily verifiable events. These cases suggest that even if the parties to a particular transaction are of the heterogeneous, single-play, multi-cultural type that would appear to undermine meaningful custom, they may implicitly agree to usages that can be defined without technical expertise, and that can readily be communicated among members of the trade without the kind of repeat play that is more likely in a localized environment.

The first set of cases under Article 9(2) involves situations in which an international mercantile association plays the entrepreneurial role of promulgating and publicizing rules that can readily be adopted by participants in a trade. Such organizations can centrally articulate obligations concerning the formation, performance, or enforcement of contracts after consultation with the parties that are affected. Thus, these cases do not implicate more casual customs that evolve locally, the scope and meaning of which are difficult to define and apply. They establish precise obligations that are intended to be incorporated into contracts and thus are not easily confused with practices that may evolve as a matter of grace to maintain ongoing relationships, but to be disregarded with impunity at endgame. At the same time, these organizations can publicize their rules, so they become cognizable even to parties who have no prior dealings with each other.

Many of the cases involving Article 9(2), for instance, involve the application and interpretation of INCOTERMS, the rules of the International Commerce Commission (“ICC”) for the interpretation of trade terms.<sup>43</sup> These terms, which govern the risk of loss and obligations concerning delivery, insurance, and transportation, “provide a set of international rules for the interpretation of the most commonly used trade terms in foreign trade.”<sup>44</sup> They are drafted with precision, are widely publicized with substantial explanations of the meanings of terms, and are applicable across industries. The ICC represents both buyers and sellers and thus is unlikely to promulgate one-sided policies. Rather, its broad constituency increases the probability that INCOTERMS will either solve coordination problems or reflect risk allocations that mimic bargains in a well-operating market. Finally, the frequent revision of rules generated by the ICC, such as INCOTERMS and the Uniform Customs and Practices for Documentary Credits,<sup>45</sup> suggest that prevailing usages have not ossified.

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<sup>43</sup> See International Chamber of Commerce, *INCOTERMS 2000: ICC Official Rules for the Interpretation of Trade Terms* (2000).

<sup>44</sup> *Id.* at 5.

<sup>45</sup> Uniform Customs and Practice for Documentary Credits (Intl Chamber of Commerce, Pub No 500, rev 1993), available online at <<http://www.jus.uio.no/lm/icc.ucp500.1993/doc.html>> (visited Mar 28, 2004).

INCOTERMS are, however, purely customary and may even conflict with domestic law.<sup>46</sup> In a variety of cases, courts have found that when commercial parties have used terms that are defined in INCOTERMS, have not otherwise defined the meaning of their terms in the contract, and are involved in an aspect of international trade in which INCOTERMS are traditionally used, INCOTERMS will be incorporated into the contract under Article 9(2).<sup>47</sup> The scope and definition of INCOTERMS are highly specific and easily accessible to nonspecialists. It takes little knowledge of the trade to determine whether goods have been delivered at a particular point. There is little discretion involved in the determination of whether the seller purchased an insurance policy. Thus, incorporation of customary terms that condition on these events does not authorize arbiters to reinterpret the terms on which the parties agreed to trade. Rather, courts need only determine whether the parties intended to be bound by the customary, well-understood meanings in INCOTERMS. Certainly there will be cases in which an issue arises as to whether the trade has adopted INCOTERMS. But the attack on the incorporation strategy is directed at far more difficult issues concerning the definition and scope of a custom, rather than at whether the parties were involved in a trade that accepted centrally promulgated rules.

Although the ICC promulgates and publicizes these rules, it does not provide any mechanism for enforcing them (though parties may select ICC Arbitration to resolve disputes). Nor does the ICC provide a repository of knowledge concerning compliance with or violation of its rules. Moreover, ICC rules are intended to be used internationally by a variety of trades. This combination of broad geographical scope, absence of repeat play, and limited communication about compliance indicates that those who utilize ICC rules cannot depend on reputational sanctions alone to enforce them. As Lisa Bernstein's studies reveal, highly localized trade associations that promulgate codes for their membership of repeat players can rely on informal enforcement of customs. But that option is less likely to be available to participants in international sales who may have only occasional contact with others in the trade and for whom gossip may provide little deterrence or redress. Thus, even if arbiters occasionally err in their application of INCOTERMS, those error costs

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<sup>46</sup> For instance, INCOTERMS conflict with § 2-319 of the Uniform Commercial Code as currently adopted by states. Proposed revisions of Article 2 of the Uniform Commercial Code would change the result. See John Spanogle, *Incoterms and the UCC Article 2—Conflicts and Confusions*, 31 *Intl Law* 111 (1997).

<sup>47</sup> See, for example, *BP Oil International, Ltd v Empresa Estatal Petroleos de Ecuador*, 332 F3d 333 (5th Cir 2003); *St. Paul Guardian Insurance Co v Neuromed Medical Systems & Support*, 2002 WL 465312, \*2 (SDNY Mar 26, 2002); *ICC Arbitration Case No 7645 of March 1995*, available online at <<http://cisgw3.law.pace.edu/cases/957645i1.html>> (visited Mar 28, 2004); *Russian 6 June 2000 Arbitration Proceeding 406/1998*, available online at <<http://cisgw3.law.pace.edu/cases/000606r1.html>> (visited Mar 28, 2004).

may be an inevitable cost of having some effective enforcement mechanism for customs to which the parties have agreed.

The second set of cases involves more informal, unwritten practices that evolve from interactions among parties rather than from a centralized decisionmaker. These constitute the type of customs that might give rise to high verification costs and that underlie the critique of the incorporation strategy. As applied in international sales, however, these practices tend to condition on the presence or absence of a salient act which can be determined without technical expertise. For instance, several cases under Article 9(2) involve the need to object to terms in a contracting party's confirmation letter to avoid the inclusion of those terms in the final contract. Like the mailbox rule, a convention about explicit objection to terms in confirmations would solve a coordination problem about the existence and content of a binding contract. The substance of the convention that arises may be less important than its creation. For that reason, however, the convention is likely to condition on a salient act which is relatively observable. In the case of a confirmation letter, the requisite letter was either sent or it was not. Because those acts do not require any technical expertise or specific knowledge of the trade, however, they are verifiable to third parties at low cost. For instance, in a contract for the sale of windows and doors between an Italian seller and a German buyer, the court found that the buyer was entitled to a discount included in a confirmation letter sent to the seller.<sup>48</sup> The seller had not objected to the content of that letter. The court concluded:

It is an accepted trade usage that a tradesperson who receives a letter of confirmation has to object to the letter's content if he does not wish to be bound by it. If he does not object, the contract is binding with the content given to it in the letter of confirmation, unless the sender of the letter has either intentionally given an incorrect account of the negotiations, or the content of the letter deviates so far from the result of the negotiations that the sender could not reasonably assume the recipient's consent. The recipient's silence causes the contract to be modified or supplemented in accordance with the letter of confirmation.<sup>49</sup>

Courts confronted with such a custom do not face costless inquiries. The court's recitation of the relevant custom still permits exceptions that require judicial inquiry into the parties' interactions. But those investigations, which consider credibility or the deviation between order and confirmation, involve traditional judicial inquiries in contract law. They are triggered by general judicial policing of contractual fairness, rather than by the custom concerning

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<sup>48</sup> Oberlandesgericht Saarbrücken, No 1 U 324/99-59 (Feb 14, 2001), available online at <http://cisgw3.law.pace.edu/cases/010214g1.html> (visited Mar 28, 2004).

<sup>49</sup> *Id.*

confirmations.<sup>50</sup> While costly, these inquiries do not condition on unique industry norms and thus do not implicate the costs typically associated with the incorporation strategy.

Similarly, in a case between an Austrian seller and a Swiss buyer for the sale of fiber, the court found that the seller had sent a confirmation to the buyer, thereby creating a binding contract.<sup>51</sup> The court concluded that the legal systems in both countries permitted formation of contracts through an exchange of confirmations for purposes of domestic contracts, and thus the parties understood that the same rule would apply “to contracts for the supply of textiles in international relationships between contractual partners established in Switzerland and Austria” under the CISG. The court may have been wrong both in its interpretation of Austrian law and on what constitutes an international trade usage under Article 9.<sup>52</sup> But those are errors of law, independent of the ability of the court to discern the existence of the custom (as opposed to its applicability in domestic law) or the level of compliance in the case before it.

Finally, in *Geneva Pharmaceuticals Technology Corp v Barr Laboratories, Inc.*,<sup>53</sup> the court recognized an industry custom to rely on implied, unwritten supply commitments to satisfy the requirements for contract formation, notwithstanding the failure to satisfy formation obligations under the CISG. The content of such a custom does not have the provenance of INCOTERMS and might be thought to constitute the kind of casual, unwritten custom that generates discomfort with the incorporation strategy. Nevertheless, like the sending of a confirmation letter, it conditions on compliance with salient, nontechnical acts (here, permitting the contracting party access to a Drug Master

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<sup>50</sup> Imagine, for instance, that there was a custom that terms of confirmation were binding unless objected to, and that buyer failed to object to a patently unfair contractual term in a confirmation. Wholly apart from custom, courts would be entitled to disregard the offensive term under Article 7 of the CISG, which requires the observance of good faith, or under domestic law concerning the validity of terms, a subject excluded from the CISG under Article 4. See, for example, Restatement (Second) of Contracts § 211(3) (1981). Indeed, the quotation from the court leaves unclear whether the “exceptions” that the court is willing to consider are part of the custom or are inquiries that the court feels qualified to make regardless of the existence of custom.

<sup>51</sup> *W.T. GmbH v P. AG*, Civil Court Basel, Zivilgericht Kanton Basel-Stadt (Dec 21, 1992) (Switzerland), available online at <<http://cisgw3.law.pace.edu/cases/921221s1.html>> (visited Mar 28, 2004).

<sup>52</sup> Professor Peter Schlechtreim concludes that Austrian law had changed prior to the decision and that concurrence on domestic practices in the states of the contracting parties is not sufficient to constitute the relevant “internationality” under Article 9(2). See Remarks of Peter Schlechtreim, in Harry M. Fletcher, trans, *Transcript of a Workshop on the Sales Convention: Leading CISG Scholars Discuss Contract Formation, Validity, Excuse for Hardship, Avoidance, Nachfrist, Contract Interpretation, Parol Evidence, Analogical Application, and Much More*, 18 J L & Comm 191, 246 (1999).

<sup>53</sup> 201 F Supp 2d 236, 281–82 (SDNY 2002).

file) that present the court with a binary choice and require no qualitative judgments.<sup>54</sup>

Some cases, however, do involve conditions that are more difficult to verify. Cases that condition on the appropriate notice period for defective performance may require knowledge of a trade's subtle characteristics. Cases that involve behavioral patterns within an industry that could be intended either as acts of grace or as legal obligations test the limits of a generalist arbiter's competence. In some of these cases, arbiters do refer to trade usages in order to define a "reasonable" period of time, such as where a seller claimed that the buyer had not complied with the standards of the frozen fish industry for giving prompt notice of defects.<sup>55</sup> When arbiters incorporate trade usages to define the scope of reasonable behavior, however, they do so because other provisions of the CISG obligate them to find some measure of "reasonableness." Presumably reference to trade usages, even if fraught with danger of misinterpretation, is superior to the alternative strategy in which courts simply intuit to their independent conception of reasonableness.<sup>56</sup>

Arbiters who invoke Article 9(2), therefore, appear to apply international trade usages only where practices approximate results that seem to have evolved from bargain relationships and that have been established with high levels of precision, observability, and verifiability. It is not clear whether this phenomenon is based on an unwillingness of litigants to introduce potential trade usages where administrative and error costs would be high, whether courts are sufficiently cognizant of their institutional roles to avoid interpretation of usages that require more expertise than they possess, or whether the conditions that would allow a usage to attract international acceptance also substantially coincide with the conditions for a usage that can be judicially enforced at low cost. But to the extent any of these explanations applies, the restricted scope of customs that have been subjected to Article 9(2)'s explicit embrace of the

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<sup>54</sup> Similarly, one arbitration panel found that the practice of revising prices in post-sale invoices was a usage regularly observed in the trade that could be enforced against a buyer. The court considered only whether a usage existed (a binary decision), rather than whether the revision made by the seller was within a range permitted by the usage (a decision that would have required deeper inquiry into the technical aspects of the trade). See *ICC Court of Arbitration—Paris*, 8324/1995, available online at <<http://www.unilex.info/dynasite.cfm?dssid=2376&dsmid=13355&x=1>> (visited Mar 28, 2004) (click on the link for "00.00.1995 ICC Court of Arbitration—Paris").

<sup>55</sup> See, for example, *CME Cooperative Maritime Etaploise S.A.C.V. v Bos Fishproducts Urk BV*, No HA ZA 95-640 (May 3, 1997) (Netherlands) (abstract available online at <<http://www.unilex.info/case.cfm?pid=1&do=case&id=332&step=Abstract>> (visited Mar 28, 2004)).

<sup>56</sup> For a critique of such judicial activism in the context of the Uniform Commercial Code, which also requires judges to inject content into the obligation to act "reasonably," see, for example, Robert E. Scott, *The Uniformity Norm in Commercial Law*, in Kraus and Walt, *The Jurisprudential Foundations of Corporate and Commercial Law* at 149 (cited in note 1).

incorporation strategy does not appear to create a significant risk of completing or misinterpreting contracts contrary to the intent of the parties.

## VI. CONCLUSION

The success of the incorporation strategy depends largely on the extent to which it can reduce contracting costs. There is little reason to believe that the components of those costs will be the same in all situations. It is much more likely that the nature of the custom and the context in which it is practiced will determine whether the savings in specification costs will exceed or be exceeded by administrative and error costs that the strategy generates. The modest claim of this paper is that we can create a taxonomy of circumstances in which desirable customs are likely to emerge and in which arbiters have the competence to apply them, and that, perhaps counterintuitively, Article 9 of the CISG as applied satisfies the latter criteria.<sup>57</sup>

Perhaps most importantly, the existing cases in international sales law reveal an interesting sensitivity to those circumstances in which generalist arbiters are competent to define and apply trade usages. The cases suggest that the parade of horrors that detractors of the incorporation strategy fear has not materialized, at least in the CISG context. Arbiters have not aggressively sought usages to alter the plain meaning of contract terms or discovered usages in circumstances where legally binding practices could easily be confused with those that evolved as a matter of grace. Rather, arbiters have largely limited the usages that they recognize under the CISG to those that reflect realistic bargains and that condition on events that can be confirmed without technical expertise or significant discretion. The result is that decisions about usages that emerge from generalist arbiters are less controversial than one might believe.

These conclusions might provide reason for some confidence in the capacity of arbiters to utilize the incorporation strategy. If arbiters systematically recognize the limits of their own institutional competence, apply customs that are readily verifiable, and avoid those that are not, then the subsequent limited incorporation of trade usages does not threaten to displace parties' intent with judicial hegemony.

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<sup>57</sup> The modesty of my claim is also related to the fact that I have focused entirely on the incorporation of custom in Article 9(2). I have not considered Article 8(3), which instructs courts to consider usages in determining the intent of a party in construing contract language. It is conceivable that courts and arbiters applying Article 8(3) would be faced with a broader set of alleged customs than under Article 9(2), since the usages applicable under the former section are not explicitly limited by the conditions that apply to the latter.