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# Present Legal and Practical Methods by Which Business Custom Is Enforced

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# PRESENT LEGAL AND PRACTICAL METHODS BY WHICH BUSINESS CUSTOM IS ENFORCED*

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"The old order changeth yielding place to new,
And God fulfills Himself in many ways
Lest one good custom should corrupt the world."

We are here concerned with those common practices which the common law has not yet accredited as reasonable. This lag or gap of unapproved practices is frequently deplored by business men and by lawyers. Perhaps in reality this gap is fortunate and necessary. Obeying the laws of physics all matter contracts with cold, water included, but at 32° above zero, Fahrenheit, water breaks away from this universal rule and expands. Upon this one mysterious phenomenon all life depends. In our society this gap of unapproved and disapproved customs supplies an expansion joint providing a flexibility that is an aid to growth and progress. Furthermore, it is important that we have orderly machinery for tolerating unapproved and even disapproved customary practices. For men can appraise customary practices more wisely than they can appraise mere prospected theories. We can better judge the reasonable value of what has been done than of what may be done.

What are the devices that constitute the orderly machinery for tolerating the customary practices which comprise the gap. First, there is the device of slightly changing the nature of the act to accomplish the desired purpose and yet make it legal—the alchemy of the lawyer that converts the prohibited into the enforcible. Consider the several million automobiles that have been sold for notes that will be paid, many of them collected in court, and with all interest, for legally those notes are not usurious. A skillful lawyer has seen to it that they are not usurious. And yet have not men who

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* At the meeting of the Association of American Law Schools, Chicago, December 1925, the Round Table Conference on Commercial Law discussed "The Introduction of Business Customs to Alter Fixed Rules of Law." Professor Max Radin of the University of California presented a paper on the historical side of the question and Professor Austin Tappan Wright of the University of Pennsylvania Law School a paper on the "Opposition of the Law to Business Usages," published in 26 Columbia L. Rev. 917. This article is in substance a paper presented at the same time.

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had the use of money for sale really sold it to yield from 10% to 20% per annum? With ten million Ford cars making America safe for democracy when otherwise there might have been but five million, perhaps in time some legislature may decide that those business men are reasonable in acting on the assumption that money and credit may be sold at the market and that risk is a fair element of the value of credit just as quality is an element of the value of cotton. If such a time comes automobile financing and subdivision financing will be slightly simpler but not fundamentally different. The repeal of all usury laws would not materially increase the amount of money now available for these activities.

In many situations where the lawyer is able to save his client whole before the law both the lawyer and the business man must bear the stigma of professional and popular disapproval while in other situations these subterfuges have the full approval of the court. Concerning the creation of trusts to reduce income tax on the highly profitable sale of property a court says, "The acts of the company in dissolving and forming a trust were not illegal or a fraud on the government but a prudent business act. It is not made illegal because the motive impelling the change is to reduce or avoid taxation."[1]

A second device is to permit the exercise of executive and administrative discretion in order to get around statutory requirements in cases where business exigencies must be yielded to. This is a dangerous subject to discuss here or anywhere, yet there is some truth in the loose statement that laws are made to be broken. Recall the letter of President Roosevelt to Attorney General Bonaparte written at the instigation of Mr. Gary concerning the purchase of the Tennessee Coal Company to prevent the precipitation of a financial panic.

A third method of enforcing business custom is the organization of groups of individuals with common interests, such as the Labor Unions, Trade Associations, Commodities and Securities Exchanges. There is nothing new or alarming in the influence which these Associations have in moulding and enforcing custom. The law has long shared with other institutions the responsibility of regulating conduct. The family and the church have been factors aiding the law in maintaining an orderly society. These associations have borne

[1] Magazine of Wall Street, Vol. 36, p. 1086.

the brunt of adapting life's action to the changed conditions created by economic revolutions. A system of law based on precedent is too slow and cumbersome to be relied on exclusively. Each of these groups of associations has made a contribution. Unions have obtained for labor a more equitable share of the wealth it produces, and have improved working conditions, when the courts would not have enforced these agreements among themselves that made mass bargaining possible. The commodity exchanges have created a constant cash market, appraised scarcity values, and contributed toward the orderly marketing of the nation's surplus production. In some places, certain customs of the trade have been merely unapproved. In other jurisdictions some of the customs have been expressly prohibited.

The extent of the organization of trade associations and the general scope of their activities is familiar to all. It is significant that the elimination of waste in industry procured by Mr. Hoover has been accomplished by the friendly coöperation of these associations. It has been accomplished by education and not by compulsion.

A fourth method of enforcing business custom is the very obvious method of making the custom legal. All other methods have their limitations and should always be considered merely as interim devices. As was stated in the beginning, a lag of unapproved customs is necessary and beneficial, but if this margin becomes more than just enough to guarantee flexibility, it becomes a disintegrating force. If the law continually refuses to sanction and aid in enforcing customs, which the business man feels are just, beneficial and necessary, those men will have an increasing disrespect for the law, and will devise means of carrying on without the aid of the law. Thus, industry will lose much of the benefit of the wisdom which the science of law has to contribute. This is right now apparent in the application of commercial arbitration. Having lost sympathy and some of their respect for the law, and having devised means of being partly independent of the law, certain business interests are making the mistake of using the machinery of commercial arbitration for the settlement of disputes where it is wholly inadequate.

Our problem is confused by the fact that these ostracized customs are neither all bad nor all good. They consist of the vestige of man's animal barbarity and of the forming embodiment of man's

hopes. Necessity often makes strange colleagues. It is unwise that constructive business interests should be forced to coöperate intimately and compromisingly with contamination, with thieves and bomb throwers to accomplish their ends. Business men and jurists alike should be alert to keep the group of ostracized customs small and both should be alert to secure the stamp of legal approval for those customs which have proved reasonable.

Professor Commons states that the science of law has added to the fundamental concepts of economics, the concept of reasonable value.[2] Law contributes the measurement of reasonableness. The assimilation by the law of extraneous customs merely involves the application to new customs of the measurement of reasonableness.

Our system of law has fairly definitely designated the appropriate persons to judge the reasonableness of customs. In some instances, it may require merely a judicial decision, in others, legislative action or a constitutional amendment.

It is appropriate for a greater proportion of this growth to occur in judicial decisions. Justice Holmes states "The very considerations which judges most rarely mention, and always with an apology, are the secret root from which the law draws all the juices of life—I mean, of course, considerations of what is expedient for the community concerned. Every important principle which is developed by litigation is in fact and at bottom the result of more or less definitely understood views of public policy, most generally, to be sure, under our practice and traditions, the unconscious result of instinctive preferences and inarticulate conviction, but none the less traceable to views of public policy in the last analysis."[3] President Wilson once said, "Have we come to a time when the only way to change a law is by statute. The changing of law by statute seems to me like mending a garment with a patch, whereas, as law should grow by the life that is in it, not by the life that is outside of it—I should hate to think that the law did not derive its impulse from looking forward rather than from looking backward, or rather that it did not derive its instruction from looking about and seeing what the circumstances of men actually are, and what the impulses of justice necessarily are."[4]

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[2] *Law and Economics*, 34 Yale L. Jour. 371, 379.

[3] Holmes, *The Common Law*, p. 36.

[4] Remarks at the annual convention of the American Bar Association on October 20, 1914.

This is a complex age. In the practical application of any science, we find that the various sciences are inter-dependent. No single science is self-sufficient. In the conduct of a large investment banking business, reliance is placed upon the opinions of a specialized lawyer, a consulting engineer, an economist, a statistical expert and others. Many of these experts are permanent members of the staff. Is law a self-sufficient science? Can the reasonableness of a vital business custom be adequately appraised solely by an understanding of what is written in the law books? Is it appropriate in valuing a business custom to investigate the background of the reason why they do it? Mr. Brandeis, as attorney in *Muller v. Oregon,*[5] devoted most of his effort to a study of the background of the conditions under which people live; to a study of human endurance, to a study of the social consequences of violating certain physical laws. Mr. Sapiro, in his brief and argument, before the Supreme Court of Texas, in the *Texas Farm Bureau v. Stovall,*[6] pictured the living conditions of existing distributive institutions, and gave factual experience of the coöperatives in the citrus and tobacco industries.

Let us illustrate the legalizing of custom by court assimilation. The State of Illinois has passed an extreme statute making void certain contracts in regard to future trading and entirely out of harmony with established custom in their great grain market. By a series of judicial decisions,[7] most of the practices were gradually approved, so that the amended statute of 1913 was virtually a codification of existing judicial decisions.[8]

Consider another situation. Professor Nathan Isaacs has been studying the relation between the automobile manufacturer and his distributor.[9] The business world calls it an agency—the lawyer is instantly certain that it is not an agency. It is, perhaps, a relation *sui generis,* similar to the relation which men have devised for present industrial conditions, but a relation which the law has not yet accurately classified. The automobile manufacturer exercises a control over his distributor, which the law does not entirely sanction

[5] *Muller v. Oregon* (1908) 208 U. S. 412, 52 L. Ed. 551.

[6] *Texas Farm Bureau v. Stovall* (1923) 113 Tex. 273, 253 S. W. 1101.

[7] *Schneider v. Turner* (1889) 130 Ill. 28, 22 N. E. 497; *First National Bank v. Miller* (1908) 235 Ill. 135, 85 N. E. 312.

[8] Judson, *Validity of Transactions on the Board of Trade,* 19 Ill. L. Rev. 644.

[9] Isaacs, *Agents and Agency,* Harvard Business Review, April, 1925.

by a vendor over his vendee, yet it is a control which the law does sanction by a principal over his agent. Dean Pound has expressed himself that it would be proper for a court to classify this relation, that is, in this case it would be proper for a court to pass upon the reasonableness of the prevailing custom. Is it appropriate for that court to look outside of law books into the industrial world, to study the conditions which are responsible for this custom? The judge would learn that the kernel of the agreement is not the purchase and sale of so many pounds of metal, it is the purchase of years or miles or ton miles of service. Today, the ultimate consumer buys a name plate and a business policy of the manufacturer that protects the name plate, plus an expectancy that the manufacturer will be able and willing to protect that name plate. Not one business man in a thousand is competent to buy an automobile or a truck on his own judgment of the machine. New customs are the result of new conditions. The law should be interested in understanding the conditions, before granting or withholding approval of the customs.

But all growth cannot be by judicial decision. Justice Holmes who is an advocate of the growth of the law through the court says in a dissenting opinion in *Lochner v. New York*,[10] "This case is decided upon an economic theory which a large part of the country does not entertain. If it were a question whether I agreed with that theory, I should desire to study it further and long, before making up my mind. But I do not concede that to be my duty, because I strongly believe that my agreement or disagreement has nothing to do with the right of the majority to embody their opinions in law." Justice Holmes holds that when a legislature acting within constitutional limitations has pronounced upon the reasonableness of a practice in the light of their opinion of an economic theory, a judge should be bound by the opinion of the legislature.

In fact the lawyer for the trade association or specific interest is more often inclined to underestimate the task involved in securing approval for his custom. The lawyer understands the condition out of which the custom has grown and is thoroughly convinced of the justice and reasonableness of the custom. He feels that no constitutional barrier is properly involved, that no legislative action should be necessary and that a court should readily approve the custom. Securing legal approval of a new custom is a grave task

[10] *Lochner v. New York* (1905) 198 U. S. 45, 75, 49 L. Ed. 937.

of social and political engineering. Often the courts and legislators do not understand the business background of conditions that created the custom. There are almost always vested interests strongly intrenched. And finally, the thinking for the country is delegated to such a small proportion of people because thinking is an onerous task.

The following illustrations of the methods employed and the comparative success in securing legal sanction for new customs may prove of interest.

### 1. City Zoning

Zoning is perhaps not a custom. Certainly not in Texas, but there was a crystalized desire that the law should give it sufficient sanction to afford an opportunity for such a custom to develop. At a time when the city of London was spending three million dollars to straighten a little bend in the street, caused by the path made by cows in walking around a tree stump, 600 years ago, the citizens of Dallas wished to build a city after a plan which would avoid such errors. Hastily without a careful study of legal questions involved an ordinance was drawn providing for a rather arbitrary zoning. The whole issue was tried and permanently settled on a case that arose out of an application for a permit which was filed before the ordinance was passed.[11] After the Supreme Court had ruled against the basic principles of the custom, the State Legislature passed an enabling act, then by popular vote, the city amended its charter, giving the commissioners the right to zone. A new zoning ordinance was drawn, making the zoning less arbitrary which it was hoped would cure the defect of the earlier ordinance. But all of this was too late. The Supreme Court had taken a stand. Clearly an act which was unconstitutional could not be validated by the passage of a mere legislative act and now nothing short of a constitutional amendment will permit zoning to be carried on in Texas. In most other states, fortunately, the problem was approached with better generalship and with an opposite result.[12]

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[11] *Spann v. City of Dallas* (1921) 111 Tex. 356, 235 S. W. 513.

[12] See the following articles: Bettman, *Constitutionality of Zoning*, 37 Harv. L. Rev. 834; Baker, *The Constitutionality of Zoning Laws*, 20 Ill. L. Rev. 213; 21 Ill. L. Rev. 284; Chamberlain and Pierson, *Zoning Laws and Ordinances*, 10 A. B. A. Jour. 185.

### 2. The Legality of Cooperative Contracts

Contrast the movement to secure the legal approval of the custom involved in coöperative marketing. The plan was first carried on quietly for a number of years in a field where the existing marketing machinery was most inefficient. Under the scant protection given a tolerated, but unapproved custom, the plan was perfected and the custom was crystalized. It became necessary to secure legal approval. Congress was asked to appoint a sub-committee and a large sum of money was appropriated to study conditions in the agricultural industry and to study the comparative efficiency of existing distribution machinery in agricultural production and in the manufacturing industry. As a part of its findings, this congressional committee reported that coöperative marketing was the most hopeful remedy for what they considered unsatisfactory conditions. Then the Secretary of Agriculture, the Secretary of Commerce and the President of the United States were induced to take up this message of education about *conditions* that made a new custom necessary. Then within the space of about a year, there were spread upon the statute books of thirty-one states and of the federal government, prolific acts which were almost identical. At that time some legal authorities criticized those statutes as being entirely useless, as nothing but a codification of existing common law, or as the granting of powers which no one had ever doubted existed, of powers which the farmers had been exercising for 100 years. But these statutes had their place in a campaign of education and, moreover, these statutes also had a very definite legal purpose. It was several years later before the courts were asked to enforce these contracts. There was no haste. The public was given time to become acquainted with this new custom. Then when the courts were in time asked to enforce these contracts, the champions of the opposing vested interests demanded that this new hybrid contract be classified either a contract of sale or a contract of agency. They were prepared to prove that it was neither. But the courts had recourse on the statute, saying that the legislature had authorized the making of this specific contract, and that it was not necessary to determine whether it was a contract of sale or a contract of agency.

The question of remedy also arose. No contract exactly like this could be found in all the ancient books. It was genuinely doubtful whether, according to all precedent, all of the prerequisites were

present for granting specific performance. Again, in those states, where the statutes covered the matter, the question was settled. The statute expressly stated that the coöperative associations might specifically enforce the contract against the producer member. The net result is that this new custom of using a new type of contract in coöperative marketing has been almost unanimously approved by the courts.[18] Ultimately, the custom may or may not prove to be economically sound. It will, however, have had sufficient legal sanction to be given a fair opportunity to prove its worth.

[18] Brown, *Co-öperative Marketing of Tobacco*, 1 N. C. L. Rev. 210, discussing *Coöperative Association v. Jones* (1923) 185 N. C. 265, 117 S. E. 174.

See also a note on *Coöperative Marketing in North Carolina*, 2 N. C. L. Rev. 188; Ballantine, *Coöperative Marketing Associations*, 8 Minn. L. Rev. 1; Henderson, *Coöperative Marketing Associations*, 23 Col. L. Rev. 91.