COMMERCIAL LAW—COURSE OF DEALING AND USAGE OF TRADE AFFECT EXPRESS TERMS—Columbia Nitrogen Corp. v. Royster Co., 451 F.2d 3 (4th Cir. 1971).

I. The Case

A. The Facts

Columbia Nitrogen Corp. produces nitrogen as its primary product, although it does manufacture some mixed fertilizer. Royster Co. primarily manufactures mixed fertilizer, a product made from nitrogen, phosphate, and potash. For several years Royster had been a major purchaser of nitrogen from Columbia. In the fall of 1966 Royster built a facility to produce its own phosphate. In so doing, Royster produced more phosphate than it could use in its own mixed fertilizer production. Consequently, it endeavored to sell some of its excess phosphate to Columbia.

After extensive negotiations, Columbia and Royster made an agreement by which Columbia was to purchase a minimum of 31,000 tons of phosphate each year for three years beginning July 1, 1967. The contract price was stipulated and included an escalation clause "up or down" dependent on Royster's production costs.[1] Shortly thereafter, the market price of phosphate plummeted. Columbia, unable even to resell the phosphate competitively, ordered only part of the scheduled tonnage. At Columbia's request, Royster lowered the price for the phosphate for three monthly shipments in 1967 but specified that the original contract price would be charged for subsequent shipments. In the first year Columbia ordered only about 10 percent of the minimum amount in the agreement. Subsequently, when Royster insisted on the contract price, Columbia refused to accept delivery.

Royster sued for contract damages. Columbia attempted to assert as a defense a usage of the trade and a course of dealing between the parties to explain the terms of the agreement pertaining to quantity and price.[2] It offered evidence to show that the quantities stipulated in supply contracts for fertilizer and its component materials were merely guesses as to future requirements[3]

---

1. An escalation clause provides a means of setting a price which has some flexibility yet is not so indeterminate as to make the contract uncertain. The escalation clause in Royster's contract is as follows:

> *Escalation*—The escalation factor up or down shall be based upon the effects of changing raw material cost of sulphur, rock phosphate, and labor as follows. [sic] These escalations up or down to become effective against shipments of products covered by this contract 30 days after notification by Seller to Buyer.

Columbia Nitrogen Corp. v. Royster Co., 451 F.2d 3, 7 n.2 (4th Cir. 1971).

2. Columbia also asserted an antitrust defense and counterclaim based on Royster's alleged reciprocal trade practices. *Id.* at 4, 13-16.

3. The court did not treat this as a requirements contract under section

which could fluctuate greatly as a result of unknown factors such as weather conditions, farming practices, and government agricultural programs.[4] Columbia asserted a usage of trade that the forces in the market at the time of delivery, not the guesses in the agreement, determined the quantity needed and the price to be paid.

Columbia also sought to invoke a course of dealing it had had with Royster over the preceding six years. During that time Columbia had sold quantities of nitrogen to Royster. Columbia contended that its dealings with Royster showed repeated and substantial deviation from the contracts in regard to both price and quantity, including four instances in which Royster took none of the goods for which it had contracted.[5] Columbia argued that it had depended on this understanding between the parties when it had negotiated the disputed agreement.

B. The Decision

The district court excluded Columbia's evidence of course of dealing and usage of trade. It held that such evidence was not admissible to contradict the express and unambiguous language of a written contract that is so detailed that it negates the idea that its terms are open to variances.[6] The court submitted the case to the jury on the evidence admitted. The jury found for Royster on both the contract claim and the anti-trust counterclaim.[7] Judgment was entered for Royster in the amount of $750,000.

Columbia appealed to the Fourth Circuit Court of Appeals claiming error in the pretrial ruling of the district court excluding all evidence on usage of the trade and the course of dealing between the parties. The Fourth Circuit affirmed the district court on all the anti-trust issues but reversed the finding on the contract claim and remanded the case for further proceedings. In reversing the district court, the Fourth Circuit held that a finding of ambiguity in the written terms was not necessary for the admission of evidence of course of dealing and usage of trade.[8] The court also held that the test for admissibility of the evidence was its reasonably being construed as consistent with the express terms of the agreement.[9] The court found no inconsistency in this case.

2-306 of the Uniform Commercial Code. Apparently, neither side argued that this was a requirements contract. Columbia Nitrogen Corp. did not argue that it was refusing delivery of the phosphate due to any lack of requirements on its part.

4. 451 F.2d at 7-8 n.3.

5. *Id.* at 8. Columbia offered to show that this constituted more than $500,000 in reduced sales. *Id.*

6. *Id.*

7. *Id.* at 6.

8. *Id.* at 9.

9. *Id.*

II. DISCUSSION

A. *Ambiguity in the Express Terms*

In cases outside the purview of the Uniform Commercial Code and those arising prior to its enactment, a court's decision to allow the admission of evidence as to custom and usage was generally based upon a finding that the express terms of the contract were ambiguous.[10] If the meaning seemed plain, the evidence was rejected.[11] The district court's exclusion of Columbia's testimony of course of dealing and usage of trade was based on this premise.

The Fourth Circuit correctly held that the Uniform Commercial Code changed this approach and that the district court had erred in excluding Columbia's evidence on this basis. It said that section 1-102(2)(b)[12] permits the expansion of commercial practices through custom and usage and that section 2-202[13] enables the court to take the commercial setting of the contract into consideration when construing the meaning of the writing.[14] This interpretation is reinforced by Comment 1(c) of section 2-202[15] which

10. *See* Jones v. Chaney & James Constr. Co., 399 F.2d 84 (5th Cir. 1968); W.G. Cornell Co. v. United States, 376 F.2d 299 (Ct. Cl. 1967).

11. *See* Mall Gift Cards, Inc. v. Wood, 288 Ala. 355, 261 So. 2d 31 (1972) (leases); Farmers Coop. Ass'n v. Phillips, 243 Ark. 809, 422 S.W.2d 418 (1968); Maskel Constr. Co. v. Town of Glastonbury, 158 Conn. 592, 264 A.2d 557 (1969); Pink v. American Sur. Co., 283 N.Y. 290, 28 N.E.2d 842 (1940) (insurance contract); Valente v. Two Guys From Harrison, N.Y., Inc., 35 App. Div. 2d 862, 315 N.Y.S.2d 220 (1970) (construction contract); Albany Discount Corp. v. Basile, 32 App. Div. 2d 723, 300 N.Y.S.2d 464 (1969) (retail installment contract guarantee); Stith v. Hudson City Savings Inst., 63 Misc. 2d 683, 313 N.Y.S.2d 804 (Sup. Ct. 1970) (mortgage acceleration clause); North Unit Potato Co. v. Spada Distrib. Co., 260 Ore. 468, 490 P.2d 995 (1971) (statute banning custom and usage except as means of interpretation); State v. F & C Eng'r Co., 438 S.W.2d 647 (Tex. Civ. App. 1969); Republic Nat'l Bank v. National Bankers Life Ins. Co., 427 S.W.2d 76 (Tex. Civ. App. 1968).

12. UNIFORM COMMERCIAL CODE § 1-102(2)(b) states:

> (2) Underlying purposes and policies of this Act are . . . (b) to permit the continued expansion of commercial practices through custom, usage and agreement of the parties.

See VA. CODE ANN. § 8.1-102(2)(b) (1965). Uniform Commercial Code provisions are found in VA. CODE ANN. in §§ 8.1-101 to 8.10-104.

13. UNIFORM COMMERCIAL CODE § 2-202 states:

> Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in a writing intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented
>
> (a) by course of dealing or usage of trade (Section 1-205) or by course of performance (Section 2-208); and
>
> (b) by evidence of consistent additional terms unless the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement.

14. Columbia Nitrogen Corp. v. Royster Co., 451 F.2d 3, 8-9 (4th Cir. 1971).

15. UNIFORM COMMERCIAL CODE § 2-202, Comment 1 states:

specifically rejects the old approach of requiring a finding of ambiguity in the written terms before any usage of trade or course of dealing could be considered.

B. *Consistency Between the Alleged Usage and the Express Terms*

1. THE ROYSTER ANALYSIS

In *Royster* the Fourth Circuit cited *Division of Triple T Service, Inc. v. Mobil Oil Corp.*[16] for the proposition that "evidence of usage of trade and course of dealing should be excluded whenever it cannot be reasonably construed as consistent with the terms of the contract."[17] *Triple T* found this concept codified in section 1-205 (4)[18] of the Uniform Commercial Code.[19]

Triple T concerned a gas station franchise agreement in which a term provided either party with the right to terminate the agreement at the end of any three-year period upon notice given not less than 90 days before the end of that period. Otherwise, the agreement provided for automatic renewal for successive three-year periods. When Mobil tried to terminate the agreement upon sufficient notice in order to establish a diagnostic and repair service center on the site, the plaintiff claimed that a usage of the trade "implicitly adds the words 'with cause' in the termination clause."[20] The court rejected the application of the alleged usage finding it to be inconsistent with the tenor of the written agreement.[21] In dicta the court went on to say that the same analysis and holding would apply if the franchise holder had called his alleged trade usage a course of dealing between the parties.[22]

While the court in *Royster* cited *Triple T* as a case in which the

---

1. This section definitely rejects:

. . . .

(c) The requirement that a condition precedent to the admissibility of the type of evidence specified in paragraph (a) is an original determination by the court that the language used is ambiguous.

16. 60 Misc. 2d 720, 304 N.Y.S.2d 191 (Sup. Ct. 1969), *aff'd mem.*, 311 N.Y.S.2d 961 (App. Div. 1970).

17. 451 F.2d at 9.

18. UNIFORM COMMERCIAL CODE § 1-205(4) states:

(4) The express terms of an agreement and an applicable course of dealing or usage of trade shall be construed wherever reasonable as consistent with each other; but when such construction is unreasonable express terms control both course of dealing and usage of trade and course of dealing controls usage of trade.

19. Division of Triple T Serv., Inc. v. Mobil Oil Corp., 60 Misc. 2d 720, 731, 304 N.Y.S.2d 191, 203 (Sup. Ct. 1969).

20. *Id.*

21. *Id. Cf.* Laskey v. Rubel Corp., 303 N.Y. 69, 100 N.E.2d 140 (1951) (parol evidence not admissible to counter a written agreement making employment contract terminable at will); UNIFORM COMMERCIAL CODE § 2-202 (quoted in note 13 *supra*).

22. Division of Triple T Serv., Inc. v. Mobil Oil Corp., 60 Misc. 2d 720, 731-32, 304 N.Y.S.2d 191, 203 (Sup. Ct. 1969).

alleged usage was inconsistent with the tenor of the written agreement, it overlooked the similarity of that case to the instant situation. In each case the alleged trade usage affected a key term lying at the heart of the agreement. In *Triple T* the effect of allowing the alleged usage evidence would have been to change a periodically renewable franchise into a permanent franchise by making Mobil's termination dependent upon the franchise holder's performance. In *Royster* the alleged usage could, upon remand, be interpreted to find no duty for Columbia to take any phosphate from Royster, even though the contract term expressed a minimum yearly quantity of 31,000 tons. The effect would be to change the essence of the agreement from a supply contract into a mere option for the buyer.

The Fourth Circuit focused its attention upon trying to show that the alleged course of dealing and usage of trade tying price and quantities to the vagaries of the market for the finished product could reasonably be construed as consistent with the express terms.[23] To support its decision the court made the following findings: 1) no provision specifically excluded course of dealing or usage of trade and 2) the writing was silent as to adjusting prices and quantities to reflect a declining market.[24]

While it is true that the *Royster* agreement had no provision expressly excluding course of dealing or usage of trade from the contract, the writing was not silent concerning the adjustment of prices and quantities to reflect a declining market. There were "detailed provisions regarding the base price, escalation, minimum tonnage, and delivery schedules"[25] to handle those problems.[26] On the question of quantity, the court stated that the heading in the contract entitled "Products Supplied Under Contract" was consistent with Columbia's alleged course of dealing involving deviations from earlier contracts.[27] The court made no further attempt to rationalize this, but suggested that the outcome might have been different had the heading been just "Products" or "Products Purchased Under Contract."[28] Such an interpretation of the meaning of the express term, at the very least, seems to fly in the face of the Uniform Commercial Code policy of preserving the deal wherever possible.[29]

---

23. These express terms included the base price provision, the escalation clause, and the minimum quantities clause.

24. Columbia Nitrogen Corp. v. Royster Co., 451 F.2d 3, 9-10 (4th Cir. 1971).

25. *Id.* at 9.

26. *See, e.g.*, the price escalation clause of the Royster contract set out at note 1 *supra.*

27. 451 F.2d at 10.

28. *Id.*

29. UNIFORM COMMERCIAL CODE § 2-605, Comment 2.

2. ROYSTER GOES BEYOND EARLIER APPROACHES

Royster has gone significantly beyond earlier cases concerning consistency between alleged usage and express terms. In *Provident Tradesmens Bank & Trust Co. v. Pemberton*[30] the court found consistency between a trade usage requiring a financer to notify a seller that the insurance on the automobile financed for time purchase had lapsed and a term in which the seller had waived "all notices whatsoever with respect to this Agreement."[31] The court did this by reasoning that this printed clause on the form agreement referred to the text of the agreement and did not specifically negate the well-established custom. The court sought to protect the seller's expectation that he would be notified of a lapse in insurance so he could take steps to protect himself.[32] This differs from *Royster* in that the matter of insurance notices in *Provident Bank* was only a secondary provision of a contract primarily aimed at the financing of a sale while the matter of quantity and price in *Royster* was at the very heart of the agreement itself.

Another case involving a modification of express terms, but not cited by the Fourth Circuit, is *Michael Schiavone & Sons, Inc. v. Securalloy Co.*[33] *Schiavone* involved the written term "500 gross tons of stainless steel solids"[34] which appeared in a supply agreement. The defendant tried to introduce parol evidence to show an oral agreement that "500 gross tons" meant up to 500 tons rather than the full amount. The court allowed the evidence finding it not inconsistent with the express terms[35] and interpreted the consistency requirement to be satisfied so long as the subsequent oral agreement had a lesser effect than the complete contradiction or negation of those terms.[36] Again, this case can be readily distinguished from *Royster* because *Schiavone* involved an alleged oral agreement to modify the terms (covered in section 2-202 of the Uniform Commercial Code).

---

30. 24 Pa. D. & C.2d 720 (Phila. Mun. Ct.), *aff'd per curiam*, 196 Pa. Super. 180, 173 A.2d 780 (Super. Ct. 1961).

31. *Id.* at 728. The notices clause was followed by the provision that "the undersigned's liability under this agreement is absolute and unconditional and shall not be affected or released by reason of any action taken by Bank which is hereby consented or agreed to." *Id.*

32. *Id.* at 728-29.

33. 312 F. Supp. 801 (D. Conn. 1970).

34. *Id.* at 802.

35. *Id.* at 804.

36. *Id.* *See* Hunt Foods & Indus., Inc. v. Doliner, 26 App. Div. 2d 41, 270 N.Y.S.2d 937 (1966), *aff'd mem.*, 272 N.Y.S.2d 686 (App. Div. 1966) (unconditional written option to purchase stock orally conditioned upon other party's misusing negotiations recess to solicit another offer held consistent).

Section 1-205(4) of the Uniform Commercial Code (quoted note 18 *supra*) seems to require a stricter view of consistency for course of dealing and usage of trade than does section 2-202(b) of the Code (quoted note 13 *supra*) for oral agreements.

The Fourth Circuit in *Royster* did not merely find a waiver clause insufficient to wipe out a customary obligation having a secondary importance in the overall contract as did the court in *Provident Bank*; nor did it find an oral agreement to cut down the obligation of one of the parties as did the court in *Schiavone*. The Fourth Circuit went further by allowing the admission of evidence of a usage of trade that could effectively negate a party's obligation to perform by his showing that others in that trade treat their written contracts as not binding because stated minimum quantities are regularly ignored.[37]

C. *Other Areas of the Uniform Commercial Code Bearing Upon Evidence of Course of Dealing and Usage of Trade*

The Official Comments to the Uniform Commercial Code set out the way in which the Code should be read and interpreted:

> The text of each section should be read in the light of the purpose and policy of the rule or principle in question, as also of the Act as a whole, and the application of the language should be construed narrowly or broadly, as the case may be, in conformity with the purposes and policies involved.[38]

1. GENERAL PURPOSE OF THE CODE

One major factor permeating the Uniform Commercial Code is the purpose expressed in section 1-106 (1) that "[t]he remedies provided by this Act shall be liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed . . . ."[39] The Code also establishes the general obligations of the parties—the seller to transfer and deliver and the buyer to accept and pay.[40] Although the Comment to section 2-301 does allow usage of trade and course of dealing and performance as well as the lay meaning of the words to define the scope of the conditions and duties, no mention is made of allowing such evidence to negate the entire duty of a party.[41]

2. GOOD FAITH

The general concept of good faith is a second factor. Section 1-203 provides that "every contract or duty within this Act imposes

37. *But see* Farmers Coop. Ass'n v. Phillips, 243 Ark. 809, 422 S.W.2d 418 (1968). This case was decided without reference to the Uniform Commercial Code but concerns a similar usage of trade argument. The Arkansas court realized the effect of allowing such an argument and held that a custom could be invoked to explain an ambiguity but not to defeat the express terms of the contract.

38. UNIFORM COMMERCIAL CODE § 1-102, Comment 1.

39. *Id.* § 1-106.

40. *Id.* § 2-301.

41. *Id.* § 2-301, Comment.

an obligation of good faith in its performance or enforcement."[42] The duty is even stronger where merchants are involved[43] (as in *Royster*). The obligation of good faith in the performance, when applied to the general obligations of the parties in section 2-301, highlights the emphasis of Article 2 of the Uniform Commercial Code in "preserving the deal wherever possible."[44]

3. REASONABLENESS

A third factor is the requirement of reasonableness.[45] The Code changes the emphasis from pre-Code views by holding that "commercial acceptance makes out a prima facie case that the usage is reasonable."[46] However, the court retains the power to police the usages.[47] Even though industries in the fertilizer business may follow a trade usage or a course of dealing which ignores the written terms of a contract, the court has the responsibility of judging the reasonableness of such practices. Columbia's proffered testimony that fertilizer producers treat their contracts as not binding hardly seems to be a reasonable practice, particularly when the Code is aimed at facilitating commercial transactions.

4. UNCONSCIONABILITY

A fourth factor bearing upon the application of course of dealing and usage of trade is section 2-302(1)[48] concerning unconscionability. This section is reinforced by Comment 6 to section 1-205:[49]

> The policy of this Act controlling explicit unconscionable contracts and clauses (Sections 1-203, 2-302) applies to implicit clauses which rest on usage of trade and carries forward the policy underlying the ancient requirement that a custom or usage must be "reasonable."[50]

This is not to say that an unconscionability argument should be made whenever a course of dealing or usage of trade question is involved. It is merely to suggest that section 2-302 may be applied to place some limitation upon the kinds of trade usages and course

42. *Id.* § 1-203.
43. *Id.* § 2-103(1)(b). See § 2-104(1) for a definition of "merchant".
44. *Id.* § 2-605, Comment 2.
45. *Id.* § 1-205(4) & Comment 6.
46. *Id.* § 1-205(4), Comment 6.
47. *Id.*
48. UNIFORM COMMERCIAL CODE § 2-302(1) states:
> (1) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

49. This proposition has also been suggested by 1 R. ANDERSON, ANDERSON ON THE UNIFORM COMMERCIAL CODE § 1-205:9 (1970).
50. UNIFORM COMMERCIAL CODE § 1-205, Comment 6.

of dealing a party may assert in court to supplement the terms of its contract. In *Royster* this concept might apply to the practice of making contracts to secure a source of supply of materials while relying on a practice of reneging on the agreements to relieve the buyer from liability at the time of purchase, if he prefers not to perform.

D. The Effect of Royster

There are at least three effects which the Fourth Circuit's decision may have. The first is the opening of the Pandora's box of course of dealing and usage of trade arguments to ease the plight of a party who has found his bargain turning sour. This may ultimately create less certainty in contract expectations through deemphasis of express terms in favor of the less tangible, and therefore more disputable, concepts of course of dealing and usage of trade.

A second effect may either be efforts by parties to exclude course of dealing and usage of trade altogether through an express term or far more care in phrasing the wording of the terms of their agreements. Since it is sometimes difficult for parties to agree on the wording of a term, *Royster* could upset commerce by making it more difficult for the parties to arrive at a binding agreement. The Uniform Commercial Code was meant as a flexible approach to contracts to facilitate transactions, not as a stultifying force.[51]

A third effect is the real dilemma *Royster* presents to any party involved in a contract dispute with another party with whom it has continuing relations. If it fails to settle the dispute, it can become involved in troublesome litigation. On the other hand, if it agrees to settle out of court, its settlement may later be used against it. Settlements of several similar disputes over a period of time might arguably form a pattern which the other party could assert as a course of dealing between the parties.[52] In such circumstances *Royster* would discourage settlement and hamper commerce.

III. CONCLUSION

At first glance *Royster* seems to be a good example of the flexibility of the Uniform Commercial Code in allowing a court to consider the commercial setting when interpreting an agreement. However, a closer analysis reveals the dangers which can be created by too much leniency in admitting evidence of course of dealing and usage of trade. *Royster* seems to have reached the point at which judicial flexibility should yield to the policy of preventing

51. *Id.* § 1-102(2).

52. This appears to be the basis of Columbia's course of dealing evidence which the Fourth Circuit ordered admitted. *See* 451 F.2d at 8-9.