The Relative Costs of Incorporating Trade Usage into Domestic versus International Sales Contracts: Comments on Clayton Gillette, *Institutional Design and International Usages under the CISG*

Avery Wiener Katz*

Clayton Gillette's paper on the use of trade usage in reported disputes arising under the United Nations Convention on Contracts for the International Sale of Goods ("CISG") presents a challenge to recent scholarly critiques of modern contractual interpretation.[1] As Gillette explains, much recent writing by economically influenced US scholars in contracts and commercial law has argued in favor of more formalistic methods of interpretation, and against the overwhelming trend of the last half of the twentieth century: a trend toward a more contextual interpretative approach that takes into account a variety of evidence, including the business purpose of the transaction, the customs and practices of the market in which the parties transact, the history of the parties' dealings, and even the parties' pre- and post-contractual communications.[2] These

* Professor of Law, Columbia University School of Law. E-mail: avkatz@law.columbia.edu. I am grateful for helpful discussions with Clayton Gillette and Lisa Bernstein, and with other participants in the Symposium, *The Empirical and Theoretical Underpinnings of the Law Merchant*, The University of Chicago Law School (Oct 16–17, 2003).

1 Clayton P. Gillette, *The Law Merchant in the Modern Age: Institutional Design and International Usages under the CISG*, 5 Chi J Intl L 157 (2004).

2 Id. The leading exponents of this position include Alan Schwartz, *Relational Contracts and the Courts: An Analysis of Incomplete Agreements and Judicial Strategies*, 21 J Legal Studies 271 (1992); Lisa Bernstein, *Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms*, 144 U Pa L Rev 1765 (1996); Alan Schwartz, *Incomplete Contracts*, in Peter Newman, ed, 2 *New Palgrave Dictionary of Economics and the Law* 277 (Palgrave Macmillan 1998); Lisa Bernstein, *The Questionable Empirical Basis of Article 2's Incorporation Strategy: A Preliminary Study*, 66 U Chi L Rev 710 (1999); Richard A. Epstein, *Confusion about Custom: Disentangling Informal Custom from Standard Contractual Provisions*, 66 U Chi L Rev 821 (1999); Robert E. Scott, *The Uniformity Norm in Commercial Law: A Comparative Analysis of Common Law and Code Methodologies*, in Jody S. Kraus and Steven D. Walt, eds, *The Jurisprudential Foundations of Corporate and Commercial Law* 149 (Cambridge 2000); Robert E. Scott, *The Case for Formalism in Relational Contract*, 94 Nw U L Rev 847 (2000), Robert E. Scott, *A Theory of Self-Enforcing Indefinite Agreements*, 103 Colum L Rev 1641 (2003); Alan Schwartz and Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 Yale L J 541 (2003).

critiques have extended even to the interpretative use of trade usage, which has long been regarded as an especially reliable source of information about the parties' intentions and which enjoys a privileged status in US domestic sales cases decided under the Uniform Commercial Code ("UCC").[3]

Gillette argues, based on a survey of international case law, that Article 9(2) of the CISG, which directs tribunals to incorporate international trade usage into private contracts governed by the Convention unless the parties agree otherwise, works well in practice and has not led to the adverse consequences of which formalist critics have warned. This Comment expands upon Gillette's argument to provide a more robust account of when substantive interpretative doctrines such as trade usage might be desirable, and why such doctrines appear to be especially useful in the transnational setting of the CISG. In my view, Gillette's account is incomplete because it does not provide an explanation of why international tribunals have not fallen prey to the temptations of more substantive interpretation in the way that US domestic courts have, and because it focuses primarily on the costs of interpretative uncertainty to the exclusion of a fuller list of costs and benefits relevant to the choice of interpretative regime. Taking this list of considerations into account renders more comprehensible the widespread use of trade usage and similar contextual standards in the transnational setting, and reinforces Gillette's conclusions regarding trade usage's commercial functionality.

I. THE DEBATE OVER FORMAL VERSUS SUBSTANTIVE INTERPRETATION

The basic critique made by contemporary formalist scholars in the fields of contracts and commercial law is that trade usage, even when it exists, is considerably more complex, subtle, and heterogeneous than mainstream scholars and commentators have appreciated. The formalists argue that much regularly observed behavior reflects not compliance with what the parties regard as customary legal obligation, but rather a conscious departure from those obligations for purposes of business goodwill or an implicit settlement of a potential contractual dispute. Generalist courts deciding disputed cases ex post, on this view, are unlikely to be able to observe and understand this complex environment with the accuracy that is needed for their interventions to be helpful. Additionally, these critics have argued that the value of commercial certainty and the need to maintain a strict separation between legal obligations

---

3 Under UCC §§ 1-201(3) and 1-205, trade usage (along with course of dealing and course of performance) supplements and gives meaning to the particular terms of every agreement governed by the Code; and under UCC § 2-202, the same sources of evidence are always available, in contrast to parol evidence, to explain or supplement the agreement, even if the agreement appears clear on its face. UCC §§ 1-201(3), 1-205, 2-202 (ALI 2002).

and social regularities conferred as a matter of grace are so great as to foreclose inquiry into trade usage even where the adjudicators are themselves experienced trade participants.[4]

The growing influence of this formalist thesis in the US scholarly literature stands in sharp contrast to the view of most international commercial lawyers and scholars, who are accustomed to a legal regime in which courts and arbitrators routinely consider contextual factors, such as trade usage, and apply open-textured legal standards, such as good faith, when rendering their decisions. As Gillette observes, by the new formalists' logic, international commerce presents a particularly inapposite arena for substantive interpretation. The ability of generalist arbitrators and decentralized national courts usefully to apply contextual standards is likely to be substantially diminished in an environment characterized by greater heterogeneity among traders, relative infrequency of repeat dealings, and linguistic, cultural, and geographic distances that make it more difficult for the adjudicators—or indeed, the traders themselves—to observe and communicate about business practice.

Nonetheless, the CISG, an international treaty drafted with the participation of business advisory groups and adopted with the consent of a heterogeneous set of national actors, incorporates a variety of contextual legal standards that depend on ex post substantive interpretation for their content. These include not just the trade usage provision of Article 9(2), but also provisions that, inter alia, prescribe a reasonableness test for all interpretative questions; allow contractual liability to be imposed without any formal writing requirement; direct tribunals to interpret the entire Convention in light of unspecified standards of good faith in international trade; indicate that questions not expressly settled in the CISG should be settled by reference to the general principles on which it is based; and direct tribunals to consider all relevant evidence in interpreting the parties' intentions and expectations, including even communications that would be barred as parol evidence under common law systems.[5] Furthermore, to my knowledge, there is no apparent pattern of attempts by contracting parties to opt out of Article 9(2)'s trade usage provision, even though such opt-out clauses are explicitly authorized by Article 6, and even

---

4 This last argument is particularly associated with the work of Lisa Bernstein. See Bernstein, 66 U Chi L Rev at 710 (cited in note 2); Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Creating Cooperation through Rules, Norms, and Institutions*, 99 Mich L Rev 1724 (2001).

5 See CISG Article 7(1) (interpretation in light of good faith), Article 8(2) (reasonableness standard for interpretation), Article 7(2) (questions not expressly settled in the CISG to be settled in conformity with the general principles on which it is based), Article 8(3) (due consideration to be given to all relevant circumstances including pre-contractual negotiations), and Article 11 (no formal requirements for proving or evidencing contracts, including a writing; the treaty elsewhere provides, though, exceptions for contracts involving countries that expressly entered reservations to this Article at the time they ratified the CISG). United Nations Convention on Contracts for the International Sale of Goods, 1489 UN Treaty Ser 58, 61 (1988) (hereinafter CISG).

though parties regularly include in their contracts merger and entire-agreement clauses that exclude pre-contractual communications from the interpretative process.

If the formalist critics are right, then something is seriously wrong with international commercial law practice; and, conversely, if the international commercial law elites are right, something is wrong with the formalist critique. With this dichotomy as background, Gillette pronounces the CISG's more substantive approach to trade usage to be a success, which he attributes to three main factors. First, few cases are litigated, so the chances are low that the costs of substantive inquiry will actually be incurred ex post. Second, the same features of international trade that make it difficult to determine trade usages in the first place also imply that most cognizable usages will be generated by mercantile associations, such as the ICC, that have the ability and incentive to disseminate efficient usages that can be applied in a straightforward fashion. And third, the courts and arbitrators that are called upon to apply trade usage under Article 9(2) have chosen to be restrained in doing so, perhaps because of their understanding of the needs of international commerce, and perhaps in deference to the textual requirement of Article 9(2) that limits consideration to trade usages that have an international character.

My own resolution of the apparent conflict between the scholarly critique and transnational practice accords more or less with Gillette's, but for a somewhat different set of reasons. In particular, Gillette's account of the incentives of courts and arbitrators in international commercial disputes is undeveloped, and so gives little reason for confidence that those tribunals will continue to be restrained in their use of contextual evidence in the future when applying different doctrinal provisions such as good faith and course of dealing. I do agree with Gillette that incorporating trade usage and using other contextual standards is likely to be less costly and more sensible in the CISG setting than in the UCC setting out of which the formalist critique originally arose, but would argue that this is the case because of a more systematic set of considerations than he provides.

As I have explained elsewhere, the optimal choice between form and substance in contract interpretation depends on a tradeoff among a variety of diverse planning and incentive considerations.[6] These considerations include:

---

6 Avery Wiener Katz, *The Economics of Form and Substance in Contract Interpretation*, 104 Colum L Rev 496 (2004). My article is hardly the first to argue against the formalist critique on economic grounds, but it does offer a more thorough survey of relevant economic considerations than previous work. For other economically influenced scholars taking a skeptical position on interpretative formalism, see Jody S. Kraus, *Legal Design and the Evolution of Commercial Norms*, 26 J Legal Studies 377 (1997); Eric A. Posner, *The Parol Evidence Rule, the Plain Meaning Rule, and the Principles of Contractual Interpretation*, 146 U Pa L Rev 533 (1998); and Jody S. Kraus and Steven D.