

Recognizing Usages of Trade: A Case Study from Electronic Commerce

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What role do social expectations play in contract formation, and why do they play it? To what degree should courts rely on market practices to determine legal questions such as whether or when a contract has been formed, or what terms it includes? For example, suppose buyers commonly encounter contracting methods such as shrink-wrap license terms delivered after a buyer places an order and, perhaps, makes payment. Suppose further that if they encounter this method often enough, over a significant period of time, buyers will expect to see post-payment shrink-wrap terms in future transactions. Is this expectation enough to hold that the terms become part of the agreement between the buyer and seller?¹

The usage of trade doctrine is relevant to these questions. The Union Commercial Code (U.C.C.) defines a usage of trade as “any practice or method of dealing having such regularity of observance in a place, vocation or trade as to justify an expectation that it will be observed with respect to the transaction in question.”² The U.C.C. also specifies that the “existence and scope” of a trade usage “are to be proved as facts.”³ Proof of usages therefore requires evidence about how persons and firms behave when they form and perform contracts. If a court is satisfied that a party proved the existence of usage, the court may use that finding as a basis to interpret or

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1. This Article will use the pairings of licensee and licensor or buyer and seller interchangeably. It will not address the question whether or when, if ever, an agreement denominated as a license may be treated as a sale.

2. U.C.C. § 1-205(2) (1998).

3. *Id.*

supplement contractual terms.

This conventional description is incomplete. Though usages are facts, a judge's decision to recognize a proffered usage as a valid interpretive tool, or to permit the evidence to go to the jury, is partly normative. As Richard Craswell has said, "the goals, beliefs, and other normative premises of the person" with the power to recognize customs "must inevitably play a part in the interpretation and application of customs."⁴ For example, suppose a party claims that it is standard practice for certain types of agreements to include punitive forfeiture provisions for nonperformance or to pledge the promisor's first-born child as security for performance. If proved, these practices would not count as usages on which courts would rely in interpreting agreements. In these two examples, the proposed usage would conflict with other contract rules: the prohibition on punitive liquidated damages and the rule that courts may decline to enforce unconscionable terms.⁵

Are trade usages limited only by conflicts with mandatory contract rules? To return to our shrink-wrap example, suppose evidence shows that all vendors employ shrink-wrap terms and all consumers ignore the terms because they believe them to be unenforceable. Such consumer beliefs are relevant to assent, the legal doctrine to which the alleged usage is relevant. A judge considering the alleged usage therefore would have to choose whether to give

4. Richard Craswell, *Do Trade Customs Exist?* in *THE JURISPRUDENTIAL FOUNDATIONS OF CORPORATE AND COMMERCIAL LAW* (Kraus & Waltz eds., 1999); see also Stewart Macaulay, *Relational Contracts Floating On A Sea of Custom? Thoughts About the Ideas of Ian MacNeil and Lisa Bernstein*, 94 NW. U. L. REV. 775, 786 (2000) (stating that Craswell is right "in all but extreme cases"); John M. Breen, *Statutory Interpretation and the Lessons of Llewellyn*, 33 LOYOLA L.A. L. REV. 263, 342 (2000) (quoting U.C.C. §§ 1-205(2), 2-202, cmt. 2):

"Clearly trade usage under the Code has a descriptive, empirical basis. Nevertheless, the decision to recognize such usages of trade as well as the requirement that they enjoy a 'regularity of observance' embodies a set of normative judgments as to what facts are likely to evidence the parties' common intentions. Likewise, the presumption that such usages were 'taken for granted when the document was phrased' and so 'have become an element of the meaning of the words used' unless 'carefully negated' is a normative judgment that such usage is a good 'indication of what [the parties] intended the writing to mean.'"

5. See U.C.C. § 2-718(1) (penalty terms invalid); RESTATEMENT (SECOND) OF CONTRACTS § 208 (1979) (addressing unconscionability).

force to the seller's wish that the terms be included or the buyer's belief that they should not. On what principle would such a decision rest? What of the used car dealer's claim that rolling back the speedometer is a usage of trade?⁶ Must we have a statute barring that conduct before a court can refuse to recognize it as a usage?

This Article uses some of the significant shrink-wrap licensing cases between 1991 and 2000 to study how a judge's own beliefs and presumptions affect the decision whether to recognize a usage of trade. A review of these cases suggests that judges became more willing to accept post-order shrink-wrap terms as a method of forming an agreement as they either became more familiar with that method or came to accept economic arguments used to justify recognition of that method.

Two cases in particular highlight this point. In its 1991 *Step-Saver* decision,⁷ the Court of Appeals for the Third Circuit rejected a defendant's claim that a course of dealing made post-order shrink-wrap terms part of the agreement between a software vendor and a value-added reseller, which wrote and licensed software itself, even though the facts provided substantial support for the claim.⁸ The *Step-Saver* court appeared to demand actual bargaining or express assent as a prerequisite to recognizing those terms as part of the agreement.⁹ In 2000, the Washington State Supreme Court reached a contrary result regarding an agreement between a vendor and an end-user in its *Mortenson* decision,¹⁰ even though the facts there presented a much weaker case for judicial recognition of either a course of dealing or usage of trade.¹¹

This Article does not attempt to prove that the two cases were decided differently only because judges became more familiar with the shrink-wrap method and were therefore more comfortable giving legal effect to it. There are too many variables for that assumption.¹²

6. Jones v. W. Side Buick Co., 231 Mo. App. 187 (1936).

7. Step-Saver Data Syss., Inc. v. Wyse Tech., 939 F.2d 91 (3d Cir. 1991).

8. *Id.* at 108.

9. *Id.* at 104.

10. M.A. Mortenson Co., Inc. v. Timberline Software Corp., 970 P.2d 803 (Wash. 2000).

11. *Id.* at 80.

12. As will be shown, the vendor in *Step-Saver* tried and failed to obtain negotiated assent to agreements that included the shrink-wrap terms. This fact probably affected the decision. The

This Article claims only that the trend of decisions throughout the 1990s suggests that judicial presumptions and attitudes are variables that should be taken into account in dealing with the usage of trade concept. The most important event in this account was Judge Easterbrook's opinion for the Court of Appeals for the Seventh Circuit in *ProCD, Inc. v. Zeidenberg*.¹³ In that case, he persuasively normalized the use of shrinkwrap terms by arguing that they provided benefits to both producers and consumers and by plausibly analogizing the shrink-wrap method to transactions with which judges would be familiar, such as the purchase of insurance or consumer electronics.¹⁴

To the extent there is a normative aspect to recognizing usages of trade, to which judicial attitudes and understandings are relevant, judges should try to make that aspect of the analysis as explicit and rigorous as possible. Bringing to the forefront the normative elements of the decision to recognize or reject a trade usage will help judges check their own biases against the purposes of contract law, make the normative analysis more systematic and reliable, help lawyers give more useful advice to clients, and thereby make the usage of trade concept more reliable and useful.

Courts should not consider evidence of widespread adoption by parties on one side of a transaction enough, standing alone, to establish a usage of trade. Instead, courts should demand additional evidence or analysis establishing that the practice or term in question can be justified under the Kaldor-Hicks welfare criterion.¹⁵ This criterion is satisfied if the gains from an action or course of conduct exceed the losses such that the winners could compensate the losers for their losses although actual compensation is not required.¹⁶

Satisfaction of this criterion implies at least potential benefits for

court did not rest on this fact alone, however, and its broader analysis is consistent with the discussion in the text. *See infra* text accompanying notes 86-94.

13. 86 F.3d 1447 (7th Cir. 1996).

14. *Id.* at 1451.

15. For discussion of Kaldor-Hicks criterion, see Thomas S. Ulen, Book Review, 41 SANTA CLARA L. REV. 643, 647 n.9 (2001) (reviewing DAVID D. FRIEDMAN, LAW'S ORDER: WHAT ECONOMICS HAS TO DO WITH LAW AND WHY IT MATTERS (Princeton Univ. Press 2000)).

16. *Id.*

both sides of the class of transactions at issue. The actual distribution of benefits will depend on market conditions and bargaining. If a proffered usage yields gains concrete and significant enough to satisfy the criterion, it also provides a basis to conclude that rational contracting parties might be willing, *ex ante*, to adopt the usage at issue.

Some might object that this approach merely invites uninformed judicial activism. That criticism identifies a genuine and serious risk. But if a proffered usage cannot satisfy this relatively modest criterion, one must ask why a judge should recognize it. The conventional answer is that judges lack the information and knowledge to understand the welfare implications of usages. On this view, the judicial decision to recognize a usage is a bet that deferring to the parties' conduct reduces both the probability of a mistaken (inefficient) decision and the harm resulting from the mistake. Courts recognize usages, in other words, to reduce error costs. This analysis is all well and good, but the lack of information and knowledge that makes it risky for judges to decide questions directly, thus justifying the use of usages, also makes it risky for judges to identify usages, too.¹⁷

If one believes that judicial perceptions of what counts as a usage cannot be divorced from normative considerations, then it is to the advantage of all concerned to make that aspect of the analysis as rigorous and transparent as possible. This Article aims not to invite judges to do something new, but to help them articulate in a rigorous and replicable manner what they are probably doing already.

Four caveats are necessary before we begin. First, this approach is more of a heuristic than a standard. It is a question a court should ask, a way of looking at a proposed usage, that might result in better analysis. A party asserting the usage should not be forced to show that rational *ex ante* contracting would necessarily have produced the precise set of terms or practices at issue. That would be too much of a judicial intrusion into the contracting process.

Second, some such benefits will be plausible in virtually every case. For example, assuming a competitive market, any term that

17. See Macaulay, *supra* note 4, at 786.

reduces a seller's costs or allows it to discriminate among types of buyers allows the seller to argue that the term lowers the average price of the product, thereby benefitting buyers generally. This example is probably true in many cases. Arguments so powerful have to be treated with care, however, because they fail to distinguish among different types of cost-reducing behavior and terms. A term pledging a first-born child as security would lower the seller's costs as well, by reducing the expected cost of default. It would not follow that the term is conscionable or that it should be recognized as a usage of trade. Such arguments have to be analyzed in the context of concrete facts, and accepted or rejected in light of that context.

Third, this Article simply assumes that meaningful usages exist with a degree of consistency that warrants attention. It is perhaps ironic that the newest uniform contracting statute—the Uniform Computer Information Transactions Act (UCITA) makes extensive use of the usage of trade doctrine at precisely the time that scholars such as Lisa Bernstein are challenging the notion the meaningful usages exist with any consistency.¹⁸ Courts are applying the usage of trade concept in deciding cases, however, and UCITA makes extensive use of the concept. This Article therefore explores analytical techniques that will assist in the application of the usage of trade concept.

Fourth, the debate over shrinkwrap terms is probably over as a legal matter, and is less relevant as a factual matter than it used to be. This Article intends not to rehash the merits of cases like *Step-Saver* or *ProCD*, but to analyze the shift in judicial presumptions about contracting between *Step-Saver* in 1991 and *Mortenson* in 2000. Tracking this shift provides a useful perspective on the analysis courts employ in recognizing or rejecting usages.

Part I of this Article briefly discusses the usage of trade concept. Part II discusses the shift in judicial approaches to shrinkwrap licenses from *Step-Saver* to *Mortenson*. Part III discusses the lessons of these cases in considering the judicial role in recognizing usages of

18. See, e.g., Lisa Bernstein, *The Questionable Empirical Basis of Article 2's Incorporation Strategy: A Preliminary Study*, 66 U. CHI. L. REV. 710, 715 (1999) (stating “. . . [u]sages of trade’ and ‘commercial standards’ as those terms are used by the Code, may not consistently exist, even in relatively close-knit merchant communities”).

trade. Part III also considers the warranty of non-infringement and the possibility of disclaiming it by trade usage as an example of the type of analysis courts should engage in when considering usages in the future.

I. USAGE OF TRADE

As noted above, Section 1-205(2) of the U.C.C. defines a usage of trade as “any practice or method of dealing having such regularity of observance in a place, vocation, or trade as to justify an expectation that it will be observed with respect to the transaction in question.”¹⁹ The Uniform Computer Information Transactions Act (UCITA) uses the same definition.²⁰ Section 1-201(3) of the U.C.C. defines “agreement” to mean the “bargain of the parties in fact as found in their language or by implication from other circumstances including . . . usage of trade.”²¹ UCITA again mirrors this language.²²

Consistent with this approach, Section 1-205(3) of the U.C.C. states that a usage of trade in any vocation in which the parties are engaged or “of which they . . . should be aware” may be used to “give particular meaning to and supplement or qualify terms of an agreement.”²³ Section 2-202(a) of the U.C.C. provides that even the final written expression of a contract may be “explained or supplemented” by a usage of trade.²⁴ Section 301(1) of UCITA is to the same effect.²⁵ Both the U.C.C. and UCITA require judges to employ “applicable” usages of trade “in the place where any part of performance is to occur . . . in interpreting the agreement as to that part of the performance.”²⁶

19. U.C.C. § 1-205(2) (1998).

20. UCITA § 102(a)(66), cmt. 57 (2000).

21. U.C.C. § 1-201(3).

22. UCITA §102(a)(4).

23. U.C.C. § 1-205(3). Comment 1 to this provision makes clear that the context created by “commercial practices and other surrounding circumstances” may be used to “explain and supplement even the language of a formal or final writing.” U.C.C. § 1-205 cmt. 1.

24. U.C.C. § 2-202(a).

25. UCITA § 301(1).

26. U.C.C. § 1-205(5); UCITA § 302(c). UCITA states a clear preference for contextual over literal or abstract interpretation, a preference that emphasizes the role of usages of trade. As the comment to section 113(b) states,

commercial factors also provide the background and give meaning to language used.

Usages have traditionally been interpretive tools that help courts ascertain the parties' agreement.²⁷ UCITA in general "treats usage of trade as a factor in determining the commercial meaning of the agreement. The language of an agreement is interpreted as meaning what it may fairly be expected to mean to parties involved in the particular commercial transaction."²⁸ Thus, when recognized, usages are as much a part of the parties' agreement as any other explicit term. To the extent applicable in a particular case, usages trump default rules that the parties can vary by agreement.²⁹ By parity of reasoning, usages do not trump rules that parties cannot vary by agreement, such as the unconscionability doctrine or the statute of frauds.³⁰

Under UCITA, usages of trade may also be employed to determine what the parties knew or should have known when dealing with each other. Section 114(f) of UCITA provides that "[a] person has reason to know a fact if the person has knowledge of the fact or, from all the facts and circumstances known to the person without investigation, the person should be aware that the fact exists."³¹ Comment 6 to this section makes it clear that presumed knowledge includes customary practice:

A person has reason to know a fact if the person has information from which a reasonable person would infer that the fact does or will exist based on all the circumstances, including the overall context and ordinary expectations. The

The meaning of the terms of an agreement must be interpreted in light of practical considerations that reflect common commercial understanding. Abstract concepts about what an agreement should mean are not as important as are grounded interpretations of what an agreement does mean in context.

UCITA § 113(b) cmt. 3.

27. See generally *Bristow v. Drake St., Inc.*, 41 F.3d 345, 351-52 (7th Cir. 1994).

28. UCITA § 102 cmt. 57. Section 113(b) of UCITA similarly provides that any usages of trade "of which the parties are or should be aware . . . are relevant to determining the existence or meaning of an agreement." UCITA § 113(b).

29. In particular, usages "furnish the background and give particular meaning to the language used, and are the framework of common understanding controlling any general rules of law which hold only when there is no such understanding." U.C.C. § 1-205 cmt. 4; see also UCITA § 302, cmt. 5.

30. UCITA § 113(a); cf. *The Star*, 53 F.2d 890 (W.D. Wash. 1931) (rejecting claim that local custom for free assistance trumped entitlement to compensation under admiralty law).

31. UCITA § 114(f).

person is charged with commercial knowledge of any factors in a particular transaction that in common understanding or ordinary practice are to be expected, including reasonable expectations from usage of trade and course of dealing and widespread business practice.³²

Inferences based on trade usage are important to the concept of “layered” contracting in which additional terms are delivered after an order is submitted and, perhaps, after payment is made. UCITA section 202(c) states that an agreement may be formed even if “one or more terms are left open or to be agreed upon,” so long as the parties agree to this procedure.³³ The comment to this section explains that parties can use usage of trade to establish the parties’ agreement: “Many contract terms are intended, expressly or by usage of trade or the like, to be defined over time, rather than on the occurrence of one specific event.”³⁴

32. UCITA § 114 cmt. 6. The comment goes on to distinguish “reason to know,” which indicates only that a party had access to facts from which knowledge of a relevant fact could have been gained, from both “knowledge” itself and the concept of “should know,” which implies a duty to investigate:

“Reason to know” must be distinguished from knowledge. Knowledge means an actual conscious belief in or awareness of a fact. Reason to know need not entail a conscious belief in or awareness of the existence of the fact or its probable existence in the future. Of course, a person that has knowledge of a fact also has reason to know of its existence. Reason to know is also to be distinguished from “should know.” “Should know” imports a duty to ascertain facts; the term “reason to know” does not entail or assume an obligation to investigate, but is determined solely by the information available to the party. The latter term is used where the person would not be acting adequately in protecting its own interests if it did not act in light of the facts of which it had reason to know.

Id.

33. UCITA § 202(c).

34. UCITA § 202 cmt. 4. The comment goes on to say that:

Contract formation is often a process, rather than a single event. A rule that a contract must arise at a single point in time and that this single event defines all the terms of the contract is inconsistent with commercial practice. Contracts are often formed over time; terms are often developed during performance, rather than before performance occurs. Often, parties expect to adopt records later and that expectation itself is the agreement. Rather than modifying an existing agreement, these terms are part of the agreement itself. Treating later terms as proposed modifications is appropriate only if the deal has previously been, in the commercial understanding of both parties, fully closed with no reason to know that new terms would be provided.

Id. The comments to the proposed revision of U.C.C. section 2-207 are less receptive to this

The knowledge requirement is given force in UCITA section 208(2), which provides that a party may agree to contractual terms, the terms of a record “after beginning performance or use if the parties had reason to know that their agreement would be represented in whole or part by a later record to be agreed on and there would not be an opportunity to review the record or a copy . . . before performance or use begins.”³⁵ Comment 3(a) to this section makes it clear that:

Contract terms proposed for later agreement to complete the initial contract are part of the initial contracting process if the parties had reason to know that later terms would be proposed. “Reason to know” means that, realistically considered, later presentation of terms should not be a surprise. It does not require specific notice or specific language, although such factors may be important because notice suffices. “Reason to know” can also be inferred from the circumstances, including ordinary business practices or marketing approaches of which a party is or should be aware and from which a reasonable person would infer that terms will follow.³⁶

“layered” contracting model. Comment 4 to the August 2001 revision of section 2-207 states that

[a]n “agreement” may include terms derived from a course of performance, a course of dealing, and usage of trade If the members of trade or if the contracting parties expect to be bound by a term that appears in the record of only one contracting party, that term is part of the agreement. However, repeated use of a particular term or repeated failure to object to a term on another’s record is not normally sufficient in itself to establish a course of performance, a course of dealing or a trade usage.

See U.C.C. § 2-207 preliminary cmt. 4 (Proposed Draft, Aug. 2001) [hereinafter U.C.C. Draft], available at <http://law.upenn.edu/bll/ulc/ucc2/ucc0612.htm> (last visited Feb. 20, 2002).

Somewhat curiously in light of this statement, comment 5 states that “[a]mended Article 2 takes no position on the question whether a court should follow the reasoning” of *Hill v. Gateway 2000*, 105 F.3d 1147 (7th Cir. 1997) or *Step-Saver Data Sys., Inc. v. Wyse Tech.*, 939 F.2d 91 (3d Cir. 1991). U.C.C. Draft, preliminary cmt. 5. The differences in those cases are discussed in the text accompanying *infra* notes 80-123. It is worth noting here that *Hill*, to which the U.C.C. comment refers, involves a consumer transaction. Though some analysts assume that usages may only be applied to persons “in trade,” the definition of a usage is not so limited. Evidence of usages may be more common within trades, but the logic behind the concept of usages applies generally to problems of information and interpretation.

35. UCITA § 208(2).

36. UCITA § 708 cmt. 3(a).

As this section suggests, and as we saw earlier, a party might be found to have “reason to know” of post-order or post-payment terms if the court finds that such terms amount to a usage of trade in a relevant market. Consequently, a court can bind licensees, in either commercial or consumer markets, to post-order or post-payment terms if a court recognizes the use of such terms as a usage of trade. Actual knowledge is not required; licensors have no obligation to inform licensees of the terms or even that they will deliver additional terms with the product.

Usages of trade are, of course, not limited to shrink-wrap licenses or problems of formation. The “reason to know” concept in UCITA is a general supplementary principle. This concept plays a role, for example, in determining when warranties have been validly disclaimed,³⁷ as well as in its more traditional role of interpreting or supplementing contractual language. The standards courts use for recognizing usages are therefore important.

The requirements for recognizing usages of trade under the U.C.C. are less stringent than the requirements for recognizing custom at common law. For a practice to be recognized as custom, it must be adopted universally within a relevant group, and practiced for a long time.³⁸ Custom in this form was a supplementary form of law. It bound persons regardless of their consent.³⁹ Custom in the

37. See UCITA § 401(e); UCITA § 406(e) (“An implied warranty may also be disclaimed or modified by course of performance, course of dealing, or usage of trade.”).

38. Hawkland states that “[t]o be effective common law custom had to be: (1) legal; (2) notorious; (3) ancient or immemorial and continuous; (4) reasonable; (5) certain; and (6) universal and obligatory.” WILLIAM D. HAWKLAND, U.C.C. SERIES §1-205.4 (2000) (quoting Joseph H. Levie, *Trade Usage and Custom Under the Common Law and the Uniform Commercial Code*, 40 N.Y.U. L. REV. 1101, 1103 (1965)); see also Elizabeth Warren, *Trade Usage and Parties in the Trade: An Economic Rationale for an Inflexible Rule*, 42 U. PITT. L. REV. 515, 519 (1981).

39. Levie, *supra* note 38, at 1102-03. As one court suggested,

Strictly speaking, there is a distinction between “custom” and “usage”; “custom” referring rather to those usages which have existed and been universally recognized for so long a period as to have acquired the force of law, and to be binding without regard to the assent of the individual, and such as the “law merchant,” etc., while “usage” refers to “an established method of dealing, adopted in a particular place, or by those engaged in a particular vocation or trade, which acquires legal force because people make contracts in reference to it.”

Byrd v. Beall, 43 So. 749, 751 (Ala. 1907) (quoting 29 AM. & ENG. ENCY. LAW, 365; 12 CYC. 1033).

commercial context faced a somewhat less stringent test. Courts used commercial custom to ascertain the best practices merchants employed and to thereby rule more sensibly on disputes about which the judge might have little expertise.⁴⁰ A commercial custom did not have to trace itself to time immemorial, a senseless requirement in this context, but it did have to be widely, if not uniformly, used among merchants. It was the widespread agreement on a practice that allowed a court to conclude that commercial customs had a normative basis deserving legal respect.⁴¹ The merchant jury, employed to advise judges on customary aspects of commercial cases, existed for similar reasons.⁴²

The U.C.C. allows courts to recognize “new usages and . . . usages currently observed by the great majority of decent dealers, even though dissidents ready to cut corners do not agree.”⁴³ The “great majority” language reflected pre-Code practice, in which majority adherence to a practice was not enough to establish it as a usage.⁴⁴ The comments to UCITA state this principle in milder terms, saying that “[f]ull recognition [of usages] is available for new uses and for uses currently observed by the majority of merchants, even though some do not.”⁴⁵

The reference in the U.C.C. comments to “decent” dealers brings

40. As Professor Cooter states, “Mansfield knew that he did not understand fully how businesses use financial instruments. Consequently, he did not try to invent better rules than the ones in practice. Rather, he carefully scrutinized business transactions and tried to identify and enforce the best practices.” Robert D. Cooter, *Decentralized Law For A Complex Economy: The Structural Approach To Adjudicating The New Law Merchant*, 144 U. PA. L. REV. 1643, 1648 (1996). On the difference between Mansfield’s approach and ancient custom, see MORTON J. HORWITZ, *THE TRANSFORMATION OF AMERICAN LAW 1780-1860* 189-90 (1977).

41. HOROWITZ, *supra* note 40, at 189-90.

42. *See, e.g.*, R. KENT NEWMAYER, *JOSEPH STORY: STATESMAN OF THE OLD REPUBLIC* 122 (1985) (noting Story’s use of merchant juries to resolve issues of custom and usage while riding circuit in New England).

43. U.C.C. § 1-205 cmt. 5 (1998).

44. Levie, *supra* note 38, at 1105 n.26 (citing cases including *Bagwell v. Susman*, 165 F.2d 412, 416 (6th Cir. 1947) (“if it were only usually or generally done by most manufacturer [sic], there is very little in such a practice to correspond to the imperative, compulsory, universal character which is considered necessary to establish a custom, as that term is understood in law”); *Caggiano v. Marchegiano*, 327 Mass. 574 (1951) (evidence that a majority of contracts between boxers and managers included certain terms was not adequate to establish custom)).

45. UCITA, § 102 cmt. 57 (2000).

up an interesting point. Some statements of the usage of trade concept, such as Article 1.8(2) of the UNIDROIT principles, provide explicitly that courts will only apply usages where it is reasonable to do so.⁴⁶ As one court said in a case decided before adoption of the U.C.C.:

The reasonableness of a particular custom for which legal effect is sought is always a subject of inquiry by the court, and when it is ascertained that the custom is contrary to the public good and is prejudicial to the many and beneficial only to the favored few, it will find itself repugnant to the principles of fair dealing which otherwise entitle a custom to be recognized in a court of justice.⁴⁷

46. UNIDROIT, PRINCIPLES OF INTERNATIONAL COMMERCIAL CONTRACTS 19 (1994) (“[P]arties are bound by a usage that is widely known to be and is regularly observed in international trade by parties in the particular trade concerned, except where the application of such a usage would be unreasonable.”).

47. *Jones v. West Side Buick Co.*, 231 Mo. App. 187, 93 S.W. 2d 1083, 1086 (1936); *accord Sherrill-Russell Lumber Co. v. Krug Lumber Co.*, 267 S.W. 14, 17 (1924).

[A] custom which requires the purchaser to accept the lumber in a car that contains only 75 per cent. of the lumber within the grade ordered, is unreasonable, placing the purchaser at a disadvantage in using and taking care of such car of lumber Such an unfair and unrighteous custom as the evidence in this case tends to establish the law should not allow to exist, much less encourage and enforce. Neither in practice nor on principle can such a custom be upheld. The evidence relating to the custom should not have been admitted.

Id.; *Stein v. Shapiro*, 145 Minn. 60 (1920) (refusing to recognize alleged custom of paying for hides with check rather than cash; stating “Nor will evidence of an unreasonable usage or custom be permitted to inject an obligation into a contract”); *Byrd v. Beall*, 43 So. 749, 751 (Ala. 1907) (refusing to recognize “bad” usage requiring shipper to accept unsworn statement of consignee as to condition of shipment); *Anderson v. Whitaker*, 11 So. 919, 920-21 (Ala. 1893) (rejecting custom evidence of workmanlike construction; stating “Any custom which would operate to convert these gross defects in the work done into work done in a workmanlike manner would be altogether unreasonable, bad, and inadmissible”); *Anewalt v. Hummel*, 109 Pa. 271, 274 (1885) (holding that proof of custom was inadequate and, in the alternative, that custom allowing tenant to use hay and cornstalks left on leased farm when tenant took possession without paying compensation to landlord or leaving a like amount on departure was unreasonable). Interestingly, in *Anewalt* the court objected to the one-sided nature of the alleged custom:

[H]ad the proof been clear, it was a bad custom. It was so wholly unreasonable that it could not be set up as a defence. It was a custom that the tenant may use the property of his landlord without making compensation. The tenant might with equal propriety have set up a custom that his landlord should pay his debts or give him his share of the crops. It is a familiar rule of law that a custom to be valid must be reasonable.

The U.C.C. significantly modified this approach. Though the U.C.C. “carries forward the policy underlying the ancient requirement that a custom or usage must be ‘reasonable’” it does so through the doctrine of unconscionability, a doctrine that typically cannot condemn merely “unreasonable” conduct.⁴⁸ The drafters believed a different approach was warranted because “[t]he very fact of commercial acceptance makes out a prima facie case that the usage is reasonable, and the burden is no longer on the usage to establish itself as being reasonable.”⁴⁹ The comment concludes by stating that “the anciently established policing of usage by the courts is continued to the extent necessary to cope with the situation arising if an unconscionable or dishonest practice should become standard.”⁵⁰

The comments to UCITA do not include a similar discussion, but it seems safe to infer that these comments are relevant to UCITA as well. UCITA’s approach to usage of trade generally tracks the U.C.C. UCITA does its best to funnel challenges to the “fairness” of terms or practices into the doctrine of unconscionability. Along this line, UCITA explicitly rejects the “unfair surprise” doctrine of Restatement of Contracts (Second) § 211(3), calling instead for courts to address such issues under the doctrine of unconscionability.⁵¹ Presumably, UCITA’s drafters hoped the relatively stringent standards for showing unconscionability will restrain judges from activist revision of terms and practices whose economic consequences a judge might dislike or misunderstand. This trend probably encompasses the recognition of usages of trade.

This approach is puzzling. One cannot carry forward a doctrine that says courts should recognize only reasonable usages by having judges apply the much looser standard of unconscionability. Perhaps

Id.

48. U.C.C. § 1-205 cmt. 6 (1998). An unconscionable contract or clause is often colloquially referred to as one that shocks the conscience of the court. One Alabama court characterized an unconscionable agreement as “one that no man in his senses, not under delusion, would make on the one hand, and that no fair and honest man would accept on the other.” *Wilson v. World Omni Leasing, Inc.*, 540 So.2d 713, 716 (Ala. 1989). Comment 2 to section 2-302 states that “the principle is one of the prevention of oppression or unfair surprise.” U.C.C. § 2-302 cmt. 2.

49. U.C.C. § 1-205 cmt. 6.

50. *Id.*

51. UCITA § 208 cmt. 7 (2000).

this option would be possible if there were some sort of reasonableness requirement for recognizing usages in the first place. If that were the case, however, there would be no reason to mention unconscionability as a check on usages. The comments to section 1-205 negate any such threshold requirement and invoke a presumption in favor of recognizing the usage once a party introduces evidence demonstrating its existence. Parties commonly employ usages of trade to clarify or supplement contractual terms; courts may refuse to enforce unconscionable terms no matter how they are specified,⁵² so to say that courts will recognize only conscionable usages adds nothing to the analysis.

To complicate matters further, one cannot fully separate the question of conscionability from the facts relevant to establishing a usage of trade. For example, U.C.C. section 2-302(2) provides that in litigating a claim that an agreement or term is unconscionable, the parties “shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose, and effect”⁵³ Commercial context may include usages of trade.⁵⁴ Presumably, a court considering context evidence under section 2-302 would follow the approach of the comments to section 1-205 and weigh the existence of a usage against a finding of unconscionability. Unless treated with care, the use of commercial context as evidence of conscionability threatens to result in circular analysis and render unconscionability a meaningless limitation on judicial recognition of usages of trade.⁵⁵ Perhaps this threat is why the court in *American Nursery Prods., Inc. v. Indian Wells Orchards* reverted to pre-Code terminology and said that only a “reasonable usage of trade” could be used to show conscionability.⁵⁶

Setting this risk aside, section 1-205 allows courts to recognize

52. *E.g.*, U.C.C. § 2-302.

53. U.C.C. § 2-302(2); UCITA § 111(b).

54. *See* *Am. Nursery Prods., Inc. v. Indian Wells Orchards*, 797 P.2d 477, 481 (Wash. 1990) (“The party defending the clause may prove the clause is conscionable regardless of the surrounding circumstances if the general commercial setting indicates a prior course of dealing or reasonable usage of trade as to the exclusionary clause.”).

55. A similar risk inheres in the U.C.C.’s use of trade usage to give content to section 1-203’s obligation of good faith, see section 1-203 cmt. 5, and in section 2-103(1)(b)’s reference to “reasonable commercial standards” to define good faith.

56. 797 P.2d at 481.

widely used terms or practices such as usages of trade as long as they are conscionable.⁵⁷ The basis for this whole structure is section 1-205's presumption that widespread use of a term implies that it is reasonable.⁵⁸ This proposition is not obviously true. For example, the court in *Henningsen v. Bloomfield Motors, Inc.*⁵⁹ thought the warranty disclaimers at issue in that case reduced nonprice competition in the relatively concentrated market in which the contracts were employed.⁶⁰ The defendant in *Jones v. West Side Buick, Co.*⁶¹ argued that he only followed custom in the used car industry by turning back the speedometer after having the car reconditioned, a claim that would have impeded, if not defeated, the plaintiff's cause of action for fraud if a court believed that widespread use of the practice gave the plaintiff reason to know of it. This problem also may surface on the buyer's side of a transaction. For example, the tenant in *Anewalt v. Hummel* sought recognition of a usage that allowed tenants to consume feed left on a leasehold property without either replenishing it or compensating the landlord.⁶²

In each of these cases, parties on one side of a class of transactions sought to establish usages that benefitted only their side. In each case, some economic argument could be made for the practice. The defendants in *Henningsen* could say the disclaimers lowered their costs and, therefore, increased social welfare, even if

57. Hawklund states that the reference to "decent" dealers in comment 5 "suggests, as would be expected, that neither unreasonable nor unethical kinds of usage may qualify as trade usage." HAWKLAND, *supra* note 38. He correctly notes the seemingly more lenient language in comment 6, however, and the cases he cites discuss unconscionability rather than reasonability as a limitation on the recognition of trade usage. See also *Fleming Farms v. Dixie AG Supply, Inc.*, 631 So.2d 922 (Ala. 1994) (clause limiting damages for breach of warranty was enforceable where it was widely used and conscionable); *Southland Farms, Inc. v. CIBA-Geigy Corp.*, 575 So.2d 1077 (Ala. 1991).

58. On their own, terms like "reasonable," "decent," or "fair" do little if any useful work. They are primarily invoked either as conclusions to analysis or, more troublingly, as assertions in place of analysis. Either way, to see the term invoked is to be forewarned that analytical work on a problem has either come to an end or is on vacation. I return to the problem of giving some content to these terms in Part III.

59. 32 N.J. 358 (1960).

60. For an economic critique of this argument, see Alan Schwartz, *A Reexamination of Nonsubstantive Unconscionability*, 63 VA. L. REV. 1053, 1071-76 (1977).

61. 231 Mo. App. 187 (1936).

62. 109 Pa. 271, 274 (1885).

cartelization reduced the output of cars.⁶³ The defendant in *Jones* could say that rolling back speedometers allowed them to recoup their cost of refurbishing cars and, relying on the assumption that the usage was widely known, resulted in no fraud because consumers were on notice. The tenant in *Anewalt* could argue that the usage would have been incorporated into the lease price, and therefore, it did not represent a windfall. These may or may not be good arguments, particularly the second one, but they are not impossible arguments, and the first may well be right.

The problem with the presumption that widespread uses are reasonable is even more complicated than these examples suggest. As Professor Craswell argued, simple observation of behavior cannot establish a usage or custom that will help judges in deciding disputes.⁶⁴ Prior behavior might have been different had the context in which it occurred been different. The observed pattern of decisions will be subject to interpretation: “any history of prior decisions will always underdetermine the possible patterns that might be ascribed to that history.”⁶⁵

For observed behavior to help a judge decide a case, the judge must first decide which aspects of the behavior are salient in the sense that they establish a practice relevant to the case at hand. For example, suppose, that all sales representatives in the software industry wear jeans and ripped T-shirts and that all license terms disclaim implied warranties. Assuming such disclaimers could otherwise stand as a course of dealing or usage of trade, do they apply if the sales representative wore a suit?⁶⁶ Undoubtedly so. The point here is only that this conclusion rests on a substantive decision about what facts are relevant to the usage in question. Judges must make substantive decisions about how to classify the prior behavior in a way that produces a usage relevant to the decision they must make. Here, as elsewhere, Judge Cardozo’s caution is apt: “While

63. Even assuming the market was cartelized, one would favor steps that reduced the cost of production and increased total surplus. As Professor Schwartz argued, because the cartelists would maximize their profits, there is no reason to expect them to refuse to offer profitable warranties. See Schwartz, *supra* note 60.

64. Craswell, *supra* note 4, at 8.

65. *Id.*

66. *Cf. id.*

judges try to see cases clearly, they can never see them with any eyes but their own.”⁶⁷

One would expect parties who were always on one side of a class of transactions to favor usages of trade that favored that side. The same outcome would not be expected where firms did business both as promisor and promisee. Not knowing which side of a usage a firm would be on could act as a type of veil of ignorance behind which rational actors would produce usages that did not predictably favor one class of persons over another. As Morton Horwitz says of Lord Mansfield’s view of custom, it “depended for its practical implementation on a relatively small commercial community with fundamentally homogenous interests.”⁶⁸ Horwitz gives marine insurance as a paradigm example, in significant part because in that field “eighteenth century English merchants served on different days as both insurer and insured, there was a common interest in settling legal rules and little resulting fear that the law would discriminate in favor of particular groups.”⁶⁹

Usages developed over numerous transactions by parties who participated both as promisor and promisee will tend to lower transaction costs to the greatest degree possible. That parties developing the usages participate on both sides of the transactions implies that suboptimal practices will not develop from efforts to skew returns to one side or another. This Article will call such usages reciprocal usages.

We may at least speculate that reciprocal usages maximize welfare under the Pareto criterion because they are likely to lower transaction costs without systematically disadvantaging any party. In this regard, reciprocal usages are different from practices employed by parties who take only one side of a class of transactions. Practices employed by sellers in transactions with consumers are the obvious example. This Article will call these one-sided usages. They are the obvious targets of analysts concerned that firms will use form agreements to take advantage of consumers.

There is nothing inherently wrong with one-sided usages. Judicial

67. BENJAMIN N. CARDOZO, *THE NATURE OF THE JUDICIAL PROCESS* 13 (1921).

68. HORWITZ, *supra* note 40, at 190.

69. *Id.*

recognition of a one-sided usage may not disadvantage anyone. Sometimes, it is more important that a standard be set than that it be set a certain way.⁷⁰ The numerous standards for commercial goods, from the width of threads on nuts and bolts to the size of spark plugs, to the TCP/IP protocol, to the dimensions of boards in a lumberyard, all attest to this fact.⁷¹ Many standards are set by organizations dedicated to the purpose, but they could be usages of trade as well.⁷² In such cases, assuming there are adequately informed parties, a court might well consider it irrelevant that a vendor had set a standard and all purchasers conformed to it. A one-sided usage might allow vendors to take advantage of economies of scale, or to lower production costs in some other way.⁷³ The result might be lower average prices and greater total surplus.⁷⁴

70. Cf. *Burnet v. Coronado Oil & Gas Co.*, 285 U.S. 393, 406 (1932) (Brandeis, J., dissenting) (“Stare decisis is usually the wise policy, because in most matters it is more important that the applicable rule of law be settled than that it be settled right.”).

71. E.g., Macauley, *supra* note 4, at 787.

72. Indeed, it may be that the most uncontroversial usages are enconced in standards promulgated by organizations whose work suggests the increasing bureaucratization of private ordering as well as government. See David Charny, *The New Formalism in Contract*, 66 U. CHI. L. REV. 842, 846, 855-56 (1999). For examples of rent-seeking in standards-setting bodies, see David McGowan, *The Problems With the Third Way; A Java Case Study*, in REGULATING THE GLOBAL INFORMATION SOCIETY (Routledge 2000); Mark A. Lemley & David McGowan, *Could Java Change Everything? The Competitive Propriety of A Proprietary Standard*, 43 ANTITRUST BULL. 715 (1998). Perhaps the most obvious example of rent-seeking within a standards-setting organization is *Allied Tube & Conduit Corp. v. Indian Head, Inc.*, 486 U.S. 492 (1988). In that case, Indian Head sought permission from the National Fire Protection Association (NFPA) to market polyvinyl electrical conduit. This conduit required the NFPA to alter the National Electrical Code it had previously written, which allowed only steel conduit. Allied Tube, the nation’s largest maker of steel conduit, packed the NFPA meeting and voted down the proposal. *Id.* at 496-97; see also David McGowan & Mark A. Lemley, *Antitrust Immunity: State Action and Federalism, Petitioning and the First Amendment*, 17 HARV. J.L. & PUB. POL’Y 293, 309-11 (1994) (discussing the *Allied Tube* case in detail).

73. There is some reason to believe, for example, that the cross-collateralization at issue in *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445 (D.C. Cir. 1965) reflected the relatively high cost of selling to low income consumers and did not result in supracompetitive profits for retailers. See LON L. FULLER & MELVIN A. EISENBERG, *BASIC CONTRACT LAW* 66-68 (6th ed. 1996).

74. For example, Lisa Bernstein suggests that broad disclaimers in shrink-wrap licenses may benefit producers by lowering litigation costs and that consumers benefit because reputational concerns may prompt vendors to grant licenses or fix defective code where the facts make such actions reasonable. Lisa Bernstein, *Merchant Law In A Merchant Court: Rethinking the Code’s Search for Immanent Business Norms*, 144 U. PA. L. REV. 1765, 1790-91 (1996).

Recognizing one-sided usages might also cause courts to approve terms that systematically favor one side of a transaction. Lower production costs might not get passed along to consumers, for example, increasing profits for firms, and persons holding equity in them, instead. Even assuming this outcome, it does not follow that courts should refuse to recognize such a usage. Even if a one-sided usage benefitted only one side of a transaction, one could defend it under the Kaldor-Hicks criterion⁷⁵ on the ground that it increased total surplus, probably by lowering production costs, by an amount greater than any losses to the other side.

For present purposes, it is enough to note that the shift away from a practice of recognizing only reciprocal usages to a practice of recognizing one-sided usages is not inherently suspicious or objectionable. The shift may not be (probably is not) a Pareto-superior move.⁷⁶ Recognizing one-sided usages in addition to reciprocal usages may therefore imply a shift in the economic justification for recognizing usages of trade from Pareto to Kaldor-Hicks optimality. That is not saying much, particularly if one believes the Pareto criterion is unrealistically strict.⁷⁷ If there is a normative component to the recognition of usages of trade, and the normative component is welfarist in nature, one would hope that the shift in theories would be justified rather than implicit, and that some form of

75. For a discussion of Kaldor-Hicks criterion, see Ulen, *supra* note at 15.

76. Such a shift may have no effect, in which case the conclusion of Pareto optimality would not be undermined. It is more likely that such a shift will make participants on one side of transactions worse off relative to a world in which one-sided usages are not recognized. For a discussion of Pareto optimality, see KENNETH J. ARROW, *SOCIAL CHOICE AND INDIVIDUAL VALUES* (2d ed. 1963).

77. *E.g.*, Guido Calabresi, *The Pointlessness of Pareto: Carrying Coase Further*, 100 *YALE L. J.* 1211, 1212 (1991).

Transaction costs (including problems of rationality and knowledge), no less than existing technology, define what is currently achievable in any society—the Pareto frontier. It follows that any given society is always or will immediately arrive at a Pareto optimal point given transaction costs. Therefore no moves from the status quo are possible without either: (a) disadvantaging at least someone (hence making distributional considerations unavoidable); or (b) trying to shift the frontier outward (itself a chancy and costly process that usually entails distributional consequences). It also follows that the frequently made distinction between removing inefficiencies (making moves to the frontier) and innovating (pushing the frontier outward) is a false dichotomy.

Id.

reasoning resembling Kaldor-Hicks analysis would be discernible in cases in which usages were recognized and employed.

Neither the U.C.C. nor UCITA goes very far in this regard. This Article returns to these points in Part III. First, however, it is useful to understand why we care about usage of trade in electronic commerce generally.

II. JUDICIAL APPROACHES TO SHRINK-WRAP CASES

Commercialization of the Internet, and the increase in products that are sold or licensed in digital form, makes contract rules for “e-commerce” transactions increasingly important. UCITA tracks the U.C.C. by stating that a contract may be formed in any manner sufficient to show the agreement of the parties.⁷⁸ This general principle allows for contracts to be formed through the exchange of terms and payment over time. This sequential or “layered” contracting model includes the notion of assent by use of a computer program or the failure to return the program after a certain time.⁷⁹

At present, UCITA’s position on sequential formation has substantial support in the case law. That was not always the case. In the early 1990s, courts in two significant cases refused to recognize the “reason to know” theory as a basis for inferring assent to post-order or post-payment terms. From 1996 on, however, courts tended to accept this practice. In 2000, the Washington Supreme Court embraced this practice in an opinion that quoted the trial judge as saying that the case might have been decided differently in 1985, but, in 1997, shrink-wrap terms were binding on the parties and provided a defense against the plaintiff’s breach of warranty claims. 1990s shrink-wrap cases may therefore be viewed collectively as a case study in the recognition of a particular usage of trade—the provision of additional contract terms with software delivered after the initial communication between the parties.

The first major case was *Step-Saver Data Systems, Inc. v. Wyse Technology*.⁸⁰ It is not actually a usage of trade case, but its facts and

78. UCITA § 202(a) (2000); U.C.C. § 204 (1998).

79. See *supra* text accompanying notes 36-37.

80. 939 F.2d 91 (3d Cir. 1991).

its course of dealing analysis are relevant here. Step-Saver was a value-added reseller that ordered software from The Software Link (TSL), which Step-Saver integrated into systems it sold to end users. The software malfunctioned and Step-Saver sued TSL for breach of warranty. TSL's shrinkwraps disclaimed all warranties on its software, as well as liability for damages due to its software. The question was whether these disclaimers were part of the parties' agreement. In an opinion by Judge Wisdom, the Court of Appeals for the Third Circuit held they were not.⁸¹

The decision in *Step-Saver* rests mainly on the court's analysis of when the parties' formed their agreement. Step-Saver ordered software over the telephone from TSL.

TSL would accept the order and promise, while on the telephone, to ship the goods promptly. After the telephone order, Step-Saver would send a purchase order, detailing the items to be purchased, their price, and shipping and payment terms. TSL would ship the order promptly, along with an invoice. The invoice would contain terms essentially identical with those on Step-Saver's purchase order: price, quantity, and shipping and payment terms. No reference was made during the telephone calls or on either the purchase orders or the invoices with respect to a disclaimer of warranties.⁸²

Step-Saver argued that the parties formed their agreement during its telephone conversations with TSL. On this view, TSL's shrinkwraps terms materially altered the terms of the telephone agreement and therefore, under U.C.C. section 2-207, were only a proposal for additional terms. Because Step-Saver did not expressly agree to this proposal, these additional terms did not limit its remedies.⁸³ The court agreed, saying that "the box-top license should have been treated as a written confirmation containing additional terms" which, because they materially altered the original terms, "did not become a part of the parties' agreement."⁸⁴

81. *Id.* at 108.

82. *Id.* at 96

83. *Id.* at 97.

84. *Id.* at 105-06.

To reach this conclusion, the court rejected TSL's argument that the course of dealing between the parties established a basis for holding Step-Saver to the terms of the disclaimer. TSL pointed out that the parties engaged in a number of transactions⁸⁵ and that it sent shrinkwrap licenses with each transaction. TSL argued that "even if the terms of the box-top license would not become part of the contract if the case involved only a single transaction, repeated expression of" the post-order terms "eventually incorporates them within a contract."⁸⁶

The court rejected this argument for two reasons. The first of these was that

the repeated exchange of forms by the parties only tells Step-Saver that TSL desires certain terms. Given TSL's failure to obtain Step-Saver's express assent to those terms before it will ship the program, Step-Saver can reasonably believe that, while TSL desires to obtain certain terms, it has agreed to do business on other terms—those terms expressly agreed upon by the parties. Thus, even though Step-Saver would not be surprised to learn that TSL desires the terms of the box-top license, Step-Saver might well be surprised to learn that the terms of the box-top license have been incorporated into the parties' agreement.⁸⁷

The court's reference to TSL's failure to obtain Step-Saver's express assent can be read as limited to the facts of the case. TSL twice asked Step-Saver to "sign agreements that would put in formal terms the relationship" between the parties; "both proposed agreements contained warranty disclaimer and limitation of remedy terms similar to those" in the shrink-wraps. Both times Step-Saver refused to sign.⁸⁸ The court's language, however, does not have to be

85. Step-Saver installed 142 copies of the software, which it ordered in twenty-copy batches in seven separate orders. *Id.* at 95.

86. *Id.* at 103. The court was skeptical that TSL could establish a course of dealing as to terms the parties had not dealt with actively, saying that TSL sought to "extend the course of dealing analysis to this case where the only action has been the repeated sending of a particular form by TSL" and that "most courts have rejected such reasoning." *Id.* at 103-04.

87. *Id.* at 104.

88. *Id.* at 102-03.

read that way. It could also imply that TSL had an obligation to obtain Step-Saver's express agreement at some point and failed to satisfy that obligation.⁸⁹

This latter reading enjoys some support in the court's second reason for rejecting TSL's course of dealing argument, which is that

the seller in these multiple transaction cases will typically have the opportunity to negotiate the precise terms of the parties' agreement, as TSL sought to do in this case. The seller's unwillingness or inability to obtain a negotiated agreement reflecting its terms strongly suggests that, while the seller would like the court to incorporate its terms if a dispute were to arise, those terms are not a part of the parties' commercial bargain [W]e are not convinced that TSL's unilateral act of repeatedly sending copies of the box-top license with its product can establish a course of dealing . . . that resulted in the adoption of the box-top license.⁹⁰

This second argument seems broader than the first. It refers both to a seller's inability to obtain express agreement and an unwillingness to seek it. The latter concept implies that the court believes sellers do have an obligation to obtain express consent if the seller wishes the terms to bind the buyer. This broader reading is borne out of the court's relatively broad statement of its holding on this issue: "the repeated sending of a writing which contains certain standard terms, without any action with respect to those terms, cannot constitute a course of dealing which would incorporate a term of the writing otherwise excluded under § 2-207."⁹¹

Setting aside Step-Saver's refusal to agree to documents including the shrinkwrap terms when actual bargaining occurred, the arguments

89. The court's opinion does not say that Step-Saver refused to sign the proffered agreements *because* of the disclaimers and limitations. Maybe these terms were the sticking point, but the court does not describe these documents in detail. The court says only that the agreements included such terms and Step-Saver did not sign them. The court later discussed "more specific evidence as to the parties' course of dealing or performance," including Step-Saver's refusal to sign the agreements TSL offered. *Id.* at 104. That the court dealt with this fact separately as a piece of "specific" evidence also suggests that the statement in the text can be considered the court's view of the law generally.

90. *Id.*

91. *Id.*

for enforcing the shrink-wrap terms on either a course of dealing or usage of trade analysis were very strong. Step-Saver was in the business of integrating software and hardware. It had started out as a value-added retailer for IBM in 1981 and then developed its multi-user system, which included both off the shelf applications and some applications Step-Saver had written itself.⁹² Step-Saver's business required it to be able to evaluate software and appreciate the probability and significance of defects. Step-Saver discussed the TSL software with TSL and tested the software itself.⁹³ The opinion also includes a footnote tracing the use of the shrink-wrap method as a way for software vendors to avoid the first-sale doctrine. In that footnote, the court implicitly recognized that shrinkwrap agreements were at least commonly used by software producers.⁹⁴

Step-Saver's expertise in software licensing and the common use of shrink-wraps in software transactions provided a basis for recognizing a usage of trade allowing delivery of additional terms with the software. Though the facts fit better with usage of trade doctrine, which was not at issue on the appeal, they were relevant to understanding the course of dealing argument as well. The *Step-Saver* court's rejection of the course of dealing argument therefore appears to be at least partly normative. In particular, the court believed that a buyer in a multiple transaction case could reasonably believe that a seller's shrink-wrap terms were not binding, even if the buyer knew the seller desired the terms, because the seller would have had a chance to seek express assent to the terms. On this view, the opportunity to obtain express agreement implied a duty to do so. The seller's failure to discharge that duty justified the buyer disregarding the terms.

This argument assumes that express assent is necessary for such terms to be binding. That assumption rejects the notion that a party can assent to terms by proceeding with a transaction in circumstances in which the party knows or should know that the other side expects shrinkwrap terms to apply. Why does the court take this position?

92. *Id.* at 94. One wonders what terms Step-Saver included with its own software, a point the court did not discuss.

93. *Id.*

94. *Id.* at 96 n.7.

The U.C.C. allows contracts to be formed in any manner sufficient to show the parties' agreement, including through conduct.⁹⁵ A course of dealing can be used to supplement an agreement as well as to interpret its terms.⁹⁶ A course of dealing can be shown by evidence sufficient to establish a "sequence of previous conduct between the parties" that can fairly be regarded as "establishing a common basis of understanding for interpreting their expressions and other conduct."⁹⁷ Express assent is therefore not necessary; requiring it contradicts the notion that conduct can supplement an agreement as well as serve as a basis for interpretation.

For these reasons, the court's treatment of TSL's course of dealing argument appears to rest on normative grounds. Rather than coming to grips with the rule that assent in the first instance might be established by conduct, the court seems to view express assent as a normative baseline requirement. Departures from that baseline seem suspect to the court, which could explain why it asserts that parties such as Step-Saver may reasonably rely on that baseline in interpreting the terms and behavior they see. If sellers have a duty to seek express assent, then perhaps this approach is acceptable. Such a duty, however, is at odds with the rule for establishing either a course of dealing or usage of trade.⁹⁸

The normative basis for the court's approach is obscure. Perhaps the opinion reflects an aversion to form agreements generally. Perhaps the court believed that requiring negotiated assent lowers the risk of judicial error in ascertaining the terms of agreements. TSL's terms were before the court, however, and the court's rule would not avoid litigation over the content of the parties' discussions when ordering software, so this reason is not very persuasive.

95. U.C.C. § 2-204(1) (1998).

96. U.C.C. § 1-205(3).

97. U.C.C. § 1-705(1). If TSL had raised a usage of trade argument, the same point would apply. The question would be why assent had to be express and could not be inferred from widespread and regular use of a method of dealing. The court did note that, on remand, a factual question remained as to whether "the custom in the trade is to exclude warranties and limit remedies in contracts between a software producer and its dealer." 939 F.2d at 105 n.48.

98. If we are to use the ruling in the case at hand to draw inferences about the parties' knowledge, it is at least equally plausible to say that a reasonable buyer would understand that such terms were binding, regardless of express agreement, if the shrink-wrap method satisfied the requirements of either course of dealing or usage of trade under the U.C.C.

Or perhaps the court worried that allowing fights over what the parties should have known would increase litigation costs while simultaneously reducing the reliability of decisions. Adding increased litigation costs to the equation, however, still does not suggest that the court's assumption is efficient. Those costs would be incurred only in the relatively few cases that went to court. Why would it be more efficient to reduce those costs through a rule that raised transaction costs across the board? There may be answers to these questions, but the court did not supply them.⁹⁹

Two years after *Step-Saver*, TSL found itself a defendant in an action brought by Arizona Retail Systems (ARS).¹⁰⁰ Like *Step-Saver*, ARS was a value-added retailer that ordered copies of TSL's operating-system software, (PC-MOS), which ARS incorporated into multi-user systems it sold to its clients. ARS's systems manager ordered a copy of PC-MOS, which he claimed was only to evaluate the software's performance. The copy arrived with a shrink-wrap license agreement that, among other things, disclaimed warranties, limited remedies, prohibited assignment, and included an integration clause.¹⁰¹

ARS's agent "read the license agreement but thought it was unenforceable and incapable of overriding" specific representations

99. Another possibility is suggested by the mild note of sarcasm with which the court responded to *Step-Saver*'s argument that disclaiming warranties allowed software firms to manage their risks and, by implication, offer lower prices. The court seemed unimpressed, though it couched its rejection of the argument in traditional doctrinal terms rather than normative ones.

TSL has raised a number of public policy arguments focusing on the effect on the software industry of an adverse holding concerning the enforceability of the box-top license. We are not persuaded that requiring software companies to stand behind representations concerning their products will inevitably destroy the software industry. We emphasize, however, that we are following the well-established distinction between conspicuous disclaimers made available before the contract is formed and disclaimers made available only after the contract is formed. When a disclaimer is not expressed until after the contract is formed, UCC §§ 2-207 governs the interpretation of the contract, and, between merchants, such disclaimers, to the extent they materially alter the parties's agreement, are not incorporated into the parties's agreement.

939 F.2d at 104-05. Because the course of dealing argument was relevant to the parties' knowledge at all times during the contracting process, the temporal distinction the court draws does not adequately respond to that argument.

100. *Arizona Retail Sys., Inc. v. The Software Link, Inc.*, 831 F. Supp. 759 (D. Az. 1993).

101. *Id.* at 761.

he said TSL employees had made.¹⁰² ARS purchased many copies of PC-MOS over the next year, using a procedure substantially equivalent to that employed in *Step-Saver*. ARS would place an order by telephone. The parties would discuss the specific software needed, the price, and the quantity. “[N]either party made any reference to the warranty disclaimers or liability limitations during either the calls or on the invoices. The license agreements, however, appeared on the face of the packaging of each set of software sent by TSL to ARS.”¹⁰³

As to the first transaction, the court found that ARS ordered an evaluation disk from TSL and that the evaluation disk came with a live copy of PC-MOS, which was enclosed in a shrink-wrap stating the license terms. The court concluded that TSL made an offer to sell PC-MOS by including the live copy with the evaluation disk, and that ARS accepted that offer by opening the shrink-wrap. The Court found that the initial transaction was different from the transaction in *Step-Saver* because the shrink-wrap terms were part of the initial offer.¹⁰⁴

The court treated later transactions differently, essentially following the approach in *Step-Saver*. Interestingly, the court did not discuss the course of dealing argument raised in *Step-Saver*, and TSL appears not to have raised the argument. This omission was curious because the facts of *Arizona Retail Systems* were much more favorable to the argument than were the facts in *Step-Saver*, where TSL tried and failed to obtain agreement to documents including its warranty terms, but continued dealing with *Step-Saver* anyway. By contrast, not only did ARS know of TSL’s terms in the first transaction, the court found the terms bound the parties as to that transaction. If the “reason to know” concept is sufficient to establish a contract that includes an agreement to post-order terms, it is hard to see why the concept did not compel a different result as to the later transactions in *Arizona Retail Systems*.

Both *Step-Saver* and *Arizona Retail Systems* may be read as treating shrinkwrap terms as a suspicious deviation from the “usual” mode of contracting. Alternatively, the courts may be read as viewing

102. *Id.*

103. *Id.*

104. *Id.* at 763-64.

TSL's forms as an example of the use of form agreements to impose onerous terms on buyers without the buyers' actual assent. Neither court held that post-order shrink-wrap terms could not be part of a contract if the parties agreed to such a procedure up front. With the exception of the initial transaction in *Arizona Retail Systems*, however, the license terms failed as a defense in both cases. Neither court was willing to assume that the purchasers either knew or had reason to know that additional terms would follow the initial order, though the *Step-Saver* court was willing to assert that Step-Saver reasonably could have concluded that the terms were not binding. Both courts therefore refused to read an agreement to that effect into the parties' initial exchange. In the case of *Arizona Retail Systems*, this reluctance was fairly strong, given the court's finding on the initial agreement.

*ProCD v. Zeidenberg*¹⁰⁵ significantly changed the presumptive baseline for analyzing shrink-wrap terms. Zeidenberg bought ProCD's SelectPhone database and software in a retail outlet. The code was packaged in a box indicating that there were additional contract terms inside.¹⁰⁶ Zeidenberg made the database information available for free over the Internet. ProCD sued for breach of license terms. Zeidenberg defended on the ground that the terms were not binding. The court held that they were and ordered that judgment be entered in favor of ProCD. Three aspects of the decision are of particular interest: (1) its Coasean approach to a gap in property rights; (2) its analysis of price discrimination; and (3) its treatment of the baseline from which post-payment terms were to be evaluated.

ProCD is first and foremost a case about a database presumed to

105. 86 F.3d 1447, 1451-53 (7th Cir. 1996).

106. Professor Macauley warns us not to make too much of the label on the outside of the box:

When we look at a ProCD box, Judge Easterbrook's "offer" becomes pure fantasy. The notice is printed on the bottom flap of the box, flanked by a statement in large type that there are 250 million telephone numbers on 11 CD-Roms and the bar code for the scanner. The notice is printed in 6-point type in a space 2 3/4 inches by 1 inch. The notice that there are terms and conditions inside the box begins in the third sentence in this paragraph.

Macauley, *supra* note 4, at 779 n.25.

be ineligible for copyright protection.¹⁰⁷ The database was costly to compile and maintain and the fairly obvious assumption driving the opinion is that a property right of some sort was needed to induce investment in a product that consumers evidently valued but to which the most nearly applicable property right did not extend. A clearly defined property right would induce investment by promising a return through exchange facilitated by the clarity of the right and legal rules lowering transaction costs.¹⁰⁸ The court's holding effectively allowed ProCD to create a property-like right which the Copyright Act did not provide. The reasoning was economic, and the choice to follow that reasoning to bridge a gap in property rights was at least partly normative.

This point is related to the second point, about price discrimination. Judge Easterbrook argued that ProCD tried to charge different prices to commercial and non-commercial users and that it had to have an effective prohibition on redistribution to prevent arbitrage markets from popping up and undermining its plan.¹⁰⁹ Enforcement of the license terms provided that prohibition.

Price discrimination is a tool by which producers can capture a greater proportion of available surplus than they can by charging a fixed price. In other words, it is a means for shifting consumer surplus to producer surplus. On the other hand, it also allows producers to charge a lower average price for their products, increasing the number of consumers who can afford to buy them. By casting the terms at a price as necessary to facilitate marketing at a lower average price, Judge Easterbrook pointed to a plausible consumer benefit to the practice at issue even though price discrimination itself might shift surplus from consumers to producers.

In a related point, Judge Easterbrook advised against any effort to use contract terms to police the division of surplus: "Competition among vendors, not judicial revision of a package's contents, is how consumers are protected in a market economy [A]djusting terms

107. 86 F.3d at 1449 (citing *Feist Pub'ns, Inc. v. Rural Tel. Serv., Inc.*, 499 U.S. 340 (1991)).

108. *E.g.*, Frank H. Easterbrook, *Cyberspace Versus Property Law*, 4 TEX. REV. L. & POL. 103 (1999); Frank H. Easterbrook, *Cyberspace and the Law of the Horse*, 1996 U. CHI. LEGAL F. 207.

109. 86 F.3d at 1449-50.

in buyers' favor might help Matthew Zeidenberg today . . . but would lead to a response that might make consumers as a whole worse off."¹¹⁰ The *Step-Saver* court can plausibly be read as implicitly rejecting this type of argument,¹¹¹ suggesting that the different normative perspective of the two courts influenced their view of course of dealing and usage of trade analysis.

Couching enforcement of the shrink-wrap terms as at least plausibly a pro-consumer measure was an important step toward recognizing the shrink-wrap approach as a usage of trade. Judge Easterbrook's argument took the classic law and economics form of demonstrating how a decision in favor of a particular member of a class might make the class as a whole worse off. This argument was a rhetorical and analytical strategy that drove Arthur Leff to distraction in 1974.¹¹² By explaining how even a one-sided practice might benefit all concerned, Judge Easterbrook provided an actual reason behind the presumption that widespread use implies reasonability.

Perhaps as importantly, *ProCD* plausibly described the use of shrink-wrap terms as an unexceptional example of a common method of contract formation rather than as the aberrant or malevolent practice the *Step-Saver* and *Arizona Retail Systems* courts seemed to perceive. Judge Easterbrook said that "[t]ransactions in which the exchange of money precede the communication of detailed terms are common,"¹¹³ citing insurance, airline tickets, concert tickets, and consumer electronics as examples. He added that the "pay now, read terms later" method of formation benefitted both consumers and producers, and that the terms were as much a part of the product as the code.¹¹⁴

ProCD's depiction of sequential formation as at least potentially benefitting consumers and as a normal and acceptable method of contracting strongly influenced subsequent courts. Judge Easterbrook's average-price argument cast the shrink-wrap terms in a more favorable light. His analogies to contracting contexts that might

110. *Id.* at 1453.

111. *See supra* note 99.

112. *See* Arthur Alan Leff, *Economic Analysis of Law: Some Realism About Nominalism*, 60 VA. L. REV. 451 (1974).

113. 86 F.3d at 1451.

114. *Id.*

be more familiar to judges who did not buy much software went a long way toward normalizing the shrink-wrap method.

Judge Easterbrook got the chance to reinforce these points in a more conventional context in *Hill v. Gateway 2000*,¹¹⁵ which extended the *ProCD* holding to cover cases where the licensee did not have a package warning that additional terms would follow after payment and delivery of a computer.¹¹⁶ *Hill* involved a mail-order purchase of retail hardware and software by an end user. The purchase was arranged over the telephone. The plaintiffs specified the desired product and provided the defendant with a credit card number. The defendant agreed to ship a computer loaded with software.

Painting a plausible picture of an uninterested consumer forced to listen to rote recitation of contract terms over the telephone, Judge Easterbrook again argued that “Customers as a group are better off when vendors skip costly and ineffectual steps such as telephonic recitation, and use instead a simple approve or return device.”¹¹⁷ This argument is true, but it does not explain why Gateway could not have

115. 105 F.3d 1147 (7th Cir. 1997), *cert denied*, 522 U.S. 808 (1997).

116. *Id.* Though in *Hill* Judge Easterbrook said that *ProCD* had already decided the matter, *ProCD* refers to terms on the outside of the software package giving notice that further terms would be found inside. 86 F.3d at 1451. Thus, the statement in that case that “notice on the outside, terms on the inside, and a right to return the software for a refund if the terms are unacceptable . . . may be a means of doing business valuable to buyers and sellers alike.” *Id.*

117. 105 F.3d at 1149. Judge Easterbrook summarized:

A customer picks up the phone, orders a computer, and gives a credit card number. Presently a box arrives, containing the computer and a list of terms, said to govern unless the customer returns the computer within 30 days. Are these terms effective as the parties’ contract, or is the contract term-free because the order-taker did not read any terms over the phone and elicit the customer’s assent?

Id. at 1148. He concluded that:

Practical considerations support allowing vendors to enclose the full legal terms with their products. Cashiers cannot be expected to read legal documents to customers before ringing up sales. If the staff at the other end of the phone for direct sales operations such as Gateway’s had to read the four page statement of terms before taking the buyer’s credit card number, the droning voice would anesthetize rather than enlighten many potential buyers. Others would hang up in a rage over the waste of their time. And oral recitation would not avoid customers’ assertions (whether true or feigned) that the clerk did not read term X to them, or that they did not remember or understand it. Writing provides benefits for both sides of commercial transactions.

Id. at 1149.

mentioned to customers before charging their credit cards that Gateway was willing to deal only on additional terms that would be shipped with the computer.

At oral argument, the plaintiffs claimed that the lack of any notice that additional terms would follow the telephone order distinguished *Hill* from *ProCD*. Judge Easterbrook disposed of the point quickly, concluding that the plaintiffs did have such notice. He wrote that “the Hills knew before they ordered the computer that the carton would include some important terms, and they did not seek to discover these in advance.”¹¹⁸ He based this statement on the ground that “Gateway’s ads state that their products come with limited warranties and lifetime support.”¹¹⁹ Because the advertisements did not specify the content of these terms, Judge Easterbrook said, they amounted to sufficient notice that additional terms would accompany the product’s delivery.¹²⁰

Judge Easterbrook probably would have found that a contract had been formed even without the snippet of language on Gateway’s advertisements. Most likely, having normalized the use of shrink-wraps in *ProCD*, Judge Easterbrook thought the shrink-wrap method was so well-established that the Hills either knew or had reason to know that additional terms would be coming. As he put it, “payment preceding the revelation of full terms is common for air transportation, insurance, and many other endeavors.”¹²¹

The approach in *Hill* contradicted the *Step-Saver* court’s treatment of course of dealing. Rather than a presumption that assent must be express, it comes close to a presumption that the parties either know or reasonably should know that the transaction involves post-order and post-payment terms. Why? Because that is how things are done in this type of business. Says who? In this case, Judge Easterbrook; in *Step-Saver*, Judge Wisdom.

Both *Hill* and *Step-Saver* work from implicit assumptions about the information contracting parties should be presumed to have. The difference in outcomes is, in significant part, a function of the

118. *Id.* at 1150.

119. *Id.*

120. *Id.*

121. *Id.* at 1149.

different presumptions the two courts applied. Ironically enough, it is at least possible that the judges in both cases were right. Perhaps use of the shrink-wrap method became more common between 1991 and 1996. Or perhaps most software vendors used shrink-wraps in both 1991 and 1996, but the extent of the software market had grown, making judges more familiar with the practice. Or perhaps Judge Easterbrook was better able or more willing to classify shrink-wraps as an instance of a familiar type of transaction, while Judge Wisdom viewed software licensing as unknown territory.

Or perhaps Judge Wisdom simply could not get past the fact that the parties had bargained over an agreement including the shrink-wrap terms but had not signed it. The court stated its reasons in broader terms, but there is always a chance that the failure to sign a bargained agreement colored the court's view of the case as a whole. Judicial presumptions about the fairness and usefulness of form agreements may have played a role too. Judge Wisdom was less receptive to the economic justifications for shrinkwraps than was Judge Easerbrook, though the database aspect of *ProCD* may account for at least some of this difference. To the degree any but the first of these conjectures is even partly true, we have a credible example of the role judges themselves play as a variable in recognizing usages of trade.

ProCD and *Hill* proved to be appealing precedents. Judges in three other Gateway cases quickly adopted their formation analysis,¹²² and another court embraced the notion that the shrink-wrap method benefitted consumers.¹²³ The court in *Brower v. Gateway 2000*, which refused to enforce the choice of an arbitrator selected in Gateway's form terms, though it enforced the requirement of arbitration, was persuaded that "transactions involving 'cash now', terms later' have become commonplace enabling the consumer to make purchases of sophisticated merchandise such as computers over

122. *Westendorf v. Gateway 2000, Inc.*, 41 U.C.C. Rep. Serv.2d (CBC) 1110 (Del. Ch. 2000); *Brower v. Gateway 2000, Inc.*, 676 N.Y.S.2d 569, 571-72 (1998); *Levy v. Gateway 2000, Inc.*, 33 U.C.C. Rep. Serv.2d (CBC) 1060 (N.Y. 1997).

123. *Rinaldi v. Iomega Corp.*, 41 U.C.C. Rep. Serv.2d (CBC) 1143 (Del. Super. Ct. 1999) ("The commercial practicalities of modern retail purchasing make it eminently reasonable for a seller of a product such as a Zip drive to place a disclaimer of the implied warranty of merchantability within the plastic packaging.").

the phone or by mail—and even by computer.”¹²⁴ Even the district court in *Klocek v. Gateway, Inc.*,¹²⁵ which criticized and refused to follow both *ProCD* and *Hill*, apparently would have recognized the shrink-wrap terms at issue as part of the parties’ agreement if Gateway had mentioned at the time of order that it would deal only subject to additional terms that would be provided with the product.¹²⁶

Which brings us full circle, to *M.A. Mortenson Company, Inc. v. Timberline Software Corporation*.¹²⁷ Mortenson was a large construction contractor. It used Timberline’s Bid Analysis software, which was “designed for use by general contractors preparing construction bids.”¹²⁸ Bid Analysis “analyzes project requirements as well as bid information from subcontractors and finds the lowest cost combination of subcontractors to carry out the work.”¹²⁹ Mortenson was using a version of Bid Analysis called Medallion. When Mortenson upgraded its hardware, however, it learned that Medallion was not compatible with its new operating system. A local dealer for Timberline advised Mortenson that a new version of Bid Analysis, ironically named “Precision,” would work with Mortenson’s new system.

On the advice of the dealer, Mortenson ordered eight copies of Precision Bid Analysis software, for use in its home and regional offices.¹³⁰ After Timberline’s dealer named a price, Mortenson issued a purchase order for the software. The purchase order did not include an integration clause.¹³¹ The software arrived in boxes filled with disks in pouches and some manuals. Timberline’s license terms were printed on the outside of the disk pouches and on the inside cover of the manuals. A reference to the license terms also appeared on the

124. 676 N.Y.S.2d at 572.

125. 104 F. Supp.2d 1332 (D. Kan. 2000).

126. *Id.* at 1341 n.14. *Klocek* cited *M.A. Mortenson Co., Inc. v. Timberline Software Corp.*, 998 P.2d 305 (Wash. 2000), and mentioned the Washington Supreme Court’s course of dealing analysis, which apparently would not have applied to *Klocek*, but did not discuss *Mortenson*’s usage of trade analysis, which presumably would have applied to *Klocek*.

127. 998 P.2d 305 (Wash. 2000).

128. *Id.* at 307 n.1.

129. *Id.*

130. *Id.* Mortenson later ordered a ninth copy. *Id.* at n.2.

131. *Id.* at 308.

first screen each time the software was booted up. The software was also accompanied by copy protection hardware, which had to be attached to Mortenson's hardware in order to run the Precision Bid Analysis program. There was one device for each copy of the program and each device carried its own license.¹³²

The Precision software had a bug. On the day Mortenson calculated a final bid for a large project, the bug caused the software to crash, displaying the intriguing message "Abort: Cannot find alternate." This series of events happened nineteen times.¹³³ Undaunted, Mortenson's employees pressed on, finally getting the software to generate a bid, which Mortenson submitted. The bid was approximately \$1.95 million too low.

Mortenson sued Timberline for breach of warranty. Timberline countered that its license terms limited the remedies for which it could be held liable to the amount of the license fee. The trial court granted summary judgment in Timberline's favor, holding that the license terms were effective to bar the recovery Mortenson sought. In granting the motion, the trial judge said that "if this case had arisen in 1985 rather than 1997, I might have a different ruling," but that, on the facts before the court, the license terms controlled.¹³⁴

One wonders what, exactly, such a statement might mean. What had changed, and why did it matter? A plausible conjecture is that the trial judge's comment reflected the court's view that the sequential formation method Timberline employed was increasingly common, or at least increasingly familiar to judges, and therefore should be respected.

The Washington Supreme Court also seemed persuaded by the notion that times had changed, and it gave some reasons for this view. Most pertinently, the Supreme Court said that "Mortenson and Timberline had a course of dealing; Mortenson had purchased licensed software from Timberline for years prior to its upgrade to Precision Bid Analysis."¹³⁵ The course of dealing was relevant

132. *Id.* The parties disputed the manner in which the software was actually installed, but that dispute is not relevant here.

133. *Id.* at 309.

134. *Id.* at 310.

135. *Id.* at 314.

because “[a]ll Timberline software, including the prior version of Bid Analysis used by Mortenson since at least 1990, is distributed under license.”¹³⁶ The court concluded that the post-order terms were therefore part of the parties’ agreement and provided a defense against *Mortenson’s* warranty claim.

The *Mortenson* court thus reversed the inference the *Step-Saver* court had drawn about the course of dealing between the parties. As we have seen, *Step-Saver* acknowledged that the purchaser in that case might well have expected that post-order terms would come with its software, but it did not view that fact as particularly significant. The court there said that the purchaser reasonably could have thought the post-order terms were a request for additional terms and were not binding. *Mortenson* looked at similar facts and concluded that because the purchaser expected additional terms to come with the software, the additional terms were part of the parties’ agreement.

Presumably, the *Mortenson* court either did not care whether the purchaser thought the additional terms were binding or thought it would be unreasonable for the purchaser to question the validity of the terms. The court did not explain why the expectation that post-order terms would be delivered justified the further conclusion that the parties agreed that such terms would be binding.

Roughly the same can be said of the court’s usage of trade analysis. The court referred to “extensive testimony and exhibits before the trial court” which established “an unquestioned use of such license agreements throughout the software industry.”¹³⁷ *Mortenson* failed to dispute this evidence, questioning only its relevance. The usage of trade analysis was, therefore, an alternative basis on which the trial court’s summary judgment ruling could be affirmed.

The court’s use of the word “unquestioned” is interesting. The court did not describe in any detail the evidence submitted on summary judgment, so it is not entirely clear: (i) whether the adjective refers only to *Mortenson’s* failure to contest the evidence; (ii) whether it implies that the evidence submitted claimed that there was no dispute that vendors such as Timberline always used post-order terms; or (iii) whether the evidence submitted claimed that both

136. *Id.*

137. *Id.*

vendors and purchasers endorsed the use of such terms. The third possibility is unlikely. If nothing else, *Mortenson* disputed the validity of the procedure in the case before the court, as did the purchasers in the other cases examined.

If we assume that the second meaning is the one the court had in mind, one faces the result contemplated by the U.C.C. and UCITA: The purchaser is bound because most if not all vendors employ the practice, regardless whether the purchaser believes the practice creates binding terms in addition to those stated at the time of the initial order.

Much more can be said about *Mortenson*, but by now the normative aspect of judicial recognition of usages of trade should be clear. To say that a purchaser has reason to know that additional terms will follow an initial order is not necessarily to say that the purchaser will or should expect such terms to be binding. The disparity between the approach employed in *Step-Saver* and in both *Hill* and *Mortenson* shows that much. To hold that the terms are binding requires some reason for preferring the vendor's expectation to that of the purchaser.

Uniformity of practice might be one such reason, as the presumption of reasonability stated in the comments to U.C.C. section 1-205 make clear. But suppose, as Mark Lemley has suggested, that the beliefs of purchasers are as uniform as the beliefs of vendors, and that purchasers believe post-order terms are unenforceable unless the purchaser expressly agrees to them.¹³⁸ In that case, we would have evidence of two mutually exclusive usages, both presumed to be reasonable, and these usages would cancel each other out. At that point, usages of trade could not be used, as UCITA contemplates, to make the terms binding. Although purchasers would have reason to know that vendors considered post-order terms binding, vendors would have reason to know that the purchaser rejected this position.

One could try to avoid this dilemma by positing that purchaser beliefs are not uniform on this point. Perhaps not, but neither *Hill* nor *Mortenson* rests on that ground, and it is not clear how such a claim

138. E.g., Mark A. Lemley, *The Law and Economics of Internet Norms*, 73 CHL.-KENT L. REV. 1257, 1274 (1998).

could be verified or disproved with any confidence. Purchasers in litigation uniformly contest post-order terms, but that sort of hindsight evidence is not worth much. It is easier for vendors to make broad statements about what other vendors do, as seems to have been the case in *Mortenson*, but the relative ease with which flat statements about practices can be made seems a particularly hollow basis for recognizing a usage of trade.

Judge Easterbrook's average-price argument provides one possible answer. If enforcement of post-order terms lowers the average price of software, then a simple rational actor assumption implies that most purchasers would agree *ex ante* that the terms were enforceable. This rule might also be true if the terms lowered only the average cost of production. The after-the-fact protestations of actual litigants could be dismissed as sour grapes, and the usage recognized on hypothetical bargain grounds, which is really just a way of describing the implication of the rational actor assumption.¹³⁹

The opinion of the Washington Court of Appeals in *Mortenson* employed just this analysis when it concluded that Timberline's limitation on remedies was conscionable. On the question of procedural unconscionability, the court considered the evidence of widespread usage to be evidence of conscionability, noting that "such limitations provisions are widely used in the computer software industry."¹⁴⁰ The court of appeals followed this approach on the substantive branch of analysis as well, saying that terms limiting liability for consequential damages

are standard in the software industry and do not shock the conscience. Indeed, they are useful in making software affordable. If software developers were prohibited from limiting consequential damages, the significant costs to the industry would be passed on to the consumer. We conclude

139. See JULES COLEMAN, RISKS AND WRONGS 169 (1992) ("[T]here appears to be nothing expressed by the concept of hypothetical consent that is not already captured in the idea of rational self interest.").

140. *M.A. Mortenson Co., Inc. v. Timberline Software Corp.*, 970 P.2d 803, 812 (Wash. App. 1999).

that the limitations of remedies provision is not substantively unconscionable.¹⁴¹

The Washington Supreme Court's opinion was consistent with this approach. The court reasoned that "the same uncontradicted evidence of trade usage and course of dealing in our analysis of contract formation supports the conclusion that the clause is procedurally conscionable."¹⁴² The Court blended consideration of both standard practice and the economics of the transaction. On substantive unconscionability the court said that, "[i]n a purely commercial transaction, especially involving an innovative product such as software, the fact an unfortunate result occurs *after* the contracting process does not render an otherwise standard limitation of remedies clause substantively unconscionable."¹⁴³

There is nothing inherently wrong with these sorts of arguments. No doubt they are right much, and perhaps, most of the time. In analyzing such arguments, however, we have to remember two things. First, if one accepts such arguments as a basis for recognizing usages of trade, one must also accept that recognition of usages is to some degree normative rather than purely descriptive. For the court of appeals in *Mortenson* and, to a less explicit degree, for the Washington Supreme Court, recognition of the usage rested to some degree on the benefits the usage provides, on average, to the class of persons against whom the usage is asserted.

Second, average cost or average price arguments are blunt instruments. They may justify recognition of usages of trade in many cases, but only as part of a broader analysis. If the usage is a penalty clause for breach, for example, one would have to consider the average cost argument in light of arguments in favor of efficient breach. If the usage is the forfeiture of the first-born child, then one would have to balance average cost arguments against whatever moral considerations one deemed relevant. Average price or cost arguments are useful, and they are important, but they must be considered in context.

141. *Id.* at 812.

142. 998 P.2d 315-16 n.12 (Wash. 2000).

143. *Id.* at 315.

III. IMPLICATIONS

The case for recognizing either a course of dealing or usage of trade justifying post-order shrink-wrap terms was much stronger in *Step-Saver* than in *Mortenson*. The buyer in *Step-Saver* was experienced in writing and integrating software and engaged in several software transactions with its vendor. The buyer in *Mortenson* was a construction firm that, insofar as the opinion discloses, had no software expertise. (Indeed, the construction firm may well have thought the relevant usages were those applying to purchases by a general contractor of inputs for a construction project.) The buyer in *Mortenson* relied on a sales agent for the vendor to diagnose why its old software would not work with its new hardware and to recommend an appropriate upgrade. This action was precisely the type of thing that *Step-Saver* could have done for itself. *Mortenson* previously licensed at least one generation of software from the vendor, but the record disclosed no more than the prior purchase of a single version.¹⁴⁴

Nevertheless, the course of dealing argument was rejected in *Step-Saver* and accepted in *Mortenson*. (And the reasoning of *Step-Saver* cut against the usage of trade analysis in *Mortenson*.) Many variables are relevant to explaining this result. But one can at least conjecture that courts became more willing to recognize the post-order shrinkwrap method as judges became more familiar with it, whether through cases or personal experience, and as they came to accept the practice as creating surplus-enhancing efficiencies rather than viewing it as a means of taking unfair advantage of consumers.

Though not formally relevant under the U.C.C. or UCITA, a judge's information about a practice will influence the judge's decision whether to recognize a usage or allow evidence of a claimed usage to go to a jury. If this statement is accepted as true, the question becomes what to do with the role of the judge in recognizing usages.

Unexplained, ad-hoc recognition of trade usages reduces the value of the concept by making it difficult for parties to determine what

144. Because *Mortenson* had several offices, its license of Medallion Bid Analysis may have included multiple copies of the program, but for present purposes it is best to characterize the Medallion transaction as a single transaction involving licenses for multiple locations.

practices will be recognized as a usage, which in turn reduces the certainty of contracting.¹⁴⁵ Recognizing that a judge's own information and opinions affect the usages of trade a judge is willing to recognize is important because it helps scholars and practitioners think clearly about a portion of the analysis that neither the U.C.C. nor UCITA recognizes. If it is inevitable that a judge's view of usages of trade will be influenced by his or her own beliefs, then providing analytical tools that allow those beliefs to be brought out and tested in a rigorous way will make the process more accessible to the parties. Hopefully, it will also lead to better decisions—ones that explain the basis for recognizing a usage of trade in a way that lawyers and clients can understand and take into account in future behavior.

Having explored the shifting assumptions in shrink-wrap cases throughout the 1990s, it is best to explore this point through a concrete example that might be relevant in the future. Section 401(a) of UCITA states that a “licensor of information that is a merchant regularly dealing in information of the kind warrants that the information will be delivered free of the rightful claim of any third person by way of infringement or misappropriation.”¹⁴⁶ In substance, this warranty assures the licensee that the licensee can use the software without breaking the law. Infringement requires no proof of intent, so a licensee making RAM copies with an infringing product is an infringer. The default warranty gives the licensee a cause of action for indemnity in the event the licensee is enjoined from using the software or otherwise suffers damages.¹⁴⁷

Section 401(d) of UCITA allows vendors to disclaim the warranty of noninfringement. Essentially, it allows vendors to refuse to provide licensees any assurance that the licensee may legally use the software in its intended manner without violating the intellectual property rights of a third party. At first, this provision seems unexceptional. Warranties are often implied and often disclaimed.

145. See Warren, *supra* note 38, at 581-82.

146. UCITA § 401(a) (2001).

147. See, e.g., *MAI Sys. Corp. v. Peak Computing, Inc.*, 991 F.2d 511, 518 (9th Cir. 1993). The 1998 Amendments to 17 U.S.C. § 117 probably do not affect this conclusion. For background on that amendment, see, e.g., MARK A. LEMLEY ET AL., *SOFTWARE AND INTERNET LAW* 201-04 (2000).

The U.C.C. allows this procedure, so why not UCITA, and why not the warranty of non-infringement? The usual arguments about warranties also apply: Contract terms are as much a part of the product as the code; to compel a vendor to provide a warranty is to dictate the terms of the agreement and the nature of the product on offer. One could argue that legislatures and judges are not competent to do these things, and therefore one should not protest if a vendor wishes to disclaim a warranty.

These are strong arguments; in many cases they are compelling. In this context, however, they may carry less than their usual weight. The intrusion into product design that these arguments protest is a fundamental feature of intellectual property rights. No vendor may use infringing code in its own product, and is subject to injunctive relief and damages if it does. A vendor who knowingly incorporates infringing code into a product is liable for the infringement of its customers, if only as a contributory infringer. Vendors already face enough liability risk to give them an economic incentive to police their product to keep out infringing code. The cost of determining whether a product infringes, and the expected cost of infringement suits, are already imposed on vendors by the relevant intellectual property statutes. No warranty disclaimer will change that fact.

The marginal cost of indemnity claims by licensees who might suffer harm if they were enjoined from using a vendor's software remains. If an injunction shut down a licensee's business, for example, the licensee might sue the vendor for lost profits. If for no other reason, infringement plaintiffs might sue licensees to put pressure on a vendor to settle a claim. It is not clear how much the risk of indemnity actions would add to the expected cost of infringement claims. If the risk of such actions was too remote, or too hard to calculate, then the additional amount might be very small, which would imply that average cost or average price arguments could do little to justify such disclaimers. If the additional expected cost was significant, however, such arguments might carry a lot of weight.

Even then, however, it would not necessarily follow that such disclaimers could be justified. The prohibition on infringement implies that, as a matter of intellectual property policy, it is desirable for vendors to determine whether their products include infringing

code. If nothing else, the vendor could seek a license for such code, the type of bargaining that drives the reward system the rights embody. Vendors are certainly in a better position to investigate whether their code infringes than are purchasers. Vendors have both the source code and the ability to trace its authorship. Purchasers often receive only binary code that vendors claim is a trade secret. Vendors are therefore better able to assess the probability that an infringement claim might be brought or be successful; they are the low-cost investigators of infringement.

Users are better able to estimate the costs of an injunction, however. They would normally be able to insure against such losses more efficiently than vendors. Without information about the content of the code, however, they are in a poor position to estimate the probability of liability. Perhaps the vendor's reputation could be used as a proxy for that probability, but the disclaimer lessens the reliability of such inferences somewhat.

It is therefore hard to use the least-cost insurer concept to decide whether to enforce the disclaimer. Insurance requires an estimation of the probability and magnitude of loss, and the best and cheapest knowledge of these two variables lies on different sides of such software transactions. One cannot say as a purely logical matter that either vendors or users are the least-cost insurers of infringement.

Section 401(d) of UCITA allows the warranty of non-infringement to be disclaimed in two ways. The first is with specific language stating that "the licensor does not warrant that competing claims do not exist or that the licensor purports to grant only the rights it may have."¹⁴⁸ The second way is through evidence of "circumstances that give the licensee reason to know" that the licensor disclaims the warranty.¹⁴⁹

As we have seen, section 114(f) of UCITA provides that "reason to know" includes usages of trade, which section 102(66) defines to

148. UCITA § 401(d). In December 2000, a UCITA Standby committee proposed an amendment to section 401(d) specifying sample language for disclaiming hold-harmless obligations. This amendment in part repeated the "reason to know" language discussed in the text. *See* Report of UCITA Standby Committee, Dec. 17, 2001, at <http://www.nccusl.org/nccusl/UCITA-2001-comm-fin.htm> (visited Mar. 1, 2002). As of this writing, no action had been taken on this proposed amendment.

149. *Id.*

include widely used practices. The upshot is that (i) software vendors can disclaim a warranty that users will not violate the law by using the software in the manner for which it is intended; (ii) if they do so individually, they must expressly disclaim the warranty; and (iii) if they do so collectively and consistently, the express disclaimer is not necessary.

In reality, of course, it probably would be a rare case in which a usage sufficient to work as a silent disclaimer under section 401(d) was proved without being established in the first instance by uniform use of the type of express disclaimers authorized by section 401(d). Once a usage was established, however, it is not clear that section 401(d) would require that the disclaimers be continued, just as in *Hill* and *Mortenson* there was no requirement that software vendors mention at the time of the initial order that they would be sending additional terms to the customer. The cost of continuing express disclaimers would be trivial, and there would be evidentiary value to using them, so the silent disclaimer notion is probably nothing more than an academic hypothetical. It does, however, serve to focus our attention on the decisions a court would have to make in confronting such a usage.

The point of all of this is not that UCITA is wrong to allow a warranty of non-infringement to be disclaimed, either explicitly or by usage of trade. It is not obvious that such disclaimers should or should not be allowed. The analysis above hopefully demonstrates that this argument presents a close and complex question. To the extent usages of trade may be relevant to disclaimers, a judge considering whether to recognize a usage should work through such an analysis in very explicit terms with the full participation of the parties. The Kaldor-Hicks criterion provides a framework for evaluating the welfare effects of disclaimers. It should help make the court's consideration of the costs and benefits of the proffered usage more rigorous and more easily replicated by lawyers who sell advice to clients.

Some courts explicitly consider the risk or loss-bearing effects of practices in deciding whether to recognize them.¹⁵⁰ One can at least

150. See Craswell, *supra* note 4, at 43-45. Professor Craswell cites *Charter Title Corp. v. Crown Mortgage Corp.*, 836 P.2d 846, 850 (Wash. 1992), as one example. The court there

conjecture that courts take such considerations into account when deciding whether to recognize usages. The consideration may or may not be purely economic, as the differences in *Step-Saver* and *ProCD* suggest, but it is simply not realistic to expect a court to ignore the economic or policy implications of a practice when deciding whether to recognize it as a usage of trade.

It is better to articulate such concerns explicitly and apply them to the facts of concrete cases than to let them operate silently. Neither the U.C.C. nor UCITA requires such articulation, which discourages the kind of reasoned elaboration that might assist lawyers and clients in determining when usages will be recognized. Although requiring litigants to explain why the usages they advance make sense in the context of a transaction might seem to risk activist judges re-writing contracts about which they know nothing, this criticism seems off the mark. If one accepts that there is inevitably a normative component to recognizing usages of trade, then the question is not whether

refused to recognize as a course of dealing a bank's practice of providing endorsements to checks that lacked them, stating that:

"There are also sound policy reasons for not judicially imposing such a duty upon depository banks. It is a well known principle of tort law that the risk of loss should be borne by the one who can most economically avoid the loss." *Id.* at 850 (citing *United States v. Carroll Towing Co.*, 159 F.2d 169, 173 (2d Cir. 1947)); see GUIDO CALEBRESI, *THE COSTS OF ACCIDENTS: A LEGAL AND ECONOMIC ANALYSIS* (1970); Richard Posner, *A Theory of Negligence*, 1 J. LEGAL STUD. 29 (1972). As Oliver Wendell Holmes wrote almost one hundred years ago: "[T]he safest way to secure care is to throw the risk upon the person who decides what precautions should be taken." OLIVER WENDELL HOLMES, *THE COMMON LAW*, 117 (1923). In this case, Charter was clearly in the best position to take the precautions necessary to prevent the loss. All it had to do was to look twice for proper endorsements before depositing its checks, hardly a burdensome task. On the other hand, imposing a duty on depository banks to find all missing endorsements would be extremely costly for the banks and would ultimately diminish the efficiency of the check collecting system as a whole.

See also *W. Indus., Inc. v. Newcor Canada, Ltd.*, 739 F.2d 1198, 1204 (7th Cir. 1984):

That contractual liability for such damages (in the absence of special notice) is of relatively recent vintage, that many breaches of contract are (as here) involuntary, that only the sky would be the limit to the amount of consequential damages that manufacturers of machinery indispensable to their customers' businesses might run up, that those customers not only have a better idea of what the potential injury to them might be but also might be able to avert it more easily than their supplier—all these things make it not at all incredible that a custom might have evolved in this industry against a buyer's getting consequential damages in the event of a breach.

Id.

normative concerns will affect the decision but whether the process will be litigated openly.

CONCLUSION

Both UCITA and the U.C.C. say they are concerned with taking into account the reality of commercial practice. But the statutes deal with judges as well as commerce, and it would seem equally desirable for the statutes to take into account the reality of judicial practice as well. In order to make the normative component of usage of trade analysis as explicit and rigorous as possible, courts should explicitly require a plausible Kaldor-Hicks justification for the usage at issue. Where contracting takes place against the prominent background of intellectual property rights and limitations, as is likely to be the case with many if not most e-commerce transactions, these policies are likely to be of great importance. Explicit consideration of the welfare implications of usages will allow parties to litigate them openly and give lawyers a more complete basis on which to advise clients.

