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The Rise and Fall of Article 2

Robert E. Scott*

INTRODUCTION

In August 13, 2001 the National Conference of Commissioners on Uniform State Laws voted eighty-nine to fifty-three to reject the Amendments to Article 2 of the Uniform Commercial Code that had just been approved in May by the American Law Institute.¹ The vote followed a last minute effort by the Article 2 drafting committee to amend the scope provisions of Article 2 in response to continuing criticism from representatives of the software and information industries. Several months later, at the request of the NCCUSL leadership, amended Article 2 with its revised scope provision was withdrawn from the agenda of the ALI Council in order to avoid its certain defeat. In the months that followed, the Article 2 drafting committee approved a new version that did not amend the basic scope section of Article 2 but did amend the definition of "goods" to exclude "information."² The Amendments, as revised, were then approved by NCCUSL at its annual meeting in August 2002. The Article 2 Amendments thus return yet again to the ALI Council and, in the event of its approval, to the ALI membership in May 2003.³

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1. The version of Article 2 voted down by NCCUSL differed from that approved by the ALI in three respects. Two amendments to the proposed final draft were adopted on the floor at the ALI meeting. The first eliminated the requirement of a quantity term in U.C.C. § 2-201 for a record to satisfy the statute of frauds. The second reinstated language in U.C.C. § 2-718 declaring unreasonably large liquidated damages agreements void as penalties. At the NCCUSL meeting, the drafting committee sent to the floor a revised scope provision in place of the original (unamended) scope language approved by the ALI. In addition, both of the floor actions approved by the ALI membership were reversed.

2. The current proposed Amendments leave intact the basic scope provision in U.C.C. § 2-102, which states that Article 2 applies to "transactions in goods." But U.C.C. § 2-103 (formerly U.C.C. § 2-105) now states that "goods . . . does not include information. . . . "Information" is not a defined term. The proposed Official Comment indicates that whether a transaction that includes both goods and information is covered in whole or in part by Article 2 is "up to the courts to determine."

3. In addition to deciding whether to approve the exclusion of "information"

This most recent series of events follows a concerted effort by the ALI and NCCUSL over the past several years to remove controversial proposals from the Article 2 revision process so as to ensure approval by both bodies and ultimate adoption by the states.⁴ In the process of downsizing the "revisions" to "amendments," the reporter and associate reporter of the original Article 2 drafting committee, who had worked on the project for over a decade, resigned in protest.⁵ The effort to sanitize the Article 2 revisions developed because industry and consumer interests squared off against one another to produce deadlock on key substantive recommendations. Thus, even if the ALI and NCCUSL are eventually able to overcome their current differences, this deadlock over substantive issues represents the likely end of the fifteen year effort to revise substantially the law of sales as embodied in Article 2. As a consequence, the statute that Karl Llewellyn called the "heart and soul" of the Uniform Commercial Code⁶ will inevitably become less relevant to the legal regulation of commercial sales transactions.

The outcome of the Article 2 revision process was predictable. Indeed, it was predicted.⁷ More than six years ago, Alan Schwartz and I developed a model for analyzing the nature of the law reform proposals that are generated by private legislatures such as the ALI and NCCUSL.⁸ Our analysis led to three predictions, two of which are relevant to explaining the rise and the fall of Article 2.⁹ The first

from the coverage of Article 2, the ALI will also be asked to approve the changes to U.C.C. §§ 2-201 and 2-718 that were approved by NCCUSL in August 2001. See note 2, *infra*.

4. See Lance Liebman, *The ALI and the U.C.C.*, 52 *Hastings L.J.* 645, 648-50 (2001); Lance Liebman, ALI Director, *Introduction to Website Discussion of U.C.C. Article 2* (Sept. 17, 2001) [hereinafter "Liebman, *Introduction*"].

5. See Richard E. Speidel, *Revising U.C.C. Article 2: A View from the Trenches*, 52 *Hastings L.J.* 607, 610-12 (2001) [hereinafter "Speidel, *View from the Trenches*"].

6. Karl Llewellyn, *Why We Need the Uniform Commercial Code*, 10 *Fla. L. Rev.* 367, 378 (1957).

7. This prediction was first made at a roundtable discussion at the AALS Conference in January, 1994, at which Alan Schwartz and I presented a draft of our paper, *The Political Economy of Private Legislatures*, 143 *U. Pa. L. Rev.* 595 (1995). The Reporter and Associate Reporter of the Article 2 Drafting Committee, who were in the audience, strongly disputed the accuracy of the prediction. See Robert E. Scott, *Is Article 2 the Best We Can Do?*, 52 *Hastings L.J.* 677, 680-81 (2001).

8. Alan Schwartz & Robert E. Scott, *The Political Economy of Private Legislatures*, 143 *U. Pa. L. Rev.* 595, 607-37 (1995) [hereinafter Schwartz & Scott, "*Political Economy*"].

9. In the article we offered three central claims, two that are relevant to the Article 2 process and a third that is relevant to understanding Articles 3, 4 and 9. The third claim is that where there is only one interest group that is dominant in the law reform process, the private legislature will generate proposals with many bright-

prediction is consistent with the well documented history of the drafting and adoption of the original Article 2.¹⁰ We predicted that, in the absence of influence from outside interest groups, these private legislative bodies will tend to promulgate many vague rules that delegate substantial discretion to courts. Such rules result not solely because of their intrinsic merits but because law reform projects of this sort are dominated by academic reformers with preferences that are typically far different from those of the median member of the legislative body. The reformers propose vague rules when they are unable to get clear, bright-line rules adopted. The original Article 2 project was, in fact, dominated by Karl Llewellyn and a cohort of fellow reformers, and their political preferences were far from those of the ALI and NCCUSL members who were considering the U.C.C. during the 1940s and 1950s.¹¹ Moreover, the original Article 2 is famous for its many open-ended, undefined terms. The use of generalized guides to decision such as custom and usage as well as vague, open-ended terms (such as reasonableness, good faith, and unconscionability) necessarily requires subsequent adjudication to give content to the parties obligations in particular cases.

The current Article 2 revision process, on the other hand, tends to confirm the second prediction. Unlike the reformer-dominated processes that characterized the initial drafting and enactment of Article 2, the recent revision process saw the emergence of cohesive and competing interest groups. When interest groups compete, we predicted that the strong institutional bias of these private legislatures to behave conservatively will be reinforced.¹² Cohesive interest groups are able successfully to block the proposals of the groups they oppose but are unable to get their own proposals enacted. The noise resulting from their competition leads the private legislature to reject any significant reform in favor of the status quo. Indeed, as the

line, clear rules. These rules will result not from their inherent merits but because they confine the discretion of courts and thus preserve the victory of the interest group in the legislative process. See Schwartz & Scott, *Political Economy*, *supra* note 8, at 637-50.

10. See Schwartz & Scott, *Political Economy*, *supra* note 8, at 645; Allen R. Kamp, *Downtown Code: A History of the Uniform Commercial Code 1949-1954*, 49 Buffalo L. Rev. 359 (2001) [hereinafter Kamp, "Downtown Code"].

11. See Kamp, *Downtown Code*, *supra* note 10, at 392-98. The disparity in normative views between the academic reformers and the business lawyers who dominated the ALI and NCCUSL was especially sharp with respect to key issues such as the appropriate scope of freedom of contract. William Schnader, an influential lawyer who was the political manager of the Code, was hesitant to incorporate amendments suggested by the academic reformers because they represented views so far from the rank and file of the ALI and NCCUSL membership. See Robert Braucher, *A Look at the Work of the Article 9 Review Committee: A Panel Discussion*, 26 Bus. Law. 307 (1970).

12. Schwartz & Scott, *Political Economy*, *supra* note 8, at 648-50.

efforts to strip Article 2 of controversy over the past three years have shown, a strong enough status quo bias can induce rejection of even apparently innocuous proposals.

But, as is often the case, explaining one puzzle only serves to uncover another. What explains why the initial drafting process of Article 2 appears to track the first prediction (a reformer-dominated process that produced many vague and open-ended rules), while the Article 2 revision process is consistent with the second prediction (a process dominated by competing interest groups that retains the status quo)? A key to unlocking this puzzle is another peculiar artifact of the current contretemps over Article 2. Practically no one who might be thought affected by the process has seemed to care about the demise of the revisions except the interest group participants themselves and the hardy band of academic reformers who were promoting them.¹³ The collapse of efforts to revise "the heart and soul of the Code" has been greeted with silence throughout the commercial community.

I suggest that nobody but the participants has seemed to care for the simple reason that, to the rest of the commercial world, Article 2 has become largely irrelevant. What has happened? There is evidence that large numbers of commercial parties have opted out of the sales provisions of the Code. Private arbitration is used to enforce trade association rules and standard form terms that replace the default rules of Article 2. The opting out by commercial interests, extending over many years, would mean that the principal remaining function of Article 2 is to regulate mass-market sales transactions. Many of those transactions implicate the licensing of computer information as well.¹⁴ The interest group competition thus arises in the clash between the representatives of retail sellers

13. Following the defeat of the ALI proposal at the NCCUSL meetings, the ALI established a web site to assess reaction by ALI members and non-members to the controversy over the scope of Article 2. As one of the final postings noted, "as the hour approaches for this forum to close, I note that there are only 25 postings from 15 ALI members, despite the fact that the forum was extended to allow more time for comment. This suggests to me that the proposed scope provision either is not opposed by, or not a topic of great interest to the overwhelming majority of our thousands of members." Mary Jo Dively, ALI Members Forum on U.C.C. Article 2 (posted Oct. 26, 2001) available at <http://www.ali.org/forum/forum.htm> [on file with author].

14. The immediate, if not ultimate, cause of the split between the ALI and NCCUSL concerned how best to delineate the proper jurisdiction as between Article 2, the common law and the proposed Uniform Computer Information Transactions Act (UCITA) over transactions involving combinations of goods and computer programs. The relevant questions, among others, are: Does Article 2 apply to the computer software that is included with a sale of goods? To what extent does Article 2 apply to so-called "smart goods" where the software is embedded in the goods themselves? See text accompanying notes 131-136, *infra*.

(and licensors) and consumer buyers (and licensees) over the appropriate scope of market regulation of standard form contracting.¹⁵

In this Essay, I examine the political economy of the Article 2 project from its origins to the present. Part I begins with the two normative questions that have preoccupied contract theorists for more than a century: What is the proper domain of freedom of contract? And, within that domain, how should the law complete the gaps in incomplete contracts? I focus on Llewellyn's unique conception that these apparently separate questions are, in fact, aspects of a single institutional objective, an objective that became the normative foundation for Article 2. In Part II, I analyze the drafting and enactment process of the original Article 2 and evaluate the success of the new sales law it introduced, a success attributable in no small measure to the replacement of archaic vestiges of property law with efficient contract default rules. In Part III, I consider the effects of the compromises Llewellyn made to secure the enactment of the Code. Of particular significance is how the vague terms that invoke the commercial context (originally intended by Llewellyn as a means of incorporating *ex ante* default rules) have been used to challenge the objective meaning of disputed contracts. For many commercial parties, exit may have been a cheaper option than lobbying for clearer and more predictable default rules. But the parties to mass-market sales transactions remain subject to Article 2, and their representatives have sought to influence the revision process. Thus, the focus has shifted from Llewellyn's original goal of prescribing optimal default rules for commercial contracts to the current debate over proscribing freedom of contract in mass-market transactions. The resulting divergence between the interests of producers and those of consumer buyers, computer information licensees and their representatives has produced deadlock.

I conclude that the flaws in the Article 2 project were present from its inception. Given the limits of legal regulation, it is unlikely that any set of "uniform" rules that are promulgated for adoption in every state can both efficiently complete the gaps in commercial contracts as well as optimally police consumer transactions. The current deadlock is likely to continue as long as the private legislators who control the U.C.C. drafting process remain determined to pursue both of these normative objectives in the same statute. One solution

15. The reference to consumer buyers does not imply that all such end use buyers are individual purchasers who are "represented" by consumer advocacy groups such as Consumers Union. To be sure, consumer advocacy groups have been involved in the process, but, in addition, many of the organized consumer interests consist of large firm licensees of computer information and their lawyers. See *infra* note 128.

would be to turn to the ordinary legislative process to resolve the normatively controversial distributional issues surrounding the regulation of standard form contracting. The private legislative process could then pursue a more modest but achievable goal: the promulgation of a limited set of efficient sales law default rules. In short, the uniform laws process works when there is distributional symmetry (when today's buyer might be tomorrow's seller). On the other hand, the process deadlocks when it seeks to produce uniform rules for transactions where the distributional effects are asymmetric and prices are unlikely to adjust efficiently so as to compensate for a single group's victory in the legislative process.¹⁶

I. LLEWELLYN'S LEGACY: THE NORMATIVE FOUNDATIONS OF ARTICLE 2

Karl Llewellyn's contributions to contract theory have been almost universally misunderstood or ignored. Part of the problem lies with Llewellyn himself and his "gnomic prose."¹⁷ Llewellyn was an unusually creative thinker, but he was not a theorist in the classic sense and he rarely bothered to link his often counter-intuitive ideas to the intellectual context of his day.¹⁸ Equally culpable are many of the scholars who have interpreted Llewellyn's writings over the past thirty years. A typical, and fundamental, error has been to use his later jurisprudential writings rather than his earlier work on contract to analyze and interpret his meaning and intent as the principal drafter of Article 2 of the U.C.C.¹⁹ Alan Schwartz has recently reminded us

16. This conclusion is qualified in the discussion that follows. Deadlock only results when the distributional effects are both asymmetric and concentrated so as to stimulate interest group competition. Where the distributional effects are asymmetric but the gains are concentrated and the losses diffused (as is arguably the case with respect to Articles 3, 4 and 9), the evidence is that the process "works" in the sense that uniform enactment can be achieved but only at the cost of potentially regressive distributional effects. See text accompanying notes 160-162 *infra*.

17. On the problems of interpreting Llewellyn, see Neil Duxbury, *The Reinvention of American Legal Realism*, 12 *Legal Stud.* 137 (1992).

18. Others have expressed the same point (perhaps less charitably) by noting Llewellyn's aversion to citing the work of others even those who obviously influenced his ideas.

19. See, e.g., Richard Danzig, *A Comment on the Jurisprudence of the Uniform Commercial Code*, 27 *Stan. L. Rev.* 621, 624-27 (1975); Kenneth Casebeer, *Escape from Liberalism: Fact and Value in Karl Llewellyn*, 1977 *Duke L.J.* 671; Alexander M. Meiklejohn, *Castles in the Air: Blanket Assent and the Revision of Article 2*, 51 *Wash. & Lee L. Rev.* 599 (1994); William Twining, *Karl Llewellyn and the Realist Movement* 335-37 (1973) [hereinafter "Twining, Karl Llewellyn"]. I count myself among the culprits. See Robert E. Scott, *The Uniformity Norm in Commercial Law in The Jurisprudential Foundations of Corporate and Commercial Law* 149, 170-72 (2000) [hereinafter "Scott, *Uniformity Norm*"]; Robert E. Scott, *Chaos Theory and*

that, contrary to conventional wisdom, Llewellyn was not a rule skeptic and that his contributions to contract theory include a commitment to ex ante default rules empirically grounded in industry practice.²⁰ Part of the confusion lies in the fact that Llewellyn's commitment to filling contractual gaps by providing parties with more tailored and apt defaults was tempered by his skepticism about the terms that are generated by "unbalanced" bargains between parties of unequal bargaining power. Thus, Llewellyn's views on contract straddle the divide between the debate over default rules and the debate over freedom of contract. It is simply impossible to appreciate Llewellyn's unique vision, a vision that formed the normative foundation of Article 2, without first understanding the fault lines that characterize these debates.

A. An Introduction to the Normative Debates in Contract Theory

In order to assess the degree to which Llewellyn's Article 2 accomplished its objectives, we must first specify what those objectives are. Article 2 regulates contracts for the sale of goods and, as such, the statute draws its normative justification from modern contract theory. The first objective of contract theory is to resolve a basic sorting problem. Our legal system does not enforce all promises, not even all those that were seriously intended. Thus, a normative theory of contract must first explain why certain bargains for promises deserve a presumption of enforceability in the first place. One response is that the freedom to exchange entitlements presupposes the freedom to contract for such an exchange. Either freedom is supported by norms of efficiency and autonomy. Parties who are denied either freedom to contract or freedom to exchange entitlements suffer unnecessary constraints on their choices, constraints that undermine the value of the entitlements themselves. Thus, the normative claim that supports enforcing bargains is that voluntary exchange offers individuals more choices than they would otherwise enjoy and, other things being equal, more choice is better than less. This norm of expanded choice is so powerful in ordinary contracts that it justifies not only the state subsidization of an enforcement mechanism, but also an array of default rules that delineate the terms of typical bargains, terms that define the contractual relationship unless the parties design their own alternatives.²¹

the Justice Paradox, 35 Wm. & Mary L. Rev. 329, 341-42 (1993).

20. Alan Schwartz, *Karl Llewellyn and the Origins of Contract Theory*, in *The Jurisprudential Foundations of Corporate and Commercial Law* 12, 14-17 (2000) [hereinafter "Schwartz, *Origins of Contract Theory*"].

21. See Robert E. Scott & William J. Stuntz, *Plea Bargaining as Contract*, 101

Article 2 accepts implicitly the premises of this dominant bargain theory paradigm. But this paradigm does not fully prescribe the set of enforceable promises, nor does it prescribe the nature of the default rules that fill the gaps in incomplete contracts. Thus, contract theory must grapple with the two questions that lie at the heart of any justification for the state's coercive enforcement of a promise against a reluctant promisor. The first, what we might call the "distributional" question, asks: What is the proper domain of freedom of contract? The second, "efficiency" question, asks: Within that domain, what is the appropriate role of the state in regulating incomplete contracts? Although these two questions intersect at various points, they are quite separate and distinct. Thus, the story of Article 2 is, at bottom, the story of how one statutory scheme has sought to answer both of these questions.

1. Policing Bargains: The Limits of "Free Contract"

While modern contract theory supports a presumption favoring the enforcement of bargains, it is also the source of many arguments for prohibiting certain bargains, or at least substantially restricting them. It might seem strange to look to contract theory to find reasons for prohibiting certain contracts, but contract law routinely embraces arguments for limiting itself. Those arguments are of two general types. One class focuses on defects in the bargaining process. Accepting for the moment the appeal of the expanded choice norm, the challenge for contract theory is how to preserve its key elements: a free, informed, and rational choice. Preserving the core of this idea requires rules that prohibit enforcement where individual promises were the product of duress, fraud or unconscionable information deficits, or where the parties lacked the capacity and judgment to evaluate the risk being exchanged.²²

Yale L.J. 1909, 1913-18 (1992) [hereinafter "Scott & Stuntz, *Plea Bargaining*"]. According to the convergence hypothesis, contract law promotes both autonomy and social welfare (efficiency) and, therefore, both viewpoints will converge on the substantive content of contract law (although the bases for their recommendations may not be compatible). Jody S. Kraus, *Philosophy of Contract Law*, in *The Oxford Handbook of Jurisprudence and Philosophy of Law* 687 (2002). Michael Tribelcock considers and then rejects the convergence hypothesis in *The Limits of Freedom of Contract* (1993). For a discussion of how both theories might be combined to produce an overall theory of contract, see Jody S. Kraus, *Reconciling Autonomy and Efficiency in Contract Law: The Vertical Integration Strategy*, 11 *Philosophical Issues* 420 (2000). For a limited Rawlsian justification for choosing efficient rules in particular legal contexts, see Daniel A. Farber, *Economic Efficiency and the Ex Ante Perspective*, in *The Jurisprudence of Corporate and Commercial Law* 54 (2000).

22. Scott & Stuntz, *Plea Bargaining*, *supra* note 21, at 1918.

A second class of objections to enforcement focuses more directly on the outcome of certain bargains. The idea here is that the bargains themselves are faulty, regardless of whether the bargaining process was informed and voluntary. Thus, for example, contracts of enslavement are uncontroversially unenforceable. That familiar restriction on contractual freedom stems from the notion that people should not bargain away too much of their liberty.²³ Contract also has a tradition of non enforcement for more systemic reasons, based on how contractual allocation affects the distribution of certain goods and services. A classic example is the non-waivability of warranties of habitability. As Dean Kronman has noted, this limitation on contractual autonomy seems to rest on society's concern about the distribution of power with respect to fundamental entitlements.²⁴ Housing plausibly falls in that category as do education and health care, two other fundamental goods that are allocated in part through non-market mechanisms. In sales law, the salient question has typically been whether warranty liability for defective goods that cause personal injuries and/or economic losses should be similarly non-waivable.

Contract doctrines that focus on process defects or that limit the domain of free contract require a mechanism by which courts (or other decision makers) can screen defective contracts from those engagements that deserve enforcement. As is the case with any legal regime, two approaches to screening are possible. The first is to draw bright line rules that are easy to administer in particular cases. The advantages of this approach, the one most commonly found in the common law of contract, are relatively low costs of adjudication and relatively high transparency of the law to prospective parties. The disadvantage is that bright line rules are inevitably over and under inclusive; that is, the underlying justification of a particular rule argues against allowing some cases that the rule permits, and in favor of allowing some cases the rule prohibits. In short, rules by nature cannot be tailored on a case by case basis to conform to the underlying goals the rules are designed to advance.

The second screening method, the one favored in Article 2, most famously in the doctrine of unconscionability, is to use vague standards that allow for case-by-case tailoring. The disadvantages of this approach are its relatively higher error costs and its relatively lower degree of transparency to potential contractors. Error costs will be higher because answering questions such as "What is a fair term?" requires much more information than courts can acquire easily in most contract cases. Thus, it will be more intellectually challenging

23. *Id.* at 1928-30.

24. Anthony Kronman, *Paternalism and the Law of Contracts*, 92 *Yale L.J.* 763 (1983).

for judges or juries to apply such standards in individual cases. Transparency will be lower because the variance among outcomes of similar cases will be higher. This not only increases the costs of transacting, but also increases the problem of unfairness due to unequal treatment among like cases.²⁵

A few moments reflection reveals the inherent difficulty for any legal regime in choosing the optimal screen for selecting between enforceable and unenforceable bargains on the grounds of process deficits or in specifying the domain of permissible bargains. The value conflict is particularly acute when the question is posed in terms of categories of suspect transactions beyond the traditional common law boundaries of fraud, duress, illegality and incapacity. Thus, for example the question that attracted much of Llewellyn's interest, and continues to trouble contemporary theorists, is whether standard form contracting in mass market transactions—the so-called contract of adhesion—is deserving of special scrutiny over and above the traditional common law tests for enforceability. Should standard form contracting between merchants be treated differently than consumer contracts? Are these categories even meaningful? Does free choice require assent to particular contract terms or only a “blanket” assent to terms that are routinely employed in market transactions? Does the answer to the preceding question depend on the nature of the market or the nature of the transaction within the market? What risks cannot be assented to under any conditions? What are the appropriate limits to paternalism?

Given the difficulty of reaching consensus on the relevant values, it seems astonishing at first blush that a private law reform group drafting a proposed uniform statute would seek to reach technical rather than political solutions to these freedom of contract questions. But that is precisely what Llewellyn and the drafters of the original Article 2 sought to do.²⁶ Before we can evaluate Llewellyn's solution to the freedom of contract debate, however, we must also consider the choice between *ex ante* and *ex post* perspectives in completing incomplete contracts.

2. *The Gap-Filling Function of Legal Rules*

Within the domain of free contract, what is the appropriate role of the state in regulating incomplete contracts? Resolving this question requires the state first to interpret the signals that the contracting parties have used, however imperfectly, in allocating contractual risk. These signals include what the parties wrote (and

25. Robert E. Scott & Jody S. Kraus, *Contract Law and Theory* 400-01 (3d ed. 2002).

26. Twining, Karl Llewellyn, *supra* note 19, at 306-07 (1973).

did not write) and said (and did not say), as well as the context in which these signals were exchanged. But this interpretive task is not self-executing. It requires a court (or other decision maker) to select among (at least) three discrete interpretive strategies. The choice among these strategies determines the mode of interpretation that is chosen and, consequently, the shape and content of contract law.²⁷

One strategy is for the state to fill gaps in incomplete contracts *objectively*, so as to maximize the ex ante value of the contract (viewed as of the time of contracting). This strategy is designed to protect (and even improve) the utility of the set of contracting signals for future parties. It requires courts to ignore the contracting parties' subjective intentions and fill contractual gaps according to assumptions about the risks that parties similarly situated would plausibly have agreed to bear at the time the contract was made. This is the default rule paradigm that has occupied much of the agenda of the law-and-economics branch of contract theory.²⁸ Default rules expand parties' choices by providing standardized and widely suitable contract terms to cover most risk contingencies. The expanded choice norm implicitly presumes that the state has a neutral policy toward individualized agreements, as it has no reason to impose its default rules on unwilling parties. Viewed ex ante, therefore, atypical parties lose nothing from the specification of default rules as they remain free to design alternatives to the state's terms.²⁹

27. For an analysis of each of these strategies and of the consequences of pursuing any one of them, see Robert E. Scott, *The Case for Formalism in Relational Contract*, 94 Nw. U. L. Rev. 847, 849-53 (2000) [hereinafter "Scott, *The Case for Formalism*"].

28. The argument in favor of the default rule strategy runs along the following lines. In a world where Coasian assumptions of zero transaction costs hold, the choice among gap-filling default rules is irrelevant because parties can and will negotiate around suboptimal legal rules. But in a world of transactions costs anything can happen and, absent substantial data on these costs, one cannot predict with certainty that any given rule is better than any other rule for any particular set of contracting parties. Surely, though, some rule for allocating common contracting risks is preferable to no rule. If so, the law ought to adopt the rule that the broadest number of parties would adopt were transactions costs low enough for parties to tailor their own rules. A legal rule mirroring what most parties would adopt where transactions costs are low saves those parties the time, cost and error inherent in negotiating contract terms and reducing them to writing. The norm of expanded choice thus justifies this preference for majoritarian default rules. See Robert E. Scott, *The Case for Market Damages: Revisiting the Lost Profits Puzzle*, 57 U. Chi. L. Rev. 1155, 1172-73 (1990) [hereinafter "Scott, *The Case for Market Damages*"].

29. Where transactions costs are too high for parties to fashion their own rule, it nonetheless may be normatively correct to provide them with the rule that they most probably would have chosen for themselves at the time of contracting had they been able to bargain. Atypical parties, after all, are not disadvantaged by the specification of a "majoritarian" default rule, so long as they remain free to opt out of the default and design their own tailor-made alternative. This preference for

The difficulty with the ex ante approach, as Llewellyn noted, was that it operates at too high a level of generality. Llewellyn was highly critical in the first instance of those sales law rules that were the product of abstract concepts such as the location of the "title" in the goods. But, more to the point, even those defaults that are based on sensible intuitions about optimal risk allocation are often too general to be of much use to parties in specific commercial contexts. What is the point of a default rule strategy based on a majoritarian selection norm if there is no "majority" of bargainers who would agree ex ante on any given contract term?

There is a second strategy. Rather than attempt to specify objective default rules that fill the gaps ex ante, the courts can seek to fill gaps subjectively from an ex post perspective. That is, they can fill in the "right" result by imposing an equitable adjustment of all the relational and contextual factors that define the parties subjective "agreement" as it appears at the time of adjudication. This strategy was advanced by Llewellyn's teacher, Arthur Corbin, who believed that contractual gaps should be filled so as to effectuate the mental states of the parties.³⁰ In the contemporary debate, the ex post perspective is the solution most frequently suggested by the "law-and-society" branch of contract theorists. Where subjective meaning cannot be divined, the argument proceeds from the claim that contracts inevitably create reciprocal "relational" duties. Courts, employing their informational advantage ex post, should enforce those duties when the parties cannot agree.³¹ Efficiency (or fairness)

"majoritarian" default rules does not undermine the selection of default rules designed to stimulate further negotiation. Certain "information-forcing" default rules are set, not because they represent the ultimate allocation preferred by most bargainers, but because they are best suited to inducing one party to share information with the other. See Charles J. Goetz & Robert E. Scott, *Enforcing Promises: An Examination of the Basis of Contract*, 89 Yale L.J. 1261, 1300 (1980); Robert E. Scott, *A Relational Theory of Default Rules for Commercial Contracts*, 19 J. Legal Stud. 597, 609-10 (1990) [hereinafter Scott, "Relational Theory"]; Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 Yale L. 87 (1989).

30. See E. Allan Farnsworth, "Meaning" in the Law of Contracts, 76 Yale L.J. 939, 947 (1967); 3 A. Corbin, *Corbin on Contracts*, at 59-61 (1960).

31. Robert A. Hillman, *Court Adjustment of Long-Term Contracts: An Analysis Under Modern Contract Law*, 1987 Duke L.J. 1. Under this view, the law explicitly recognizes that courts adjudicate a contract dispute only after the parties have failed to specify a contractual solution to the particular problem ex ante and have been unsuccessful in bargaining their way to a solution ex post. Assume, then, that courts are in possession of information at the time of adjudication that the parties did not possess either ex ante or upon renegotiation. Under these conditions, courts should fill in the gaps ex post and direct an efficient outcome. While under this regime contracting parties would be unable ex ante to predict the payoffs if certain contractual risks materialized, they would know that courts would reach an equitable adjustment that would be efficient as viewed from that vantage point.

of result thus replaces efficiency of prediction. While many of the legal realists were attracted to this strategy and to the notion of subjective intent that supports it, Llewellyn, for reasons that will be explored later, did not share this *ex post* view.

A third strategy traces its lineage to the Willistonian approach to contract interpretation and requires courts to decline to fill gaps except in clear cases of linguistic ambiguity or where the law has already provided clear, binary default rules.³² Willistonian formalism rested on two basic claims: (1) that contract terms could be interpreted according to their plain meaning; and (2) that written terms have priority over unwritten expressions of agreement.³³ Unlike Willistonian conceptualism, the contemporary version of this strategy rests on the functionalist justification that parties often write incomplete contracts because of problems of hidden or private information (or because the transaction costs of specifying a complete state contingent contract exceed expected benefits) and that, in such circumstances, courts are incapable of doing better than the parties themselves. Under this “neo-formalist” approach, courts are instructed not to create additional, context-sensitive defaults or to undertake *ex post* adjustments. Rather courts are asked to enforce the (facially unambiguous) express terms of the contract literalistically or “as written,” supplemented only by the existing default rules of contract law.³⁴ One consequence of not filling more contractual gaps is that courts then must decline to enforce some contracts that are seriously incomplete, and, in consequence, contracting parties may expend more resources in specifying the terms of their agreements.³⁵

32. For an example of linguistic ambiguity, *see* note 148 *infra*. As for the question of whether the law can usefully create more complex, tailored default rules, consider the doctrines of perfect tender, mistake, excuse and breach. These familiar default rules of contract law are all framed in terms of generalized, categorical, winner-take-all risk allocations. The consistent character of these rules is that they assign risks on an all or nothing basis. The normative claim underlying this third strategy is that binary default rules have evolved because they deal with contracting problems in which there are only a small number of relevant future states (*i.e.*, either the contract goods are destroyed or they are not). But these common law defaults do not respond to incomplete contracts where there are an extremely large number of possible and likely future states—*i.e.*, where the market has price volatility. Because many contracting problems more closely resemble price uncertainty problems rather than the problem of loss or destruction of goods, this suggests that there is a hard upper bound on the number of problems that the law can solve with *ex ante* defaults.

33. Dennis M. Patterson, *Good Faith, Lender Liability, and Discretionary Acceleration: Of Llewellyn, Wittgenstein, and the Uniform Commercial Code*, 68 *Tex. L. Rev.* 169, 187-88 (1989) [hereinafter “Patterson, *Of Llewellyn, Wittgenstein and the Uniform Commercial Code*”].

34. For an evaluation of the merits (and demerits) of this approach, *see* Scott, *The Case for Formalism*, *supra* note 27, at 871-75.

35. This third approach might be understood as a kind of global information-

Llewellyn, who was above all a functionalist, also rejected the conceptualist foundations of formalism. In his view, context was the single most important determinant to the meaning of contractual language. But Llewellyn's rejection of formalism and embrace of context was far different from that of Corbin and the subjectivists. For Corbin, context was simply an opportunity to uncover the subjective intent of the contracting parties. Llewellyn viewed context as a means of implementing fully an objective *ex ante* default rule approach. In using context to fill gaps, Llewellyn would not instruct courts to focus on what the parties subjectively intended their words to mean in context but rather on what the *trade took the words to mean*.³⁶ In short, Llewellyn did not object to the notion that parties should be taken to have accepted, explicitly or implicitly, a set of default terms; he objected to the manner in which those defaults were determined. Rather than a set of abstract, generalized defaults, he argued for defaults that were tailored to the particular commercial context.

B. Llewellyn's Contributions to Contract Theory

Most theorists have attempted to evaluate the two core questions of contract independently. Thus, for example, it is a common analytical technique to assume conditions of free contracting when evaluating the merits of the different strategies for filling contractual

forcing default, one that uses the threat of non-enforceability to encourage parties to specify the solution to certain contingencies themselves. For an argument that these additional specification costs may well exceed the interpretive error costs of contextual interpretation, see Jody S. Kraus & Steven D. Walt, *In Defense of the Incorporation Strategy*, in *The Jurisdictional Foundations of Corporate and Commercial Law* 193 (2000). To be sure, a neo-formalist strategy does not absolutely preclude courts from contextual interpretation of a given contract, but it does require the parties to signal expressly their preference for more subjective modes of interpretation of the contract terms. The neo-formalist strategy is not as radical as it seems. It emerges from the classic work of Stewart Macaulay advancing the claim that flexible social norms, rather than rigid legal rules, govern commercial contracting behavior. Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 *Am. Soc. Rev.* 55 (1963). Following in Macaulay's path, I suggested in a later article that contracting parties may have learned to behave under two sets of rules: a strict (and formal) set of rules for legal enforcement and a more flexible (and contextualized) set of rules for normative enforcement. The lesson for the courts following his strategy, therefore, is to resist the temptation to judicialize these social norms on the theory that this effort will destroy the very informality that makes them so effective in the first instance. Scott, *Relational Theory*, *supra* note 29, at 615.

36. Patterson, *Of Llewellyn, Wittgenstein and the Uniform Commercial Code*, *supra* note 33, at 189-90; Zipporah B. Wiseman, *The Limits of Vision: Karl Llewellyn and the Merchant Rules*, 100 *Harv. L. Rev.* 465, 505-06 (1987) [hereinafter "Wiseman, *The Limits of Vision*"].

gaps. Similarly, analysts who focus on the domain of contracting assume implicitly that the choice between expanding and contracting the field of contract is independent of the way in which contractual gaps should be filled once one is within that domain. But for Llewellyn these two questions were linked and, moreover, linked in a way that admitted (at least in his view) of a normatively uncontroversial solution. Llewellyn's solution purported both to regulate the domain of free contract in standardized transactions and also to provide an array of apt and appropriately tailored default rules superior to the formal and largely abstract rules that had emerged from the common law process (and had been enshrined in Williston's Sales Act).

1. Llewellyn's View on Default Rules

Llewellyn's writings on contract, worked out over a fifteen year period from 1925 to 1940, reveal his continuing effort to resolve fundamental normative questions of contract theory. Although he was dismissive of the artificial and abstract character of legal formalism, he was not in any sense a rule skeptic. Rather, he believed that most legal reformers and courts took too seriously the legal rules as reflected in taught legal doctrine. Rather than focusing on the reasons for court decisions, Llewellyn advocated an approach that focused on the "working rules" that were reflected in the outcomes of decided cases.³⁷ These patterns, in turn, were revealed by a careful classification of the different commercial contexts in which the cases arose. Searching for the patterns of working rules in specific commercial contexts led him to the belief that commercial practice itself was the best source of default rules.

It is commonly believed that Llewellyn advocated a search for the "immanent" commercial law—moral norms that could be derived from actual practices. But, as Alan Schwartz has shown, Llewellyn's contract writings illustrate that Llewellyn believed that custom had only an epistemological and not a normative relevance, and that courts can and should infer the efficient rule from the standard practice.³⁸ Thus, Llewellyn belongs clearly in the camp of those who advocate completing incomplete contracts with ex ante default rules

37. Llewellyn called himself a "contract theorist," stating that this role required one to "have as [his] *first* objective to state accurately and neatly what the courts have been doing." Karl Llewellyn, *The Rule of Law in Our Case-Law of Contract*, 47 *Yale L.J.* 1243, 1269 (1938) ("A rule which states accurately the outcome of the cases, seen as *cases*, incorporates *pro tanto* such wisdom on the cases as prior courts have shown, and such similarity of reaction as courts are likely to continue to show . . . [The working rule] gives some guidance (to the judge) about wherein his more personal judgments on such matters may be wisely tempered. *Id.* at 1257).

38. Schwartz, *Origins of Contract Theory supra* note 20, at 15-19.

(which he called "yielding rules") that reflect the deals that typical parties would make in the circumstances.³⁹ Thus, for example, he wrote approvingly of the warranty provisions of the Sales Act that: they *seek* less to lay down controlling rules than to standardize, on the basis of the most general practice discoverable, the probable meaning of the acts or words concerned, to most bargainers [sic] concerned And this, in my view, is the sound basic approach to regulative law about socially unobjectionable transactions which can be reasonably standardized, and where bargaining power is moderately balanced or fair dealing is the practice."⁴⁰ Llewellyn's criticism of the Sales Act and Willistonian formalism was leveled against their two major flaws: many of the defaults were inefficient (grounded as they were in legal doctrine rather than actual practice) and others operated at too high a level of generality (they were insensitive to the particular circumstances that might lead parties in some industries to allocate risks differently than parties in other commercial contexts). The default rule task, therefore, was to direct courts to fashion both efficient and tailored defaults. This courts could not do unless and until they became more acquainted with the commercial context of the particular dispute. Although Llewellyn was committed to an empirical foundation for contract rules, his empirical techniques were at best indirect. Rather than look for business practices directly, he inferred that practice from the contractual arrangements in litigated cases.⁴¹ Party consent to that arrangement constituted presumptive evidence that the arrangement was efficient and should become the legal norm for similar transactions in similar contexts. In this way, courts could create a menu of tailored default terms that would both constrain courts decisions in the future and enable commercial parties to predict outcomes *ex ante*.⁴²

39. Karl Llewellyn, *On Warranty of Quality, and Society*, 36 Colum L. Rev. 699 (1936) ("Common to all [of these cases] is a picture of the way in which dickens of this kind typically happen, and so of how the parties *ought to have understood what was said and done.*" *Id.* at 722 (emphasis added)).

40. Karl Llewellyn, *Through Title to Contract and a Bit Beyond*, 15 N.Y.U. L. Rev. 159, 197 (1938) [hereinafter "Llewellyn, *Through Title*"].

41. Twining, Karl Llewellyn, *supra* note 19, at 313-21.

42. Llewellyn's use of custom as a source of default rules did not commit him to the use of custom as a source of meaning in contract disputes. He recognized that custom was often unhelpful in resolving disputed transactions ("trouble" cases) because such cases typically arose out of an exogenous shock for which the custom—created for typical transactions—was not applicable. In such circumstances, he was not interested in solving interpretive problems by inferring what the contracting parties subjectively *meant or would have meant* (as would Corbin and the subjectivists). Nor did he approve of courts resolving trouble cases by imposing an outcome that was fair *ex post*. Rather, he thought such occasions were opportunities for courts using the resolution of such disputes to impose efficient solutions, that is, solutions that maximized the *ex ante* value of the contract

2. *Llewellyn and Freedom of Contract*

Llewellyn's interest in freedom of contract questions stemmed from his focus on litigated commercial contracts as a source of tailored default rules. Before one could infer that the observed practice or contract term was efficient for that trade or industry, one would first have to ensure that the terms in question were "bargained for" and not "dictated" by a stronger party to a weaker one. If the terms were dictated in a "fiat" contract, then one could not conclude that the terms were an appropriate source for defaults as they might only benefit the stronger party. This focus on "balanced" transactions led naturally to a concern with adhesion contracts in general and with "lop-sided" contracts in particular.⁴³

But Llewellyn's concern with adhesion contracts and with delineating the domain of free contract was narrowly focused. He believed that distributional goals played no role in contract: "[M]ost of the Sales field is uncolored as most other law is not by the clash of class and passion . . . because the same parties, and the same types of party, can tomorrow be occupying each the other end of similar disputes."⁴⁴ In short, since parties to sales transactions were both buyers and sellers, there was no reason to believe that one group or class was distributionally disadvantaged over the other. Thus, the goal of sales law was to "solve practical problems by providing rules that are "practical tools for practical men."⁴⁵

The focus on balanced transactions as a source of efficient defaults (rather than as being distributionally fair) led Llewellyn in general to prefer *selective* regulation of bargains rather than mandatory rules. His early views presaged the development of the doctrine of unconscionability as the key mechanism for regulating bargains, especially in standard form contracting. Contracts that were substantively objectionable or "lopsided" should not be enforced when the bargaining process that produced them was procedurally defective.⁴⁶ One exception to this general view was his belief that warranty disclaimers should be universally unenforceable even where the "[buyer] has freely agreed thereto" unless the court finds that the

and/or reduced transactions costs for future parties. See Schwartz, *Origins of Contract Theory*, *supra* note 20, at 15-17.

43. Karl Llewellyn, *The Effect of Legal Institutions Upon Economics*, 15 Am. Econ. Rev. 665, 673 (1925).

44. Karl Llewellyn, *Across Sales on Horseback*, 52 Harv. L. Rev. 726-27 (1939).

45. Karl Llewellyn, *Our Case-Law of Contract Offer and Acceptance I*, 48 Yale L.J. 779 (1939) [hereinafter "Llewellyn, *Our Case-Law*"].

46. Karl Llewellyn, *Book Review*, 52 Harv. L. Rev. 700, 704 (1939) (the goal is the marking out of the impermissible).

“clause lies within the reasonable region of self-regulation by parties.”⁴⁷ This view resulted from his conclusion that such disclaimers were almost always the product of lopsided contracting. The conclusion that warranty disclaimers justified a prophylactic rule against contracting out, in turn, was a function of his empirical technique of inferring the efficiency of practice from disputed cases. Warranty disputes arise where the buyer is disappointed with the quality of goods sold. In that class of transactions, a term allocating the risk of quality defects to the buyer seems always to deny buyers the benefit of their bargain. Of course, the question whether such disclaimers are sometimes an efficient means of reallocating quality risks requires as well an analysis of those transactions where the buyer receives a lower price for the contract goods in return for assuming a risk that never materializes.

3. *Llewellyn's Solution to the Tension between Ex Ante Defaults and Regulated Bargains*

At first blush, Llewellyn's views on the two normative concerns of contract theory seem to be hopelessly inconsistent. On the one hand, he held a strong view that parties, not courts, should determine the terms of their contracts. Parties should be permitted to make “any agreement they please” because the “animals probably know their own business better than their keeper [does]—a theory which has not only charm but virtue, *most* of the time.”⁴⁸ On the other hand, he advocated a theory of regulation that empowered courts to strike down and/or rewrite contract terms whenever the contract was “unbalanced.” To accommodate both views within a single theory thus requires a sorting mechanism by which courts can reliably screen balanced transactions where contracting out is freely permitted from unbalanced transactions where courts should impose customary terms that reflect the “reasonable expectations” of the parties.⁴⁹

For Llewellyn, however, the tension was only a technical and not a normative problem. He did not view the regulatory function as representing a clash of interests—as between retail sellers and consumer buyers—but rather as an exercise in policing outlier sellers, the “contract-dodger” or “sharper.”⁵⁰ Viewed through this lens, the

47. Karl Llewellyn, *On Warranty of Quality, and Society: II*, 37 Colum. L. Rev. 341, 364-65, n.58 (1937).

48. *Id.* at 403. See also Llewellyn, *Book Review*, *supra* note 46, at 700-01 (“Almost any particular clause included in a deal represents the parties’ joint judgment . . . and this alone is ground enough for letting it . . . displace and replace the general law.”)

49. Llewellyn, *Book Review*, *supra* note 46, at 704.

50. Karl Llewellyn, *What Price Contract? An Essay in Perspective*, 40 Yale

regulatory task could be appropriately confined to policing aberrant transactions without hindering the facilitation of efficient contracting for the vast majority of contracting parties. In short, for Llewellyn, the distributional question was derivative of the efficiency question. Thus, he was willing to privilege the freedom of parties to contract out of default rules over the regulatory role of courts in policing unbalanced bargains because he viewed the former as the norm and the latter as atypical. The regulatory role could be properly confined because, in Llewellyn's view, the key unit of analysis was the group—merchants in a particular trade or practice—and the group can and would engage in self-policing.⁵¹

It is difficult to appreciate in the abstract Llewellyn's "solution" to the tension between party autonomy to contract out of default rules and judicial regulation of lopsided bargains. To those committed to contract as a distributional as well as an allocative mechanism, it may appear that Llewellyn too readily acquiesced in the creation of a tool for policing bargains—the unconscionability doctrine—that was mostly form and little substance. But for Llewellyn the contemporary focus on individual rights, on a methodological individualism that is shared by both sides of the free contract divide, was unfamiliar. Instead, he was committed to a methodology that focused on the group as the key unit of analysis. To understand his theory of group behavior, including the means by which groups could, with the aid of legal tools, effectively police themselves, one must appreciate his commitment to the law-and-economics of his day, the institutional economics of John Commons.⁵²

4. *Llewellyn's Law and Economics*

Llewellyn was particularly influenced by the work of John Commons and the other members of the Institutional school of economics.⁵³ Commons rejected the focus of economic models on

L.J. 704, 725 n.47, 734 (1931) [hereinafter "Llewellyn, *What Price Contract*"].

51. Allen R. Kamp, *Between-The-Wars Social Thought: Karl Llewellyn, Legal Realism, and the Uniform Commercial Code in Context*, 59 Albany L. Rev. 325, 354-65 (1995) [hereinafter "Kamp, *Between-The-Wars Social Thought*"].

52. For an excellent discussion of the institutionalists and their influence on academic law, see Herbert Hovenkamp, *The First Great Law & Economics Movement*, 42 Stan. L. Rev. 993 (1990).

53. Institutional economics was a label given to the work of Thorstein Veblen, W.C. Mitchell and John Commons, although their work has few common elements. G.C. Veljanovski, *The New Law and Economics* 55 (1982). Institutionalism has three methodological comments: (1) dissatisfaction with the level of abstraction of neo-classical economics and with the static nature of orthodox price theory; (2) a belief in the integration of economics with other social sciences, especially psychology and sociology; and (3) a belief in detailed quantitative investigations.

the choices made by rational, utility-maximizing individuals in markets devoid of institutional structures. After all, most economic activity involved individuals as members of groups—corporations, unions, the family, political parties, etc. He sought to include collective action and institutional analysis within the standard economic models. Commons principal contribution, therefore, was to replace the individual with the transaction as the basic unit of analysis.⁵⁴ The larger unit in Commons framework was the “going concern.” According to Commons, “a going concern is a joint expectation of beneficial bargaining, managerial and rationing transactions, kept together by *working rules* . . . and by control of the changeable strategic or limiting factors which are expected to control others.”⁵⁵

Llewellyn adopted Commons notion of working rules (social norms in contemporary terminology) and incorporated them as a “common law” applying not only within an economic unit but between economic units as well. Since these rules were produced by the strategic interactions between economic units in society, those units had an ongoing motivation to police those members of the group who attempted to chisel or otherwise violate the norms. Hence his commitment to group-policing of contractual chiselers was based on a theory of the group’s self-interest in protecting its place in the economic order.

Because of the uniquely specialized regulatory role of economic groups, Llewellyn was unwilling to delegate the primary regulatory responsibility either to courts or legislatures. In the case of courts, “the adjustments . . . are and must continue laggard and partial; inelastic and sometimes mistaken . . . [because] judges are neither industrial workers, business men, nor bankers. . . . Hence in a vast body of their cases they sit as laymen, groping to solve a controversy they cannot understand, by a rule whose import they cannot guess.”⁵⁶ Legislatures were little better, “though better adapted for general policy-shaping than courts, [they] are both by size and membership hampered in doing the legal engineering necessary to their purposes.”⁵⁷ Administrative agencies were a possibility; they offered “the means of developing experts specialized in their field, of getting quick decisions, and, above all, of getting a wealth of *detailed, specific* rulings.”⁵⁸ But bureaucracy, too, had its limitations. “Administrative Poo-bahisim,—plaintiff, judge, hangman all in

See M. Blaug, *The Methodology of Economics* 678-79 (1980).

54. John Commons, *Law and Economics*, 34 *Yale L.J.* 371-82 (1924).

55. John Commons, *Institutional Economics* 8-10 (1934).

56. Llewellyn, *The Effect of Legal Institutions*, *supra* note 43, at 670.

57. *Id.* at 671.

58. *Id.*

one—is not always happy.”⁵⁹ Thus, Llewellyn concluded, “it may be queried whether any sane public regulation of economic activity in the public interest—whatever that may be—is not largely accidental.”⁶⁰ The best option for regulating lopsided bargains, therefore, lay with the groups themselves.⁶¹

In the case of lopsided standardized contracts between members of different groups, both judicial and legislative intervention is typical both in its incidents and in its limitations. Outsiders law can hold inequity somewhat within bounds; but it has little machinery to effect a cure. The more hopeful movement is the meeting of organization with organization. There were the conferences between shippers, carriers, and bankers which led to the uniform railroad bill of lading. And even more important and extensive is the introduction of the balanced standardized contract without official stimulus. . . .

The standardized contract with arbitration is thus a shining engine of control for any highly specialized going concern within, and partly independent of that greater going concern, the state.⁶² In sum, the principle that evolved into Llewellyn’s doctrine of unconscionability was specifically designed to permit courts to regulate lopsided contracts by finding and then simply applying group outrage at the excesses of the “chiseler.”

II. THE POLITICAL ECONOMY OF ARTICLE 2

A. A Brief Overview of the Uniform Commercial Code Project

The story of the Uniform Commercial Code project and Llewellyn’s unique role in the process has been told many times.⁶³

59. *Id.* at 672.

60. *Id.*

61. “[P]rivate interests seem to have been the influential factors in law’s major changes in the past. Their working constitutes the striking phase of law’s relation to economics today. Increasingly, associations are forming which adopt their own rules of action and even settle their own disputes.” *Id.*

62. *Id.* at 674-75.

63. See Twining, Karl Llewellyn, *supra* note 19, at 270-301. Recently, Allen Kamp has published a series of articles that give a fresh and more detailed perspective on the story. Kamp, *Between-the-Wars Social Thought*, *supra* note 51; Allen R. Kamp, *Uptown Act: A History of the Uniform Commercial Code, 1940-49*, 51 SMU L. Rev. 275 (1998) [hereinafter “Kamp, *Uptown Act*”]; Kamp, *Downtown Code*, *supra* note 10. See also Wiseman, *The Limits of Vision*, *supra* note 36; Ingrid M. Hillinger, *The Article 2 Merchant Rules: Karl Llewellyn’s Attempt to Achieve the Good, The True, The Beautiful in Commercial Law*, 73 Geo L.J. 1141(1985); Kathleen Patchel, *Interest Group Politics, Federalism, and the Uniform Laws Process: Some Lessons from the Uniform Commercial Code*, 78 Minn. L. Rev. 83 (1993) [hereinafter “Patchel, *Interest Group Politics*”]; Schwartz & Scott, *Political Economy*, *supra* note 8.

The current that carried the Code project forward was the impetus for uniformity in commercial law. The rise of the modern industrial state in the late nineteenth century exposed the significant diversity that existed in the commercial law of various states. The resulting uncertainty and legal information costs led to proposals for the enactment of a federal commercial code to govern interstate commercial transactions.⁶⁴ These proposals in turn stimulated the formation of the National Conference of Commissioners on Uniform State Laws (NCCUSL) in 1892.⁶⁵ Rather than accept federal intrusions on traditional state authority, the National Conference proposed to formulate and seek adoption of various uniform laws governing different aspects of commercial law. Each state was then encouraged to adopt these uniform statutes. One of those uniform statutes was the Uniform Sales Act, drafted by Samuel Williston and adopted by NCCUSL in 1906.⁶⁶

The Sales Act was never an unqualified success. It received a mixed reception in the states, and initially was adopted in just over half the states.⁶⁷ Moreover, Llewellyn was not alone in criticizing some of its central features, most significantly its reliance on the concept of title in the goods to determine risk of loss and other responsibilities arising out of the sales transaction. The shortcomings with the Sales Act, and the impediments to its revision, led Llewellyn to lobby for the introduction and passage of a Federal Sales Act.⁶⁸ The National Conference reacted to the threat of federalization with predictable speed. The commissioners lobbied against federal enactment, began drafting a revised sales act and, perhaps most significantly, persuaded Karl Llewellyn to assume the principal revision responsibilities.⁶⁹

By 1944, the NCCUSL had formed a collaboration with the American Law Institute ("ALI") and, working in tandem, they expanded the revised sales act project to include the drafting of a comprehensive Uniform Commercial Code.⁷⁰ The decision to

64. See Committee on Commercial Law, Report, 10 ABA Rep. 332-44 (1887); E. Hunter Taylor, Jr., *Federalism or Uniformity in Commercial Law*, 11 Rutgers-Cam. L.J. 527 (1980).

65. Allison Dunham, *A History of the National Conference of Commissioners on Uniform State Laws*, 30 Law & Contemp. Probs. 233 (1965).

66. The Sales Act was modeled on the English Sale of Goods Act, 1893. See Twining, Karl Llewellyn, *supra* note 19, at 277.

67. Ultimately, the Sales Act was adopted in 34 states.

68. Twining, Karl Llewellyn, *supra* note 19, at 276-78; See Karl Llewellyn, *The Needed Federal Sales Act*, 26 Va. L. Rev. 558 (1940).

69. Twining, Karl Llewellyn, *supra* note 19, at 276-78.

70. The marriage between the ALI and NCCUSL was proposed and arranged in the 1940s by William Schnader, a prominent attorney who was a vice-president of the ALI and also served as President of NCCUSL. See Patchel, *Interest Group*

produce a code was primarily instrumental. The ALI and NCCUSL believed that this consolidation of commercial law into a single statutory scheme would enable them to sell the entire project to the states on a "take it or leave it" basis thus avoiding the selective enactment that had occurred with earlier uniform acts.⁷¹ While Llewellyn worked on the Code project for over ten years, responsibility for drafting key provisions dealing with credit instruments, bank collections, and secured transactions—Articles 3, 4, and 9—was assigned to others.⁷² In short order, the drafting process of these articles came to be dominated by representatives of banking and commercial financing interests.⁷³ Articles 3, 4, and 9 were, in the main, characterized by detailed, precise rules that allocated commercial risks in ways favorable to the commercial interests that participated so actively in the drafting process. No doubt the clarity of the new rules governing asset based financing, credit instruments and payment systems reduced transactions costs in the relevant credit markets. But, equally clearly, the rules favored the interests of sophisticated repeat players in those markets over those of occasional participants in financing transactions.⁷⁴

The Article 2 project, on the other hand, proceeded without the active participation of external interest groups. The project was dominated by Llewellyn and his band of academic reformers.⁷⁵ The revisions that the academic reformers agreed to during the drafting process were those that they felt were necessary to secure the approval of the far more conservative lawyers and other legal professionals that dominated the two sponsoring private legislative bodies. Once Article 2 passed the twin hurdles of approval by the ALI and NCCUSL, it was essentially carried along by widespread industry support for the credit and financing articles. Although Pennsylvania adopted the Code in 1952, it was not until the comprehensive lobbying following the New York Law Revision Commission analysis of the Code in 1956 that the professional community joined forces to ensure the enactment of the Code in

Politics, *supra* note 63, at 98.

71. William D. Hawkland, *The Uniform Commercial Code and the Civil Codes*, 56 La. L. Rev. 233-36 (1995) [hereinafter "Hawkland, *UCC and Civil Codes*"].

72. William Prosser was the principal reporter for Article 3 (Commercial Paper); Fairfax Leary followed by Walter Malcolm were the reporters for Article 4 (Bank Collections); Allison Dunham and Grant Gilmore were the reporters for Article 9 (Secured Transactions).

73. Kamp, *Downtown Code*, *supra* note 10, at 382-88; Gilmore, *Confessions of a Repentant Draftsman*, *infra* note 163, 619-26; Schwartz & Scott, *Political Economy*, *supra* note 8, at 638-45.

74. Robert E. Scott, *The Politics of Article 9*, 80 Va. L. Rev. 1783, 1815-45 (1994); Schwartz & Scott, *Political Economy*, *supra* note 8, at 643-48.

75. Twining, Karl Llewellyn, *supra* note 19, at 280-90.

New York and thereafter within a decade in every other American state except Louisiana.⁷⁶

B. *The Default Rules of Article 2*

Llewellyn had two principal objections to Willistonian formalism, as embodied (most irritatingly, in his view) in the Sales Act. First, he objected to those default rules that were based on artificial doctrinal conceptions, such as the location of "title" in the goods. These defaults were "inefficient" in the sense that they did not reflect the terms of agreement that most parties in the relevant trade would have made for themselves.⁷⁷ Second, the Sales Act default rules applied in the main to all transactions equally and thus were insufficiently tailored to the circumstances of particular trades and industries.⁷⁸ Llewellyn's effort to solve the first problem by substituting more efficient defaults was, in general, a conspicuous success. His attempt to solve the second problem by creating a mechanism for the recognition and incorporation of tailored, industry specific defaults was, in the end, a notable failure.

1. *Regulating Contractual Breakdown: Efficient Allocation of Commercial Risks*

Since the focus in recent years has turned to the deficiencies of Article 2, it is easy to neglect its singular contribution: a series of efficient default terms for salvaging broken contracts that reduced

76. Scott, *Uniformity Norm*, *supra* note 19, at 155. By 1975, Louisiana had enacted Articles 1, 3, 4 and 5. Subsequently, Article 9 and portions of Article 2 were enacted as well.

77. Llewellyn, *Through Title*, *supra* note 40, at 168-70; Karl Llewellyn, *Introduction to Cases and Materials on Sales at VI* (1930) ("title is a wholly unnecessary major premise"). Tellingly, Article 2 begins in U.C.C. § 2-101 with an initial comment:

The arrangement of the present article is in terms of contract for sale and the various steps of its performance. The legal consequences are stated as following directly from the contract and action taken under it without resorting to the idea of when property or title passed or was to pass as being the determining factor. The purpose is to avoid making practical issues between practical men turn upon the location of an intangible something, the passing of which no man can prove by evidence and to substitute for such abstractions proof of word and actions of a tangible character.

U.C.C. § 2-101 (1995).

78. Llewellyn, *On Our Case-Law*, *supra* note 45. "A meaningful rule is one that is defined by "operative fact;" such rules are "understandable and clear about what action it is which is to be guided, and . . . must state clearly how to deal with cases on the raw facts as they arise." *Id.* at 12, 28.

contracting costs for many (if not most) parties to sales transactions. As noted in Part I, Llewellyn was committed to the idea of filling contractual gaps with defaults that were ex ante efficient; that is, defaults that reduced expected contracting costs and thus, presumably, mimicked the arrangement most commercial parties would have made for themselves. Under the Sales Act, most risk allocation questions were resolved by determining who had the title to the contract goods. The problem was, that while everyone knew that the party who had the title assumed the relevant risk, no one knew who had the title.⁷⁹ The resulting uncertainty increased transactions costs and complicated efforts to contract out of the legal default. Llewellyn's risk of loss rules illustrate his commitment to legal defaults that reduce transactions costs for contracting parties. Rather than using artificial conceptions of title, Article 2 assigns the risk of loss in general to the party in control of the goods, on the (generally sound) intuition that the party in control can best take precautions to reduce endogenous risk and/or insure against exogenous risks.⁸⁰ A similar approach is reflected in the "salvage" rules of Article 2—rejection, cure, acceptance, and revocation of acceptance.⁸¹ These rules were also drafted with the purpose of reducing contracting costs ex ante by encouraging ex post adjustments by the party with the comparative advantage in mitigating the costs of broken contracts.⁸²

79. As Llewellyn observed, under the Sales Act, title governed questions of "risk of loss, action for the price, the applicable law in an interstate transaction, the place and time for measuring damages, and the power to defeat the other party's interest, or to replevy, or to reject." Llewellyn, *Through Title*, *supra* note 40. He went on to say that "this would be an admirable way to go at it if the Title concept had been tailored to fit the normal course of a going or suspended situation during its flux or suspension. But Title was not thus conceived, nor has its environment of buyers and sellers had material effect upon it." *Id.* See Jody S. Kraus, *Decoupling Sales Law from the Acceptance-Rejection Fulcrum*, 104 *Yale L.J.* 129, 130-32 (1994) [hereinafter "Kraus, *Decoupling Sales Law*"].

80. See U.C.C. § 2-509 (1995). Comment 1 to U.C.C. § 2-509 states: "The underlying theory of these sections on risk of loss is the adoption of the contractual approach rather than an arbitrary shifting of the risk with the 'property in the goods.'" Comment 3 explains why a merchant seller bears the risk of loss until actual receipt by a buyer:

The underlying theory of this rule is that a merchant who is to make physical delivery at his own place continues meanwhile to control the goods and can be expected to insure his interest in them. The buyer, on the other hand has no control of the goods and it is extremely unlikely that he will carry insurance of goods not yet in his possession.

Id.

81. See U.C.C. §§ 2-601 through 2-608 (1995).

82. See Alan Schwartz & Robert E. Scott, *Sales Law and the Contracting Process* 230-311 (2d ed. 1991); Kraus, *Decoupling Sales Law*, *supra* note 79, at 135-60.

Llewellyn was particularly sensitive to the costs of strategic behavior in the performance of sales contracts. He initially proposed to substitute a substantial performance standard in place of the traditional perfect tender rule on the grounds that it was the more efficient default rule for sales contracts in which the seller's investment in the transaction exposed it to the risk of opportunism by the buyer.⁸³ Llewellyn understood, however, that a substantial performance rule operated as a double edged sword. Requiring a buyer to accept goods that "substantially conformed" to the contract reduces the risk of strategic rejections by the buyer, but, in turn, it exposes the buyer to an opportunistic tender by the seller of substandard goods.⁸⁴ His solution to this dilemma reflects his understanding that legal defaults that impose flexible adjustment on one party become opportunities for exploitation by the other. The answer, in his view, lay in the practices and norms of the particular trade and industry. These norms presumably would have evolved with sufficient fact-specificity to screen legitimate requests for adjustment from strategic ones.

To solve this conundrum, therefore, Llewellyn proposed the establishment of a merchant tribunal—a specialized fact finder that would measure each party's performance and its responses to the other's performance against established industry norms.⁸⁵ The merchant jury was too radical a proposal, however, and was soon abandoned in the face of objections from more conservative members of the private legislatures.⁸⁶ In the end, Llewellyn returned to the

83. Section 11-A of the Revised Uniform Sales Act (Second Draft 1941) proposed to substitute the standard of mercantile performance for the traditional sales law standard of perfect tender. See Report and Second Draft, *The Revised Uniform Sales Act (1941)* reprinted in 1 *Uniform Commercial Code Drafts* 269, 378-81 (Elizabeth S. Kelly ed. 1984). Under this test the buyer was required to accept performance where the risks and burdens on the buyer were not materially increased and the goods met the "operating or marketing requirements of the buyer in the course of his business." *Id.*

84. For a discussion of the trade-offs between a substantial performance standard and the perfect tender rule, see Charles J. Goetz & Robert E. Scott, *The Mitigation Principle: Toward a General Theory of Contractual Obligation*, 69 *Va. L. Rev.* 967, 995-97, 1009-11 (1983) [hereinafter "Goetz & Scott, *The Mitigation Principle*"].

85. The comment on section 11-A of the Revised Uniform Sales Act (Second Draft 1941) states: "The proposed policy presupposes the availability of a *skilled and specialized mercantile tribunal to pass on the question of fact* in case of dispute. Section 59. There is no question of incurring the uncertainty which would be involved by letting such a matter go in first instance to an ordinary jury." Section 59-C(1) provided that the merchant experts were to sit with a court "not as party representatives, but as a special sworn expert tribunal to find the true facts."

86. The 1944 draft of the Uniform Revised Sales Act abandoned both the substantial performance standard for rejection of goods as well as the merchant tribunal. See *Uniform Revised Sales Act*, § 91 (Proposed Final Draft 1944),

perfect tender rule but, by incorporating a cure provision, was able to create a structure for mutual adjustment that accomplishes many of the same purposes as a substantial performance rule.⁸⁷

A final example of efficient defaults for broken contracts is the remedial scheme introduced in Article 2. Llewellyn began by focusing on the central question of all disputed contracts: which party is responsible for salvaging the broken contract? This question, in turn, requires one to answer a deeper one: given a default rule of expectation damages equal to the value of the broken contract to the promisee, why would anyone ever breach (except inadvertently)?⁸⁸ And yet, we observe advertent breach. There are two possible explanations for a promisor's decision to breach in the face of an expectation damages rule. The first is benign: the decision to breach is a "cry for help"—a request that the contracting partner adjust to the broken contract by covering (or reselling) on the market and

reprinted in 2 Uniform Commercial Code Drafts 60-61 (Elizabeth Kelly ed. 1984). The substantial performance standard was objected to by merchants themselves, who felt that it would expose them to the risk of sellers tendering non-conforming goods. See George L. Priest, *Breach and Remedy for the Tender of Nonconforming Goods Under the U.C.C.: An Economic Approach*, 91 Harv. L. Rev. 960, 971 n.27 (1975). The merchants tribunal was seen as unworkable, and politically unfeasible. See National Conference of Commissioners on Uniform State Laws, Fifty-Second Annual Conference, at 131 (1942).

87. See Goetz & Scott, *The Mitigation Principle*, *supra* note 84, at 997-1000. Stating that:

to invoke [the cure provision] properly, one must imagine a case in which a tender is clearly defective, but the seller nonetheless anticipates that the buyer will accept the tender as a legitimate readjustment option. These requirements are satisfied where one can evaluate the deficiency on the market and correct it with a monetary payment accompanying the tender Granting a seller the right to cure under appropriate conditions serves two functions. First, section 2-508(2) encourages a buyer anticipating special losses from non performance to bargain for additional protection at the time of contracting Second, and perhaps more importantly, the cure provision restrains opportunistic claims by the buyer. Unfortunately, it also invites evasion by the seller through the tender of inadequate substitutes as a 'cure.'

88. The efficient breach hypothesis—which holds that breach enables the promisor to take advantage of a better market opportunity while guaranteeing the promisee the value of its bargain—fails to explain breach in markets where substitute goods are available. In such a case, the promisor can always "perform" the contract by covering on the market from a third party and tendering the substitute "performance" in satisfaction of the contract, thereby freeing the promisor to pursue any alternative market opportunity without having to suffer the reputational consequences of breaching a contract. Thus the question: in a market where goods are available in substitution for the contract, what explains why any party would advertently breach? See Scott & Kraus, *Contract Law and Theory*, *supra* note 25, at 115-17.

submitting a "damages" bill to the promisor.⁸⁹ The alternative explanation is strategic: breach is motivated by the imperfections in the judicial system that systematically deny the promisee his contractual expectancy. Promisors who breach, under this conception, are able to exploit these imperfections to secure a favorable settlement of the disputed transaction. The challenge for contract theory is to predict when the benign scenario is more likely than the malign one (and vice versa). If the benign story is the more probable explanation for the promisor's breach, an efficient default rule would direct courts to award only a damages remedy to the promisee, thus encouraging the promisee to respond to the cry for help by acting appropriately on the market. On the other hand, if the malign scenario is the more probable in the particular case, the rule should direct the court to grant specific relief to the promisee, thus trumping the (presumptively) strategic request for assistance.

Under the Article 2 scheme, the determination of which of these explanations is more likely in any particular setting turns on the nature of the market for substitute goods.⁹⁰ Where the market is thin, the implicit assumption is that breach is more likely to be strategic and the promisee can trump the "cry for help" by demanding either specific performance or the contract price (as the case may be).⁹¹

89. The assumption here is that the promisor recognizes that it will suffer a loss on the contract and wishes to enlist the promisee's assistance in minimizing that loss. The decision to breach, on this view, is made after comparing the promisor's costs of acting on the market with the (presumably lower) salvage costs of the promisee (for example, a breaching seller presumably would incur greater costs in finding a substitute seller from whom to purchase conforming goods to tender to the buyer than would the buyer, who knows better the market for the goods that it requires).

90. The Code's remedial scheme implicitly adopts an initial presumption that breach is a cry for help. Thus, specific performance (or an action for the price) is an extraordinary remedy. (See U.C.C. §§ 2-703, 2-711(1995)). The promisee buyer has an option of either covering on the market (U.C.C. § 2-712 (1995)) or establishing what a cover contract would have cost (U.C.C. § 2-713 (1995)). But, in either case, as long as there is a market for the goods, the buyer is presumed to have the comparative advantage in salvaging the broken contract and must act on the market and subsequently submit a damage claim to the seller. The same presumption holds for the promisee seller, who must initially choose between resale (U.C.C. § 2-706 (1995)) or proof of what a resale would have yielded on the market (U.C.C. § 2-708(1) (1995)). In either case, only when the promisee can show that the market for substitutes is thin does the Code presumption shift toward the malign story. In such a case, the promisee buyer can secure specific performance (See U.C.C. § 2-716, cmt. 2 (1995) stating "[i]nability to cover is strong evidence of 'other proper circumstances'"), and the promisee seller can recover the price (U.C.C. § 2-709(1)(b) (1995) stating "[u]nable after reasonable effort to resell").

91. See U.C.C. §§ 2-716, 2-709(1)(b) (1995). The argument is that, in a thin market, a promisee is unlikely to enjoy a comparative advantage over the promisor in covering on the market while, at the same time, the promisee is more vulnerable

Where there is an available market for the contract goods, however, the promisee is limited to market damages. This motivates the promisee to adjust efficiently to the broken contract by salvaging the broken contract on the market, either by resale or by cover (or, in the alternative, relying on proof of what such an action on the market would have yielded).⁹²

The success of Article 2 in substituting efficient defaults that encourage cost minimizing efforts to salvage broken contracts should not be underestimated. While the people for whom Llewellyn was drafting were not sophisticated theorists, they were sophisticated commercial lawyers who were well aware of the inefficiencies embedded in the Sales Act. In drafting these provisions of the Code, as well as a set of efficient defaults that reduced contract formation costs,⁹³ Llewellyn relied upon his long career as a commercial lawyer. Tearing down the "wall" of title and drafting sophisticated schemes to facilitate the salvaging of disputed contracts was seen then, as it is now, as a major improvement in the legal regime, one that would likely ensure the support of the ALI and NCCUSL members whose approval was necessary for the Code project to succeed.

2. Regulating Ongoing Contractual Relationships: Flexibility and Tailored Defaults

Llewellyn's solution for regulating on-going contractual relationships was even more ambitious than his scheme for regulating broken contracts. But here he had fewer theoretical guideposts on which to rely. The economic analysis of relational contracts was not available to him (and neither were developments in game theory and decision making under conditions of imperfect information. As this literature shows, relational contracts are more difficult for the law to address. In these environments, the parties

to strategic claims that the cover contract was unreasonable since market prices are more difficult to prove. Scott & Kraus, *Contract Law and Theory*, *supra* note 25, at 990-91.

92. Scott, *The Case for Market Damages*, *supra* note 28, at 1188-1201.

93. The most successful contract formation defaults in Article 2 are (1) the presumption that parties care more about the fact of assent than the manner in which assent is given (U.C.C. § 2-204(1) (1995)), and (2) cost minimizing rules for dealing with open price and quantity contracts. See U.C.C. §§ 2-305, 2-306 (1995). See also Charles J. Goetz & Robert E. Scott, *Principles of Relational Contracts*, 67 Va. L. Rev. 1089, 1111-26 (1981). But see Victor P. Goldberg, *Discretion in Long-Term Open Quantity Contracts: Reining in Good Faith*, 35 U.C. Davis L. Rev. 319 (2002) (arguing that the search for "good faith" in interpreting open quantity contracts often supplants the parties actual agreement with a "wooden, uninformed reading of the agreement").

are confronted with problems of uncertainty and complexity that effectively prevent them, even in theory, from allocating all relevant risks at the time of contracting. Parties in these situations write incomplete contracts either because the transactions costs of predicting the future are prohibitive or because they are trying to cope with problems of asymmetric information.⁹⁴

Lacking the conceptual tools to address this problem at the level of theory, Llewellyn relied on an intuitive sense (derived from his years as a commercial lawyer) that ongoing contractual relationships were not efficiently regulated by binary default rules that allocated risks on an "all or nothing" basis. What Llewellyn saw was similar to the findings of Stuart Macaulay a generation later.⁹⁵ Parties adjusted voluntarily to changed circumstances during the life of the contract. If an exogenous shock delayed the delivery of goods in a particular industry, the buyer would accept the late delivery and look for a price discount on a subsequent transaction. Not only were these patterns of flexible adjustment ubiquitous, but Llewellyn saw as well that the parties coped with moral hazard problems in much the same way: strong social norms in the form of trade practice or even contract-specific patterns of interaction developed to police opportunism on both sides of the transaction.

The solution to the dilemma of relational contracting seemed straightforward. Rather than impose abstract and general rules to regulate ongoing relationships, the law should simply identify and incorporate the "working rules" already being used successfully by the parties themselves. These working rules (or "by-laws" as Llewellyn also called them) needed the imprimatur of the state for two reasons. First, the primary culprit in the depressed economic times of the period was thought to be the contract-dodger or chiseler who would violate the norms, sell shoddy goods (or fail to pay for conforming ones) and thus set off a spiraling race to the bottom. Moreover, the "jurisdiction" of the "working rules" was uncertain because they arose from custom and practice. Legal incorporation was necessary, therefore, in order to resolve "trouble" cases where the relevant norms were in dispute.

Llewellyn addressed the incorporation objective by reversing the common law presumption that the parties' writings and the official majoritarian default rules (the law of contract) are the definitive elements of the agreement. Rather, Article 2 explicitly invites incorporation by defining the content of an agreement to include trade

94. Alan Schwartz, *Incomplete Contracts*, 2 *New Palgrave Dictionary of Economics and Law* 277 (1997); Scott, *The Case for Formalism*, *supra* note 27, at 862-66.

95. See Stuart Macaulay, *Non-Contractual Relations in Business*, 28 *Am. Soc. Rev.* 555 (1963).

usage, prior dealings and the parties experiences in forming the contract. The parol evidence rule under the Code admits inferences from trade usage even if the express terms of the contract seem perfectly clear and are apparently "integrated."⁹⁶ The invitation to contextualize the contract in this manner is explicitly embodied in the Code's definition of agreement,⁹⁷ and it is amplified in section 1-205 which specifies that course of dealing and usages of trade give particular meaning to, and qualify terms of, an agreement.⁹⁸

It is important to emphasize that Llewellyn did not embrace commercial context as a method of filling gaps from an ex post perspective. He was not concerned with a subjective determination of what the particular parties "really meant" by their agreement. Rather, as a committed devotee of ex ante default rules, his purpose was to incorporate *rules* that would encourage efficient ex ante contracting. Unfortunately, this point was completely lost on those who subsequently wrote about and interpreted Llewellyn's statutory scheme. Since Llewellyn's purpose was to incorporate flexible and tailored defaults, he required a mechanism by which these local norms could be identified by courts. That mechanism was the merchant tribunal. Linked originally to his effort to substitute substantial performance in place of perfect tender, the merchant jury was a panel of experts that would find specific facts—such as whether the behavior of a contracting party was "commercially reasonable." To avoid questions of constitutionality, Llewellyn proposed to retain the lay jury as the final arbiter of the facts, informed by the merchant

96. U.C.C. § 2-202, cmt. 1, 2 (1995) ("This section definitely rejects . . . the requirement that a condition precedent to the admissibility of evidence [by course of dealing, usage of trade or by course of performance] is an original determination by the court that the language used is ambiguous. [Section 2-202(a)] makes admissible evidence of course of dealing, usage of trade and course of performance to explain or supplement the terms of any writing stating the agreement of the parties in order that the true understanding of the parties . . . may be reached."). See Charles J. Goetz & Robert E. Scott, *The Limits of Expanded Choice: An Analysis of the Interactions Between Express and Implied Contract Terms*, 73 Cal. L. Rev. 261, 273-280 (1985) [hereinafter "Goetz & Scott, *Expanded Choice*"].

97. U.C.C. § 1-201(3)(1995) defines "agreement" as "the bargain of the parties in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance as provided in this Act."

98. U.C.C. § 1-205(3) (1995). U.C.C. § 1-205 cmt. 1 (1995) provides that: [T]he meaning of the agreement is to be determined by the language used by them and by their action, read and interpreted in the light of commercial practices and other surrounding circumstances. The measure and background for interpretation are set by the commercial context, which may explain and supplement even the language of a formal or final writing.

Id.

tribunal's judgment about the relevant commercial working rules that applied to the particular dispute.⁹⁹

The idea of the merchant tribunal was entirely too radical for the commercial lawyers who dominated the ALI and the drafting process. By 1944, Llewellyn had abandoned this key device for discovering the relevant social norms, while still retaining the architecture of incorporation, including the injunction that parties conform their behavior to the supereminent norm of commercial reasonableness. Viewed in retrospect, eliminating the merchant jury while retaining the pervasive notion of commercial reasonableness was a drafting disaster.¹⁰⁰

But the failure to provide for the merchant jury is only a symptom of a larger jurisprudential mistake for which Llewellyn must be held at least partly responsible. Llewellyn believed that custom and usages—the by-laws of commercial practice—were indistinguishable from legal rules. Thus, when a court incorporated a relevant norm as the rule of decision in a contract dispute, this action would not, he assumed, change either the character or the utility of the norm itself.

99. Revised Uniform Sales Act, § 59-D(1) (Second Draft 1941) states “[T]he special finding of the merchant experts shall be received in evidence, and shall be sufficient to sustain the evidence.” In addition to the issue of substantial performance, the merchant tribunal was competent to opine on the effect of any mercantile usage on the terms of a contract, the mercantile reasonableness of any action by either party and “any other issue which requires for its competent determination special merchants knowledge rather than general knowledge.” See Revised Uniform Sales Act, § 59(1)(c),(d) (Second Draft 1941).

100. Jim Whitman has noted that the abandonment of the merchant tribunal was not accompanied by a similar jettisoning of the many issues that the tribunal was to decide:

But when the commissioners abandoned Section 59, they did not abandon a host of provisions that assumed the institutional framework of Section 59. Llewellyn's Code retained its deference to “custom,” the “law merchant,” “good faith” and “reasonableness.” In Llewellyn's Romantic vocabulary, however, “custom,” the “law merchant,” “good faith” and “reasonableness” were not terms of substantive law, but procedural directives, indications to a court that it should refer its decision to lay specialists with a feel for commercial law.

James Whitman, *Commercial Law and the American Volk: A Note on Llewellyn's German Sources for the Uniform Commercial Code*, 97 Yale L.J. 156, 174 (1987). Thus, while the idea behind the provisions on commercial reasonableness was that the merchant juries would, over time, develop default rules defining “reasonable” behavior in particular contexts, the absence of these juries has caused courts to rely on intuition. As a result, the norm of reasonableness has become a major source of non-uniformity in the application of the Code. *Id.* at 175. See also, Scott, *Uniformity Norm*, *supra* note 19, at 185 n.68 (In the overwhelming majority of sampled cases, courts did not attempt to examine evidence of the actual commercial context to determine commercially reasonable behavior. Rather, they viewed the commercial reasonableness question as requiring an deductive evaluation based on Code principles or other intuitions about reasonable behavior.).

To the contrary, however, there is growing evidence that social norms and legal rules, while both complements and substitutes, operate in different domains. These differences support the preferences of many contracting parties to be governed under separate regimes of bright-line legal default rules and flexible relational norms that are not legally enforceable.

There are several reasons why parties may wish to maintain the distinction between legal rules, enforceable by a third party, and self-enforcing social or relational norms. One important reason is that by explicitly writing flexibility into the contract as a legal rule the parties may actually *increase* the risk of opportunism in the relationship.¹⁰¹ Given the error costs of third-party enforcement, flexible legal standards are subject to opportunistic exploitation by the promisor. In other words, any default rule that makes the promisee's duty to cooperate a condition of the promisor's duty to perform will inevitably invite *both* cooperative responses from the promisee *and* opportunistic behavior from the promisor. For example, a promisor may be tempted to claim that the promisee's efforts to cooperate are inadequate thus justifying a suspension of the return performance.¹⁰² Since each party is both a promisee and a promisor, they have reciprocal motivations to avoid writing contracts with terms that increase contracting costs. It may be, therefore, that the lesson Llewellyn failed to learn is that contracting parties have learned to live under two sets of rules; a stricter set of legally enforceable rules and a more flexible set of self-enforcing relational norms. Any effort to judicialize these social and relational norms threatens to destroy the very informality and flexibility that makes them so effective in the first instance.¹⁰³

3. Rule Form and Structure in Article 2

Many observers have noted the striking differences in the rule form between Article 2 and the other substantive articles of the Code.

101. See Benjamin Klein, *Vertical Integration as Organizational Ownership: The Fisher Body-General Motors Relationship Revisited*, 4 J.L. Econ. & Org. 199, 203 (1988) ("Although writing down binding contract terms may . . . reduce the probability of being outside the self-enforcing range [of social and relational norms], the rigidity of long term contract terms may create a much larger hold-up potential if events actually place the parties outside the self-enforcing range. To avoid this rigidity transactors may intentionally leave their contracts incomplete and thereby give themselves 'an out' if market conditions 'get out of hand.'").

102. Goetz & Scott, *The Mitigation Principle*, *supra* note 84, at 982-84.

103. Scott, *Relational Theory*, *supra* note 29, at 613-15; Lisa Bernstein, *Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms*, 144 U. Pa. L. Rev. 1765 (1996) [hereinafter "Bernstein, *Merchant Law*"]; Omri Ben-Shahar, *The Tentative Case Against Flexibility in Commercial Law*, 66 U. Chi. L. Rev. 781 (1999) (arguing that incorporating flexible adjustments as legal rules increases enforcement costs to promisees).

Article 2 contains a large number of open-ended, vague admonitions and “muddy” rules. Many sections are little more than statements of principle that delegate broad discretion to courts to apply them to specific circumstances. The vague rules of Article 2 stand in sharp contrast to Llewellyn’s frequently expressed preference for precise, bright line rules in commercial law.¹⁰⁴

There are several obvious explanations for the many vague rules of Article 2. First, Llewellyn believed that codes differed from ordinary statutes in their resistance to amendment. A good code, therefore, facilitates “judicial development (not mere interpretation)” by stating broad principles and directing courts to reason from them by analogy.¹⁰⁵ Second, Article 2 applies to a wide range of contexts and parties. The greater the heterogeneity of the parties and the greater the variety of contexts to which a particular rule applies, the more convenient it is for a lawmaker to draft rules that are more open-ended and abstract.¹⁰⁶ But even beyond the number of vague rules that one would expect to find in such a broadly applicable statute, the rule form of Article 2 is a product of the political economy of its enactment. Article 2 was a “reformer dominated” process, one that was characterized by the virtual absence of pressure from external interest groups. The lack of interest group influence in shaping Article 2 default rules is easy to understand. Unlike, for example, the rules that govern classes of secured and unsecured creditors in Article 9, sales law applies equally to commercial buyers and sellers. Since contracting parties may at any point in time occupy either role, the new default rules of sales law did not excite the attention of defined interest groups of sellers or buyers.

The major influence on rule form in such circumstances is the tension between the interest of the dominant academic reformers (in this case, Llewellyn and his cohort) in securing the adoption of the reform proposals, on the one hand, and the normative values reflected in the proposals themselves, on the other. Under these conditions, the Schwartz/Scott model of private legislatures predicts that the private legislature will adopt reform proposals that contain many vague and muddy rules. These rules will result, not from their intrinsic merits, but from the compromises that reformer-dominated groups will accept in order to secure enactment.¹⁰⁷ In this way, Llewellyn’s abandonment of the merchant tribunal left his notions of commercial

104. Schwartz, *Origins of Contract Theory*, *supra* note 20, at 22-23.

105. Llewellyn, *On Warranty of Quality and Society II*, *supra* note 47, at 381. *See also* Twining, Karl Llewellyn, *supra* note 19, at 310-13.

106. In short, it is less costly for the drafter of a broadly applicable statute to instruct parties to behave “reasonably” than to draft clear, sensible rules for a large number of contexts. Schwartz & Scott, *Political Economy*, *supra* note 8, at 618.

107. Schwartz & Scott, *Political Economy*, *supra* note 8, at 615-21.

reasonableness without an anchor. Consider, for example, section 2-609. It provides that “when *reasonable* grounds for insecurity arise with respect to the performance of either party the other may in writing demand *adequate assurances* of due performance and until he receives such assurances may if *commercially reasonable* suspend his own performance. . . . (emphasis added).” Generations of law students have begun their study of the Code by confronting the facially vacuous nature of that default rule. Without a careful identification and incorporation of the relevant commercial context, the provision offers little in the way of a standardized risk allocation since it has little predictable meaning. For these and other reasons, the project of crafting flexible, tailored default rules failed in the implementation. But the vacuous nature of the provisions that invite incorporation nonetheless generated little opposition from the ALI and NCCUSL membership whose approval was critical to the enactment of the Code.

C. Article 2 and Freedom of Contract

Llewellyn’s views on freedom of contract were reflected in the early drafts of Article 2. His concern with “unbalanced” transactions prompted the creation of an obligation of good faith that, for merchants, imposes a duty to observe reasonable standards of fair dealing in the trade.¹⁰⁸ While he viewed standard form contracting as an efficient adaptation to a modern, mass production economy, he created the doctrine of unconscionability to encourage group policing (under judicial direction) of lopsided contract terms. In addition, the initial drafts reflected Llewellyn’s earlier, specific concerns with freedom of contract in allocating the risks of defective products. The early drafts imposed nonwaivable risks of product defects on sellers based either on their status as merchants, their specialized knowledge of the buyer’s needs, or on implied guarantees inferred from the process of describing the goods and/or their attributes.¹⁰⁹ This expanded warranty liability was, in turn, extended to remote sellers regardless of the absence of privity of contract.¹¹⁰

None of the proposals to further narrow the domain of free contract through mandatory (or “iron”) rules survived the drafting process. Implied warranties were expressly made disclaimable, either by the incorporation of custom or by the invocation of conspicuous “magic words.”¹¹¹ Warranty actions by disappointed buyers were generally limited to those sellers in privity of contract with the

108. U.C.C. § 2-103(1)(b) (2000).

109. See Revised Uniform Sales Act, (Second Draft 1941) §§ 15(2), (6).

110. *Id.* § 16-B.

111. U.C.C. § 2-316(2), (3)(a), (c) (2000).

plaintiff.¹¹² Finally, in significant places throughout the article—most notably in the Code's statement of normative purposes—the final drafts affirmed the principle of freedom of contract (and the concomitant right to contract out) as a fundamental norm of Article 2.¹¹³ To be sure, Article 2 retains the traditional, common law limits on bargaining.¹¹⁴ Formal rules, such as the statute of frauds and the parol evidence rule, are mandatory as are those provisions that incorporate traditional common law prohibitions on fraud and duress. But, viewed against the backdrop of the fundamental changes in the nature and form of sales law default rules, the statute is remarkably muted in its response to the problems of mass market, standardized contracting.

While this was the effect, it was not the intent. Llewellyn conceived of the unconscionability provision as the key method of policing unfair and unbalanced transactions. He wanted courts to undertake a two step process to identify those contracts that unconscionably violated group norms. The first step, now commonly denoted procedural unconscionability, is present when one party to the transaction has market power or when one side is more sophisticated or knowledgeable than the other.¹¹⁵ While he understood the value of competition in protecting buyers from unfair terms, Llewellyn believed that the race to the bottom stimulated by the "chiseler" would ultimately degrade even competitive markets. Thus, he saw the use of similar terms by all firms in a market as strong evidence of market failure. This *prima facie* evidence of procedural defects in the transactions would then justify asking whether the transaction was substantively unconscionable.

In Llewellyn's view, a transaction is substantively unconscionable if it is "unbalanced" or "lopsided." A lopsided contract imposes too many risks on one party. The key test of balance was the set of default terms ("yielding rules") that the law has developed over many years. "Bodies of yielding rules have grown some balance in their allocation of risks and rights."¹¹⁶ Thus, too much contracting out in transactions that were procedurally deficient rendered the transaction unbalanced. But this commitment to policing parties who contract out seems inconsistent with Llewellyn's other commitment to the specification

112. U.C.C. § 2-318 (Alternative A) (2000).

113. U.C.C. § 1-102(3) (2000) provides that "[t]he effect of provisions of this Act may be varied by agreement, except as otherwise provided in this Act. . . ." Comment 2 states that "[s]ubsection (3) states affirmatively at the outset that freedom of contract is a principle of the Code. . . ."

114. See, e.g., U.C.C. §§ 1-103, 2-721 (2000).

115. See Llewellyn, *The Effect of Legal Institutions*, *supra* note 43, at 671; Llewellyn, *What Price Contract*, *supra* note 50, at 731.

116. Llewellyn, *Book Review*, *supra* note 46, at 704.

of useful default rules that parties could accept or not at their option. Llewellyn's answer to this tension was instructive:

[T]he policy of leaving yielding rule[s] free to change by individuated bargain does not involve commitment to a policy of allowing displacement of the whole set of yielding rules at once, and without individuation. . . . [T]here must be decent balance in the frame of contracting which is to hold for all points not individuated by the parties."¹¹⁷

But how to determine how much contracting out is "too much?" Once again, the answer to this question could come only from the commercial context. The merchant group itself had an interest in policing the "contract-dodger" and they knew when a transaction was "unconscionably unbalanced." Thus, the merchant tribunal (or some reasonable substitute method of identifying group norms) was an essential component in the scheme to harmonize the commitment to incorporating ex ante default rules with the commitment to policing unfair bargains. As famously noted by Arthur Leff, the unconscionability doctrine, once removed from its anchor in actual commercial practices, was facially vacuous.¹¹⁸ Indeed, the only prima facie application of unconscionability that survived—the ban on consequential damages for personal injuries in the case of consumer goods—served to highlight the freedom to reallocate non-personal injury risks through standard repair and replacement clauses.¹¹⁹

In short, Llewellyn's Article 2, once it emerged from the private legislative process, was entirely congenial to the commercial interests whose eyes were fixed firmly on the prizes contained in Articles 3, 4, and 9. Some of the drafting compromises—for example, the decision to abandon the mandatory assignment of defective product risks to sellers—were no doubt prompted by Llewellyn's instinct to avoid concrete, bright-line rules that might jeopardize Article 2's approval by the more conservative members of the ALI and NCCUSL. On this view, it is not surprising that the vague unconscionability standard was the only surviving mechanism for regulating standard form contracting. But equally important to the political economy of the enactment process was the fact that Llewellyn was a product of his

117. *Id.*

118. Arthur A. Leff, *Unconscionability and the Code—The Emperor's New Clause*, 115 U. Pa. L. Rev. 485 (1967).

119. See U.C.C. § 2-719(1)(a), (3) (2000). It is unsurprising, therefore, that the unconscionability provision did not excite the opposition of merchants, either individually or collectively. This was especially true once Llewellyn's drafting ally, the commercial lawyer, Hiram Thomas, persuaded him that the U.C.C. § 2-302 standard for intervention should not be simply "unreasonable" terms but rather should be limited to those instances that truly "shock[ed] the conscience." Kamp, *Uptown Act*, *supra* note 63, at 306-07.

time. Our contemporary focus on protecting individual consumer interests through aggressive judicial policing of contracting behavior was simply inconsistent with his world-view. Llewellyn's view of the proper domain of free contract reflects the collectivist world-view that he shared with the other institutionalists. The regulatory structure of Article 2 is not designed to protect one class (consumers) against another (producers) because Llewellyn simply did not think in those terms. The doctrine of unconscionability was designed to assist working groups engaged in commerce to police the "chiselers" in their midst by testifying to the shocking nature of the terms used in lopsided contracts. In sum, Llewellyn's regulatory scheme for Article 2 was to empower merchants collectively rather than to empower consumers individually.¹²⁰

D. Summary

The dramatic success of the Code project following its approval by the ALI and NCCUSL in 1951 is a thoroughly familiar story. Pennsylvania adopted the Code in 1952 but no states followed suit until the New York Law Revision Report in 1956 prompted changes (principally in Articles 3 through 9) that responded to concerns of the commercial interests whose support was critical to adoption by the states. Thereafter, success was rapid. By 1967, every state except Louisiana had adopted the Code and, at least in a formal sense, uniformity in commercial law had been achieved.

Karl Llewellyn's active role in Article 2 and the Code project ended in the early 1950's, but his achievement in rescuing the default rules of sales law from the artificialities of the Sales Act was immediately apparent. There were (and are) measurable efficiency gains that inhere in a uniform scheme of ex ante efficient default rules. Prime among these are the reduction in "learning effects" (the costs involved in learning about how best to use and deploy novel terms) that result from a common legal language and method of categorization of legal rules.¹²¹ This notion of a uniform "filing system" that permits the storage and retrieval of key information was one of the strongest justifications offered by Llewellyn in the 1950's for the adoption of a uniform sales law.¹²² As courts began to decide cases under the Code throughout the latter half of the century, specific court decisions were filed under the broad rubric of Code-defined

120. Kamp, *Between-The-Wars Social Thought*, *supra* note 51, at 392-93.

121. See Steven D. Walt, *Novelty and the Risks of Uniform Sales Law*, 39 Va. J. Int'l L. 671 (1999); Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 Va. L. Rev. 757, 786-89 (1995).

122. Karl Llewellyn, *Why We Need the Uniform Commercial Code*, 10 U. Fla. L. Rev. 367, 369 (1957).

categories such as rejection, cure, revocation of acceptance, etc. This systematizing of the retrieval of legal rules reduced the information costs imposed by the jurisdictional diversity that governed the pre-Code era.

But despite the Code's initial comparative advantage, a similar movement toward interjurisdictional uniformity evolved in the common law over the same period. Indeed, the past fifty years have witnessed a remarkable degree of harmonization of American commercial common law. The variations in contract law from state to state today are relatively small and insignificant. The result outside the Code over the same period of time, therefore, has been substantive harmony without uniformity.¹²³ Thus, in one sense, the benefits of Article 2 have now been internalized in the common law process, exposing the deficiencies inherent in the statute. Those deficiencies, in the end, may have contributed to the decision by many commercial parties to abandon Article 2 and its open-ended default rules in favor of more concrete, privately devised alternatives. At the same time, the debate over freedom of contract, especially in the regulation of standardized contracting, has intensified. Whether these two forces are primary causal factors in the decline of the Code's relevance and the ultimate failure of the revision process remains an open question. But it seems hard to deny that they are salient contributing factors in explaining the dramatically different environment that surrounds the private legislative process today.

III. ARTICLE 2 FIFTY YEARS LATER

A. *The Article 2 Revision Process*

Article 2 needs revision. This uncontested fact has been self-evident for two decades. This is not to say that Article 2 has functioned inadequately as a framework for cataloguing judicial decisions in sales contract disputes. Indeed, a number of contemporary scholars believe that the statute has performed well in directing courts as to the best means of filling the gaps in incomplete contracts and policing unconscionable bargains.¹²⁴ But whatever

123. Scott, *Uniformity Norm*, *supra* note 19, at 167-69.

124. The Code's defenders far outnumber its critics, even among those who are dismayed by the failure of the current revision process. The comments of Professor Melvin Eisenberg in the ALI members web site forum sum up this majority view: "I should add that if the result [of the current deadlock] is no revision of Article 2, that's not the worst thing in the world. Article 2 works well now, and whatever serious drafting flaws it had have by and large been fixed up by the courts. Of course a minor tuneup would probably be desirable, but it's not imperative, and very little will be lost by sticking with Article 2 as it stands." Melvin Eisenberg,

one's views on these questions, it is clear that the information revolution threatens to leave Article 2 in an increasingly small backwater of commercial transactions. If the statute is to retain its primacy as a source of legal defaults that both facilitate and regulate commercial sales transactions, it must be adapted to technological and economic developments that have created entirely new markets in information technology. The original scope provision of Article 2—covering all transactions in goods—seems inadequate, even with its subsequent common law gloss, to answer fundamental jurisdictional questions.¹²⁵ Does or should Article 2 govern information contracting? If not, what is the domain of Article 2 as distinct from the domain of alternative statutory or common law rules governing software licensing transactions?¹²⁶

ALI Members Forum on U.C.C. Article 2 (posted Oct. 19, 2001) *available at* <http://www.ali.org/forum/forum.htm> [on file with author].

125. U.C.C. § 2-102 (2000) provides that “this Article applies to transactions in goods.” Goods, in turn, are defined in U.C.C. § 2-105 (2000) as “all things movable at the time of identification to the contract.” Thus, Article 2 by its terms declines to resolve the issue of jurisdiction over “mixed” transactions, such as transactions involving both a sale of goods and the provision of services. Many courts have settled on two tests to provide more clarity to scope disputes. The “divisibility” test asks whether the transaction can be separated into its goods and non-goods components. If so, then Article 2 applies to the portion of the contract dealing with goods and other relevant state law (typically the common law of contracts) applies to the non-goods components. Where the goods portion of a transaction cannot be separated functionally, most courts apply a “predominant factor” test that asks which component of the mixed transaction—goods or non-goods—predominates. The predominant component determines which legal regime applies. *See, e.g.,* Valley Farmers’ Elevator v. Lindsay Bros. Co. v. Martin Steel Corp., 398 N.W. 2d 553 (Minn. 1987); *but see* Elkins Manor Assoc. v. Eleanor Concrete Works, Inc., 396 S.E. 2d 463 (W.Va. 1990) (declining to use the predominant factor test because the “test is too subjective to provide any basis for rational analysis” *Id.* at 469.).

126. The original scope provision was unchanged in the version of the 2001 Amendments to Article 2 that was adopted by the ALI membership in May 2001. All attempts to draft a clearer and more definitive scope provision that drew lines between the coverage of Article 2 and the coverage of other law dealing with information and software transactions fell victim to interest group competition. Lobbying by the representatives of the software and information industries was successful in persuading the Article 2 drafting committee at the NCCUSL annual meeting in August 2001 to change its position and recommend a new scope provision negotiated and drafted that day. As noted above, the new provision survived a motion to delete, but a motion necessary to obtain NCCUSL approval of the entire package failed. Subsequently, the drafting committee forged a new compromise, one that left the original scope provision unchanged, but amended the definition of goods in U.C.C. § 2-103 (formerly U.C.C. § 2-105) to exclude information. This version was approved by NCCUSL at its annual meeting in August 2002. By leaving “information” undefined, the compromise purports to leave to the courts the task of defining the line of demarcation between goods and computer information transactions.

In 1987, the Permanent Editorial Board for the Uniform Commercial Code set out to resolve these and other questions under the auspices of a study committee. The study committee concluded that Article 2 was not an adequate legal framework for addressing the many unique issues raised by software licensing transactions. In 1991, acting upon the report and recommendation of the study committee, the ALI and NCCUSL appointed a drafting committee to begin work on a comprehensive revision of Article 2, that, among other things, would bring within the scope of Article 2 the provisions on lease transactions that were then embodied in Article 2A, and would also include provisions to address the unique characteristics of software licensing transactions. The Article 2 Drafting Committee worked for several years on this "hub and spoke" scheme for incorporating all relevant transactions within the Article 2 umbrella. But the effort was abandoned when key insiders concluded that the differences between the products, their markets and practices made the draft unworkable.¹²⁷ The ALI and NCCUSL then decided to return leases to its own statute (Article 2A) and also to draft a separate U.C.C. Article 2B for computer information contracts. Separate drafting committees were thus appointed for each of Article 2, Article 2A and Article 2B and the drafting work proceeded on parallel, but separate, tracks.

The first public indication that the private legislative coalition that had supported the U.C.C. project for fifty years was beginning to unravel surfaced in 1999 when proposed Article 2B was brought forward by the drafting committee for final approval by the ALI and NCCUSL. The ALI declined to approve Article 2B on the ground that the drafting process, dominated by the software and information industry, had produced a "seller-friendly" statute. NCCUSL, on the other hand, decided to go forward with the project on its own, reissuing the statute as the Uniform Computer Information Transactions Act (UCITA). The controversy over UCITA centers on the provisions of the statute dealing with contract formation in standardized retail transactions. UCITA endorses current market practices in which consumers signify advance acceptance of subsequently disclosed terms.¹²⁸ Subsequently, UCITA has been

127. Speidel, *View from the Trenches*, *supra* note 5, at 612-13.

128. The subsequently disclosed terms typically have provisions by which sellers or licensors seek to limit their warranty liability and/or limit the buyer/licensee's remedies for "bugs" or defects in software or other "smart" goods. Thus, at bottom, the issue has to do with the extension of Article 2 warranty liability to software and computer information providers and the mechanisms by which that liability can be shifted (in whole or in part). See Jean Braucher, *Uniform Computer Information Transactions Act (UCITA): Objections from the Consumer Perspective*, 5 No. 6 GLCY Law 2 (2000); James C. McKay, Jr., *UCITA and the Consumer: A Response to Professor Braucher*, 5 No. 8 GLCY Law 9 (2000); Michael L. Rustad, *Making*

adopted in Virginia and Maryland, but has encountered stiff opposition from consumer interests in other jurisdictions.¹²⁹

The split between the ALI and NCCUSL broke into the open in the summer of 1999 when revised Article 2 and 2A were brought forward for final approval. Revised Articles 2 and 2A were approved

UCITA More Consumer-Friendly, 18 J. Marshall J. Computer & Info. L. 547 (1999).

129. In an effort to respond to some of these concerns, the NCCUSL Standby Committee issued a report in December 2001 detailing recommendations concerning proposed amendments to UCITA that it planned to make to NCCUSL at its Summer 2002 meeting. On January 30, 2002 an ABA Working Group appointed by the ABA Board of Governors filed a report on UCITA, concluding that it would be desirable to have a uniform law that set forth legal rules governing licensing in computer transactions. But the working group also raised a number of critical concerns both with the alleged lack of clarity of UCITA's terms and with the policy judgments implicit in specific provisions, particularly those governing scope and contract formation in retail transactions. See American Bar Association Working Group Report on the Uniform Computer Information Transactions Act (Jan. 31, 2002). According to the dissenting member of the working group, the disagreements within the ABA are a reflection of interest group competition between the computer information industry on the one hand and representatives of large firm licensees (and their lawyers) on the other: "The key policy issue that confronts the Board of Governors in reviewing the Working Group's report is whether narrow parochial interest groups that have failed to win policy or political arguments in the . . . drafting process will have a second chance to defeat . . . a NCCUSL approved statute." See Minority Report of Donald Cohn at 6.

Contrast the current interest group clash over UCITA with the original efforts by Llewellyn to enact Article 2. Interest group competition of this sort did not emerge, as Llewellyn recognized, because "the same parties and the same types of party can tomorrow be occupying each the other end of similar disputes." K.N. Llewellyn, *Across Sales on Horseback*, 52 Harv. L. Rev. 725-27 (1939). In short, since parties to commercial sales transactions are both buyers and sellers, there is no reason to believe that one group or class is distributionally disadvantaged over the other. That symmetry of effects is clearly not present in the battle between the large firm licensors of computer information and their licensees.

Thus, the UCITA project is a further example of the effects of interest group competition in the private legislative process. The Schwartz/Scott model would predict continuing deadlock within the three key private legislative groups—the ABA, the ALI and NCCUSL—over the enactment of a statutory scheme governing computer information transactions. Much as with the Article 2 revisions, the debate over UCITA centers on the question of the appropriate domain of freedom of contract in mass market license transactions. In the words of dissenting member Cohn:

UCITA is and has always been intended as a commercial statute. Some interest groups have attempted to change UCITA into a national uniform consumer protection statute. The problem . . . is a desire on the part of various interest groups to require UCITA to include mandatory, non-waivable provisions to protect their constituents, even large companies that do not need this type of protection. The underlying current in the opposition to UCITA is a desire for more mandatory provisions and not less. More restrictions on freedom of contract and not less.

Minority Report of Donald Cohn at 8-9.

by the ALI in May 1999 but, after encountering severe opposition from industry interests, the leadership of NCCUSL suddenly withdrew the drafts from consideration during its annual meeting two months later.¹³⁰ This action, in turn, prompted the Reporter and Associate Reporter for the Revised Article 2 to resign.¹³¹ In an attempt to patch the tattered alliance together, ALI and NCCUSL agreed on a newly reconstituted drafting committee covering both articles, which was directed to focus on “non-controversial,” technical amendments to the existing statute.¹³² Two years later, the new committee brought forward the Proposed 2001 Amendments to Article 2, which were approved (subject to several minor amendments) by the ALI in May 2001. Despite the uncertainties surrounding the jurisdiction of Article 2, UCITA, or the common law over transactions in information products, especially “smart goods” that contain and are often controlled by computer programs, the drafting committee decided to retain Article 2’s original, open-ended scope provision.¹³³ That decision was primarily a pragmatic acceptance of the status quo since intense interest group competition was able to block the more precise, bright-line alternatives suggested by either side.

Following the ALI vote, the software and information interests continued to lobby NCCUSL for changes in the scope provision. Their interests were to prevent validation in the new Article 2 of judicial decisions that applied (directly or by analogy) “buyer-friendly” provisions of Article 2 to transactions in information and, concomitantly, to have the Article 2 amendments acknowledge the existence and applicability of UCITA.¹³⁴ At the NCCUSL annual meeting in August, the drafting committee agreed on new scope language that, while not referring to UCITA, parallels to some extent the structure and substance of the UCITA scope provision. Brought to the floor, the new scope provision survived a motion to delete by a vote of sixty to ninety-eight. NCCUSL also effectively reversed the

130. There are differing explanations for the sudden decision by the NCCUSL leadership to withdraw the July, 1999 draft. The Reporter of the Article 2 drafting committee believes that the action followed a threat by the so called “strong” sellers (i.e. General Electric and the Automobile Manufacturer’s Association) to oppose the draft, if approved, in every state legislature. See Speidel, *View from the Trenches*, *supra* note 5, at 611, 617-18.

131. *Id.*

132. *Id.* at 615-17. As reported by the Director of the ALI to its members, the drafting committee was asked “to preserve the substantive gains in the [earlier] version while restoring some of the language of the original Article 2 with which lawyers and business people are comfortable.” Letter from Lance Liebman, ALI Director, to the Members of the ALI (Sept. 17, 1999) (on file with author).

133. See U.C.C. § 2-102 (2000).

134. Liebman, *Introduction*, *supra* note 4, at 1.

ALI floor amendments to the statute of frauds and liquidated damages provisions. Finally, a motion to approve the new Article 2 failed by a vote of fifty-three to eighty-nine,¹³⁵ an action subsequently described as the “left joining the right to beat up on the middle.”¹³⁶

In the months that followed, the drafting committee forged a new compromise that amended the definition of “goods” to exclude “information.”¹³⁷ By leaving “information” undefined, the compromise delegates to the courts the task of separating goods from computer information transactions. This version of the Amendments was approved by NCCUSL at its annual meeting in August 2002. Thus, the deadlock over scope was broken but only by virtue of a strategy that carefully preserves the status quo in the ongoing competition over the regulation of computer information transactions.

The open split between the ALI and NCCUSL is merely a symptom of the intense interest group competition that has emerged during the Article 2 revision process. Retail manufacturing interests (the so-called “strong” sellers), opposed to provisions that extended warranty liability for economic loss to remote sellers, were able successfully to block the adoption of the initial revisions to Article 2. In turn, consumer interests (including large firm licensees) opposed to the “seller-friendly” provisions in the proposed Article 2B, were able to separate the computer information article from the rest of the U.C.C. project. From there the battleground moved to rival efforts to either secure or block the further enactment of UCITA. This included the tug-of-war over efforts to acknowledge UCITA in the scope provisions of the revised Article 2. Thus, even in the effort to bring forward the seemingly uncontroversial Amendments to Article 2, each side was able to block approval of the other’s proposals but unable to secure approval of its own. The competition among interest groups continues to block significant revision of Article 2, supporting the prediction that private legislatures are strongly biased toward the status quo whenever their proposals encounter such competition.¹³⁸

It is unlikely that Article 2 will ever be revised so as to deal directly with any of the unique problems presented by the new technology. Whatever happens in the future, therefore, non-Code legal regimes will be called upon to resolve the increasingly intense normative debate over the domain of free contract in retail computer

135. *Id.* at 2.

136. Email from Chris Hoving, Managing Editor to UCCLaw-1@lists.washlaw.edu (Aug. 14, 2001) [on file with author].

137. See Preliminary Comment to proposed U.C.C. § 2-103: “the definition of goods has been amended to exclude information not associated with goods. . . . For example, the sale of “smart goods” such as an automobile is a transaction in goods. . . . On the other hand, an architect’s provision of architectural plans on a diskette would not be a transaction in goods.”

138. Schwartz & Scott, *Political Economy*, *supra* note 8, at 633-37.

information transactions as well as to specify the default rules to fill gaps in commercial information transactions. We are left with three questions: First, what happened in the intervening fifty years to change a reformer dominated process, with little interest group involvement, to a process dominated by competing interest groups? Second, why has the resulting deadlock generated such little interest beyond the affected interest groups and the academic reformers who are active participants in the private legislative process? Third, assuming the causes of deadlock and indifference can be identified, what adverse effects on contracting are the likely consequences?

B. Interest Group Competition over the Domain of Free Contract

There are, no doubt, many reasons why the debate over how best to regulate standardized contracting was framed as a “technical” or “practical” problem in 1950, but emerged as a sharp clash over values fifty years later. One of the salient facts, however, is that Llewellyn’s solution to the tension between the freedom to contract out from legal defaults and the regulation of “unbalanced” transactions depended heavily on his institutionalist perspective. Llewellyn saw groups, rather than individuals, as the key unit of analysis. The question that interested him was “how do groups work?” He found the answer to this question in the group norms that were the source of the tailored defaults (“working rules”) that permit flexible adaptation within those groups. At the same time, these norms were the means of regulating the outlier behavior of “contract-dodgers and chiselers.” Article 2 incorporates this institutionalist conception through its focus on the trade usages and commercial practices of groups of merchants. In that sense, the contemporary notion of interest groups—individuals bound together not by what work they do but by their effort to secure common political outcomes, was simply foreign to Llewellyn and the social scientists who influenced him. As Allen Kamp puts it, “The consumer group is a product of our consumption-driven, individualistic society. It is hard to reconceptualize the Code to include it.”¹³⁹

139. Kamp, *Between-the-Wars Social Thought*, *supra* note 51, at 347. The most vivid illustration of this methodological divide has been the experience with the doctrine of unconscionability. The unconscionability provision as it has come to be applied by courts bears little relation to its original conception. Most courts have adopted Llewellyn’s two part test, but have applied the doctrine more narrowly than he envisioned. See David L. Shapiro, *Courts, Legislatures, and Paternalism*, 74 Va. L. Rev. 519, 534-35 (1988) (“Despite the charter granted to the courts by the Code’s unconscionability provision, such decisions remain especially rare in the realm of commercial and consumer sales.”). Procedural unconscionability has been most commonly found in standard form contracts where significant risks are shifted from sellers to buyers through inconspicuous and/or obscure terms. In turn, courts

Contemporary analysis has shifted to a focus on methodological individualism. Neoclassical economics justifies default rules by reference to the savings that they offer to bargainers who need not specify an alternative allocation of risks and by the freedom of idiosyncratic bargainers to opt out. Consumer advocates argue for judicial regulation of standardized contracts on the grounds that individual assent is absent. In both cases, therefore, autonomy interests justify conflicting policy prescriptions: the "right" to contract out on the one hand, and the "right" toicker individually over contract terms on the other. In a world that focuses on "rights," the normative objectives of filling gaps with efficient defaults and regulating unbalanced bargains are fundamentally in conflict. It is unsurprising, therefore, that a single statutory scheme can no longer accommodate both objectives without stimulating value conflicts that the private legislative process is ill suited to resolve. In sum, Llewellyn's Article 2 assumes that there are "technical" resolutions to contested normative questions. The private legislative process is peculiarly ill equipped to deal with the regulation of consumer transactions precisely because it lacks the capacity to accommodate the underlying, competing values.

C. The "Corbinization" of Article 2 Default Rules and the Exit of Commercial Contracting

We can only speculate about why so few seem to care about the deadlock in the Article 2 revision process. What we do know is that the incorporation mechanism introduced by Llewellyn has not functioned as he intended. Llewellyn intended the key instruction to courts—focus on commercially reasonable merchant practices—as a

find such risk allocations substantively unconscionable if the risk in question materializes. Viewed ex post, therefore, the two tests are effectively collapsed into one. In effect, the unconscionability doctrine has become a straightforward extension of the common law doctrine of fraudulent concealment, designed to police the practice of "concealing" key terms in standardized agreements. The lesson for sellers in mass market transactions, therefore, has been to use bold print, clear language and other similar prophylactics to insulate important risk allocations from subsequent attack. In sum, unconscionability has become an ex post litigation strategy by which individual consumers can shift losses back to careless sellers. But the unconscionability litigation has failed to generate any new legal rules that redraw the boundaries of free contract in mass market transactions. See Melvin A. Eisenberg, *The Bargain Principle and its Limits*, 95 Harv. L. Rev. 741, 752 (1982) ("... the effect (if not the purpose) of this distinction [between procedural and substantive unconscionability] ... was to domesticate unconscionability by accepting the concept insofar as it could be made harmonious with the bargain principle (that is, insofar as it was 'procedural'), while rejecting its wider implication that in appropriate cases the courts might review bargains for fairness of terms.").

direction to examine the relevant contracting environment and then (presumably over time) to announce ex ante defaults that would apply to particular populations of commercial parties.¹⁴⁰ But the abandonment of the merchant tribunal doomed this effort from the start. There is substantial evidence that courts have consistently interpreted these statutory instructions not as directions to incorporate commercial norms but rather as invitations to use context as a source of subjective meaning—a determination of what the parties to the particular dispute “must have meant” by their agreement.¹⁴¹

There are several reasons why this ex post perspective has been the dominant interpretive strategy under the Code. I have argued elsewhere that one reason was the (primarily instrumental) decision by Llewellyn and his colleagues to create a “true commercial code.”¹⁴² To the extent that a code is a preemptive, systematic and comprehensive enactment of a field of law, it dictates a different interpretive methodology than that of the common law or ordinary commercial statutes. When a court in interpreting a code confronts a gap in an incomplete contract, its duty is to use the processes of analogy and extrapolation to find a solution consistent with the purposes and policy of the codifying law. In this way, the code itself

140. James Whitman, *Commercial Law and the American Volk: A Note on Llewellyn's German Sources for the Uniform Commercial Code*, 97 Yale L.J. 156, 174 (“In Llewellyn’s Romantic vocabulary, however, ‘custom,’ ‘the law merchant’ and ‘reasonableness’ were not terms of substantive law, but procedural directives, indications to a court that it should refer its decision to lay specialists with a feel for commercial law.” *Id.*); Schwartz & Scott, *Sales Law and the Contracting Process*, *supra* note 82, at 5 (“[T]he admonition to act in a commercially reasonable manner functions . . . as an empirical directive: to decide if the parties have acted in a commercially reasonable manner, the decision maker must look to the marketplace and observe relevant commercial behavior [to determine the legal norm].”).

141. A LEXIS search for cases of the past ten years that invoke commercial reasonableness in close conjunction with the mention of at least one Article 2 section returned 164 hits. A detailed examination of fifty-five cases randomly selected from this base pool revealed only two cases where the court viewed the commercial reasonableness question as requiring an inquiry into actual commercial practice. In eighteen other cases, the court used an intuitive, subjective approach, evaluating commercial reasonableness in terms of whether the particular contracting parties acted reasonably under the contextual circumstances. The remaining cases either dealt tangentially with commercial reasonableness or dealt principally with commercial reasonableness under other sections of the Code. See Scott, *Uniformity Norm*, *supra* note 19, at n.68.

142. Scott, *Uniformity Norm*, *supra* note 19, at 166, 170-72. The decision to create a code was combined with the political instincts not to publicize the project as a codification. William Hawkland, who served as Llewellyn’s research assistant, suggests that if Llewellyn had publicized his intention to codify the commercial law, the U.C.C. “probably would have died aborning.” Hawkland, *U.C.C. and Civil Codes*, *supra* note 71, at 231, 233 (1995).

provides the best evidence of what it means.¹⁴³ In other words, a code has a systematic method of filling gaps through a self-referential process that divines the purposes of the enactment. In the U.C.C., this methodology is specified in section 1-102, which directs courts to liberally construe and apply the specific provisions of the act "to promote its underlying purposes and policies."¹⁴⁴ In short, the Code not only has the force of law but it is a source of law.¹⁴⁵ The net effect of this institutional design is a highly contextualized interpretive methodology, one that embeds the explicit terms of a contract within the larger jurisprudential context of the Code as well as within the specific commercial context.

In addition, subjective modes of interpretation were widely accepted by many, if not most of the contract scholars who opined on the meaning of the new statute. Following the lead of Arthur Corbin, courts interpreting the Code were advised to use context evidence to ascertain the mental states of the parties. To Corbin and other Code commentators, therefore, context was an occasion for recovering the intention of the parties in litigation, not an occasion for promulgating default rules derived from commercial practices.¹⁴⁶ Courts thus disregarded Llewellyn's intention that, in construing the meaning of sales contracts, a court should focus on what the relevant usage of trade took the contract to mean and not on what the parties mentally intended. As Dennis Patterson has pointed out, Llewellyn's search for ex ante default rules was closer to Williston than to the post-Code adherents of subjective intention.¹⁴⁷

Whatever the merits of such an ex post strategy in ensuring a just resolution of disputes between contesting parties, the method carries costs for future contracting parties who are less able to devise "working rules" for predicting how contractual terms and language will be interpreted in subsequent transactions.¹⁴⁸ The irony, in the

143. Hawkland, *U.C.C. and Civil Codes*, supra note 71, at 233-35; William D. Hawkland, *Uniform Commercial "Code" Methodology*, 1962 U. Ill. L. F. 291 (1962).

144. U.C.C. § 1-102 (1995).

145. Mitchell Franklin, *On the Legal Method of the Uniform Commercial Code*, 16 Law & Contemp. Prob. 330, 333 (1951).

146. See, e.g., 3 A. Corbin, *Corbin on Contracts* § 538 (1960).

147. Dennis M. Patterson, *Good Faith, Lender Liability, and Discretionary Acceleration: Of Llewellyn, Wittgenstein, and the Uniform Commercial Code*, 68 Tex. L. Rev. 169, 189-90 (1989).

148. Interpretive questions are complex and this complexity has obscured the scholarly debate over the choice between contextual and textual modes of interpretation. To begin to sort the problems out, consider two polar interpretive stances: (a) pure textualism: The interpreter considers only a contract's written text when deciding what the contract directed; (b) pure contextualism: The interpreter does not privilege the written words over any other relevant evidence of the parties' intentions, such as the negotiations that preceded the contract, the parties practice

under it, and any customary meaning of a contract term. Courts properly reject both "pure" interpretive stances. Words derive meaning from the context in which they are used, thereby justifying a court in rejecting pure textualism. On the other hand, the writing often is the best evidence of the parties' intentions because parties *intend* the writing to be the best evidence, thereby justifying a court in rejecting "pure" contextualism. The interesting questions, therefore, concern where an interpreter should locate herself on the continuum between pure textualism and pure contextualism. See Alan Schwartz & Robert E. Scott, *Contract Theory and The Limits of Contract Law* (forthcoming 2002).

In answering this question, it is useful to identify three canonical cases where courts will be called upon to interpret the meaning of incomplete contracts. The first case involves the interpretation of contract terms that are linguistically vague or ambiguous. When a single contract term has more than one possible meaning, the same set of factual conditions may generate alternate sets of prescribed consequences. Such ambiguity is normally unintended. Thus, in most instances, had the possibility of the dispute-triggering conditions been pointed out in advance, the parties could have reformulated the terms so as to remove the ambiguity and would have preferred to so rectify the error. When unresolvable controversies arise over the meaning of "ambiguous" contractual language, the parties must resort to a third party interpreter. A classic example of this first interpretive task is *Frigalment Importing Co. v. B.N.S. Int'l Sales Corp.*, 190 F. Supp 116 (S.D.N.Y. 1960) ("The issue is, what is chicken?"). Here contextual evidence is generally admissible on the sensible grounds that it produces greater accuracy in ascertaining the parties intentions. There is a trade-off, however, between accurate interpretation of the disputed contract and the promulgation of interpretive rules (such as the plain meaning rule) designed to encourage cost-effective precautions in contract drafting.

A second interpretive challenge arises when the parties dispute the meaning of facially unambiguous express contract language that purports to opt out of a state-created or customary default rule. Thus, for example, a seller may urge the enforcement of a contract term that calls for the buyer to purchase 70,000 cubic yards of cement. The contract further provides that "no conditions which are not incorporated in this contract will be recognized." The buyer defends by claiming that, customarily, parties in the trade understand such quantity terms as only estimates subject to renegotiation. See *Southern Concrete Services, Inc. v. Mableton Contractors, Inc.*, 407 F. Supp. 581 (N.D. Ga. 1975). Here the risk is that, unless the court privileges the written agreement by excluding the contextual evidence, parties such as the buyer will be motivated to dispute the meaning of perfectly communicative contract terms as a strategic response to a now disfavored contract.

The third canonical case has not been well recognized by courts or commentators. The contract may be incomplete because it is insufficiently "state contingent," that is, there are a number of possible future states about which the contract is silent. In this case, a court intent on admitting context evidence to determine the parties actual intent will do damage to future contracting *if* it completes the contract in a way that the parties themselves never would have agreed to. Thus, for example, if a buyer cannot observe or verify the value of a relevant economic parameter, such as the seller's costs, the buyer will reject a contract that conditions on that parameter because of the risk that the seller will behave strategically. Here, a contextualist interpretive approach increases the risk of ex post strategic behavior relative to a textualist approach. Thus, there is a trade-off between the presumed benefits of greater accuracy in finding what the parties at bar intended and the likelihood that parties in general will be induced by a court's

case of a uniform code, is that the ex post method impairs genuine, "substantive uniformity." An interpretation is "substantively uniform" when it is transparent to the litigating parties and predictable to other parties. Uniform interpretation thus has both a jurisdictional and a temporal dimension. One uniformity value is for parties to know at the time they write contracts that their verifiable obligations will be interpreted in the same manner by courts in different jurisdictions. In addition, uniformity values are enhanced if parties are certain that courts in any given jurisdiction will interpret their verifiable obligations uniformly over time. If the state performs this function inconsistently, the costs of contracting will rise.¹⁴⁹

Casual observation suggests that the risk of unpredictable interpretation has increased for commercial parties under the Code. Courts under the Code have interpreted the meaning of express terms in a contract by looking to the commercial context to determine what the words mean. While this may seem perfectly logical (the parties negotiated the contract in a particular context, so courts should look to that context to determine what the parties meant by the words they used), this interpretive approach injects a bias into the process. Giving the commercial context interpretive priority subverts the efforts of those commercial parties who wish to opt out of the relevant commercial context.¹⁵⁰ Moreover, these uncertainty and error costs are not the sole effects of interpretation bias under the Code. An ex post or subjective strategy of interpretation also undermines Llewellyn's original goal of increasing the supply of legally sanctioned default terms that subsequent parties could use in formulating their agreements.

Uncertainty is a deadweight cost and contracting parties have substantial incentives to reduce these contracting costs. Whether causally linked or not, the dominance of ex post interpretation has coincided with the exit from the Code by important classes of commercial parties. Exit has taken several different forms. Commercial trade associations are able to solve the collective action problems that otherwise impede contractual innovation.¹⁵¹ They have

interpretive rules to shift to less efficient contracts. *Id.*

149. Scott, *Uniformity Norm*, *supra* note 19, at 152.

150. *Id.* at 164. See, e.g., *Brunswick Box Co. v. Coutinho, Caro & Co.*, 617 F.2d 355 (4th Cir. 1980); *Steuber Co. v. Hercules, Inc.*, 646 F.2d 1093 (5th Cir. 1981); *Nanakuli Paving & Rock Co. v. Shell Oil Co.*, 664 F.2d 772 (9th Cir. 1981); *Columbia Nitrogen Corp. v. Royster*, 451 F.2d 3 (4th Cir. 1971); *Modine Mfg. Co. v. North E. Indep. Sch. Dist.*, 503 S.W.2d 833 (Tex. Civ. App. 1975).

151. A transition to new default terms and different interpretive rules requires parties to first develop and then groups of contractors to coordinate their joint adoption of a standard formulation of the novel terms. So long as parties must bear the full costs of developing novel contract terms but are incapable of capturing the full benefits of their innovative efforts, novel terms will be under-produced. Goetz

devised substitute sets of substantive rules for intragroup transactions that are made subject to binding arbitration. The trade rules governing the contracts between members of the National Grain and Feed Association,¹⁵² the American Cotton Shippers Association and the American Textile Manufacturers Institute,¹⁵³ and many other trade associations,¹⁵⁴ create private legal systems for resolving contract disputes among themselves. These rules substitute clear, bright-line rules and objective modes of interpretation in place of the Code's vague rules and subjective, contextualized approach to interpretation.¹⁵⁵ For whatever reason, these groups evidence a preference for acontextual (and thus more certain) modes of interpretation. In so doing, they decline to judicialize the more flexible relational norms that control strategic behavior in their ongoing relationships.¹⁵⁶

Parties to inter-industry contracts generally cannot (and do not) opt out of the Code entirely. But they can and do opt out of the Code's ill-fitting default rules and its preference for highly contextualized interpretation. Here the strategy is to develop standard terms that create customized risk allocations for commonly arising risks, such as the risk of product defects. There are a number of common examples of these customized terms. The standard "repair and replacement" clause replaces the Code's warranty rules as well as the rules governing rejection and cure. This standard provision governs most commercial equipment sales today.¹⁵⁷ Exculpatory or

& Scott, *Expanded Choice*, *supra* note 96, at 283-86.

152. Bernstein, *Merchant Law*, *supra* note 103, at 1772-77.

153. Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Creating Cooperation through Rules, Norms and Institutions*, 99 Mich. L. Rev. 1724 (2001).

154. A number of other trade associations have codified trade rules that govern intra-industry contracts and that are subject to arbitration under trade-specified rules of interpretation. See, e.g., American Fats and Oils Association, American Tin Trade Association, Association of Food Industries, Diamond Dealers Club, General Arbitration Council of the Textile and Apparel Industries (Worth Street Rules), National Hay Association, North American Lumber Association, Rubber Trade Association, Tea Association of the USA. See Bernstein, *Merchant Law*, *supra* note 103, at 1772-77 n.134.

155. In enforcing arbitration agreements under the Federal Arbitration Act, the Supreme Court has held that arbitration procedures, including the principles governing the interpretation of the agreement, may be specified by the agreement itself. See *Volt Info. Sci., Inc. v. Bd. of Tr.*, 489 U.S. 468, 479, 109 S. Ct. 1248, 1256 (1989). ("Just as [parties] may limit by contract the issues which they will arbitrate, so too may they specify by contract the rules under which that arbitration will be conducted." *Id.* (citations omitted)).

156. See Bernstein, *Merchant Law*, *supra* note 103, at 1775-82.

157. In the place of Code warranties and the rules for rejection, revocation, cure, etc., parties who trade in hard goods, most especially in sales of equipment, substitute standardized "repair and replacement" clauses. Such clauses purport to divide quality risks between buyer and seller and to displace the binary default rules

force majeure clauses replace Code provisions governing performance and excuse.¹⁵⁸ Finally, the standard "contractual insecurity" clause displaces Code rules governing insecurity and anticipatory repudiation.¹⁵⁹ In each case, there is growing anecdotal evidence that inconsistent judicial interpretations of these standard terms under the Code regime of subjective interpretation has stimulated the substitution of compulsory arbitration to resolve disputes over liability under these customized clauses.

CONCLUSION

There are no reliable measures of the extent to which commercial parties have opted out of the Code, either in whole or in part. But casual observation points to an hypothesis: Article 2 has failed to provide many commercial parties with reliable (i.e., uniform) rules that reduce contracting costs. The dominance of subjective modes of interpretation imposes uncertainty costs without providing the corresponding benefits of incorporation. Some classes of commercial contractors have exited entirely; others have opted out of particular portions of the statute. In any case, the upshot is a statute that is less relevant to many (if not most) commercial parties. Commercial interests have left the field to mass market transactions and to the resulting clashes over the legal regulation of form contracting in these markets.

Does any of this matter to anyone other than those whose professional expertise involves advising others about the meaning of

governing revocation of acceptance and cure. See Schwartz & Scott, Sales Law and the Contracting Process, *supra* note 82, at 204-09. One of the reasons that may have contributed to the increase in agreements to arbitrate disputes under the standard clause are the inconsistent interpretations of the repair and replacement clause in different jurisdictions. Compare, e.g., *Myrtle Beach Pipeline Corp. v. Emerson Elec. Co.*, 843 F. Supp. 1027 (D.S.C. 1993) with *Earl M. Jorgensen Co. v. Mark Constr., Inc.*, 540 P.2d 978 (Haw. 1975) and *International Fin. Serv., Inc. v. Franz*, 23 U.C.C. Rep.2d 1078 (Minn. Ct. App. 1994) *aff'd in part, rev'd in part* 534 N.W.2d 261, 26 U.C.C. Rep.2d 1137 with *Chatlos Sys., Inc. v. National Cash Register Corp.*, 635 F.2d 1081 (3d Cir. 1980).

158. See, e.g., a standard "excusable delay" clause: "Seller shall not be responsible nor deemed to be in default on account of delays in performance . . . due to causes beyond Seller's control and not occasioned by its fault or negligence, including but not limited to . . . any act of government, governmental priorities, allocation regulations or orders affecting materials, equipment . . . failure of vendors (due to cause similar to those within the scope of this clause) to perform their contracts . . . , provided such cause is beyond Seller's control."

159. See, e.g., *Northwest Lumber Sales, Inc. v. Continental Forest Prod., Inc.*, 495 P.2d 744, 749 (1972) (standard insecurity clause in industrial association's "Terms and Conditions of Quotation and Sale" construed as an enforceable variation of U.C.C. § 2-609 by agreement of the parties).

the Code? The major cost of wholesale opting out is the loss of the social benefits that derive from judicial resolution of disputed contracts. Commercial arbitration decisions remain unpublished for the most part. This means that the positive externalities that result from authoritative resolution of disputed contracts are sacrificed. The state facilitates the contracting process to the extent that courts in the process of interpretation create standardized (or uniform) terms that future parties can use in signaling their intentions. These standardized signals are developed in two ways. The first is through gap filling, the specification of default rules that complete incomplete contracts. The second method of standardization occurs when courts interpret authoritatively the meaning of *invocations* or standard form terms and clauses that parties frequently use in writing contracts. In either case, the primary role of the state in regulating incomplete contracts is the standardization of the meaning and jurisdiction of the state-supplied defaults and the privately provided invocations from which parties can customize their contracts. Substituting unpublished arbitration decisions for published judicial opinions thus represents a real social cost. In this sense, then, Article 2 threatens to become a uniform statute that provides the parties who rely on it few, if any, of the benefits that inhere in uniformity.

These costs might be offset by the social benefits inherent in a normatively acceptable regime for regulating standard form contracting or computer information transactions. But this task is one that recent evidence shows the Code is peculiarly incapable of performing. Contrast, for example, the current interest group clash over UCITA with the original efforts by Llewellyn to enact Article 2. Interest group competition of that sort did not emerge, as Llewellyn recognized, because "the same parties and the same types of party can tomorrow be occupying each the other end of similar disputes."¹⁶⁰ In short, since parties to commercial sales transactions are both buyers and sellers, there is no reason to believe that one group or class is distributionally disadvantaged over the other. That symmetry of effects is clearly not present in the battle between the large firm licensors of computer information and their licensees (whether the licensees are large firms or individual consumers).

In sum, uniformity worked when there was symmetry (when today's buyer might be tomorrow's seller) and Article 2 has always had great success in that subpart of contract law. Indeed many of the vague provisions that remain in the original Article 2 coincide with distributional asymmetries, and one can surmise that Llewellyn avoided interest group competition by drafting vague rules in just

160. K. N. Llewellyn, *Across Sales on Horseback*, 52 Harv. L. Rev. 725-27 (1939).

those instances. But where the distributional effects were symmetric, the evidence suggests that Llewellyn worked with more effort and effect to find the best possible default rule, unless there was real reason to think judges could do better on the ground in the future.

Viewed from that perspective, the extension of the Code to Article 2A (Leases) was a big step for the ALI and NCCUSL because lease transactions are not entirely symmetrical. On the other hand there likely were significant gains to uniformity in enacting 2A, and, in any event, even if there were political deals, they were not worth much because they could subsequently be priced in the lease contract. In other words, if lessors got better rules in Article 2A than they would obtain in freely dickered, customized contracts, then the Code-regulated contract would result in giving lessors slightly worse prices.¹⁶¹ But the same cannot be said for many consumer transactions and perhaps not for computer information contracts under proposed Article 2B. On this view, the breakdown occurred where you might expect it, where the distributional effects were asymmetric and the pricing effects were uncertain.¹⁶²

One normative implication of the deadlock over the revisions to Article 2, therefore, is that the ALI and NCCUSL should not propose uniform rules for transactions where the distributional effects are asymmetric and prices are unlikely to adjust efficiently so as to compensate for a single group's victory in the legislative process. These issues are better resolved in the ordinary political process where competing value claims can be accommodated more effectively. When it was first enacted, Article 2 created social value by removing the detritus of common law notions of title from sales law. It has served us continuously, if not completely well, for fifty years. But the methodological premises which formed the foundation of the distributional judgments in the statute are no longer widely shared. A statute created to incorporate the group ideology of institutionalism is ill-suited as a template for regulation in an era whose ideology is self-consciously individualistic. As Grant Gilmore

161. The argument is slightly different in those cases, such as Articles 3, 4 and 9 where the distributional effects are both asymmetric and unevenly spread between a few concentrated winners and many diffused losers. In those cases, there is a respectable argument that, even if the political deals are *on average* fully priced out in the resulting contracts, the costs are too high because the losers do not adjust prices in individual transactions that favor the winners. See Lucian Ayre Bebchuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy*, 105 Yale L.J. 857 (1996).

162. In this latter case, the argument is that the market will price inefficiently because of market imperfections such as monopoly power or asymmetric information. Moreover, any distributional effects of the statute are likely to be redistribute wealth from the relatively poor and uninformed to the rich and sophisticated. Robert E. Scott, *The Truth About Secured Financing*, 82 Cornell L. Rev. 1436 (1997).

famously said, Karl Llewellyn was “always willing—indeed eager—to rethink his own earlier formulations. . . . To Llewellyn the ultimate absurdity would have been not to be able to improve on what . . . [he] had written [fifty] years earlier.”¹⁶³

163. Grant Gilmore, *The Good Faith Purchase Idea and The Uniform Commercial Code: Confessions of a Repentant Draftsman*, 15 Ga. L. Rev. 605, 606 (1981).

