NANAKULI PAVING & ROCK CO. v. SHELL OIL CO.

United States Court of Appeals for the Ninth Circuit
664 F.2d 772 (9th Cir. 1981)

Before BROWNING, Chief Judge, and KENNEDY, Circuit Judge, and HOFFMAN, District Judge.

HOFFMAN, J.:

Appellant Nanakuli Paving and Rock Company (Nanakuli) initially filed this breach of contract action against appellee Shell Oil Company (Shell) in Hawaiian State Court in February, 1976. Nanakuli, the second largest asphaltic paving contractor in Hawaii, had bought all its asphalt requirements from 1963 to 1974 from Shell under two long-term supply contracts; its suit charged Shell with breach of the later 1969 contract. The jury returned a verdict of $ 220,800 for Nanakuli on its first claim, which is that Shell breached the 1969 contract in January, 1974, by failing to price protect Nanakuli on 7200 tons of asphalt at the time Shell raised the price for asphalt from $ 44 to $ 76.· Nanakuli's theory is that price-protection, as a usage of the asphaltic paving trade in Hawaii, was incorporated into the 1969 agreement between the parties, as demonstrated by the routine use of price protection by suppliers to that trade, and reinforced by the way in which Shell actually performed the 1969 contract up until 1974. Price protection, appellant claims, required that Shell hold the price on the tonnage Nanakuli had already committed because Nanakuli had incorporated that price into bids put out to or contracts awarded by general contractors and government agencies. The District Judge set aside the verdict and granted Shell's motion for judgment n. o. v., which decision we vacate. We reinstate the jury verdict because we find that, viewing the evidence as a whole, there was substantial evidence to support a finding by reasonable jurors that Shell breached its contract by failing to provide protection for Nanakuli in 1974. …

Nanakuli offers two theories for why Shell's failure to offer price protection in 1974 was a breach of the 1969 contract. First, it argues, all material suppliers to the asphaltic paving trade in Hawaii followed the trade usage of price protection and thus it should be assumed, under the U.C.C., that the parties intended to incorporate price protection into their 1969 agreement. This is so, Nanakuli continues, even though the written contract provided for price to be "Shell's Posted Price at time of delivery," F.O.B. Honolulu. Its proof of a usage that was incorporated into the contract is reinforced by evidence of the commercial context, which under the U.C.C. should form the background for viewing a particular contract. The full agreement must be examined in light of the close, almost symbiotic relations between Shell and Nanakuli on the island of Oahu, whereby the expansion of Shell on the island was intimately connected to the business growth of Nanakuli. The U.C.C. looks to the actual performance of a contract as the best indication of what the parties intended those terms to mean. Nanakuli points out that Shell had price protected it on the two occasions of price increases under the 1969 contract other than the 1974 increase. In 1970 and 1971 Shell extended the old price for four and three months, respectively, after an announced

increase. This was done, in the words of Shell's agent in Hawaii, in order to permit Nanakuli's to "chew up" tonnage already committed at Shell's old price.[4]

Nanakuli's second theory for price protection is that Shell was obliged to price protect Nanakuli, even if price protection was not incorporated into their contract, because price protection was the commercially reasonable standard for fair dealing in the asphaltic paving trade in Hawaii in 1974. Observance of those standards is part of the good-faith requirement that the Code imposes on merchants in performing a sales contract. Shell was obliged to price protect Nanakuli in order to act in good faith, Nanakuli argues, because such a practice was universal in that trade in that locality.

Shell presents three arguments for upholding the judgment n. o. v. or, on cross appeal, urging that the District Judge erred in admitting certain evidence. First, it says, the District Court should not have denied Shell's motion in limine to define trade, for purposes of trade usage evidence, as the sale and purchase of asphalt in Hawaii, rather than expanding the definition of trade to include other suppliers of materials to the asphaltic paving trade. Asphalt, its argument runs, was the subject matter of the disputed contract and the only product Shell supplied to the asphaltic paving trade. Shell protests that the judge, by expanding the definition of trade to include the other major suppliers to the asphaltic paving trade, allowed the admission of highly prejudicial evidence of routine price protection by all suppliers of aggregate. Asphaltic concrete paving is formed by mixing paving asphalt with crushed rock, or aggregate, in a "hot-mix" plant and then pouring the mixture onto the surface to be paved. Shell's second complaint is that the two prior occasions on which it price protected Nanakuli, although representing the only other instances of price increases under the 1969 contract, constituted mere waivers of the contract's price term, not a course of performance of the contract. A course of performance of the contract, in contrast to a waiver, demonstrates how the parties understand the terms of their agreement. Shell cites two U.C.C. Comments in support of that argument: (1) that, when the meaning of acts is ambiguous, the preference is for the waiver interpretation, and (2) that one act alone does not constitute a relevant course of performance. Shell's final argument is that, even assuming its prior price protection constituted a course of performance and that the broad trade definition was correct and evidence of trade usages by aggregate suppliers was admissible, price protection could not be construed as reasonably consistent with the express price term in the contract, in which case the Code provides that the express term controls.

We hold that the judge did not abuse his discretion in defining the applicable trade, for purposes of trade usages, as the asphaltic paving trade in Hawaii, rather than the purchase and sale of asphalt alone, given the unusual, not to say unique, circumstances: the smallness of the marketplace on Oahu; the existence of only two suppliers on the island; the long and intimate connection between the two companies on Oahu, including the background of how the development of Shell's asphalt sales on Oahu was inextricably linked to Nanakuli's own expansion on the island; the knowledge of the aggregate business on the part of Shell's Hawaiian representative, Bohner; his awareness of the economics of Nanakuli's bid estimates, which

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[4] Price protection was practiced in the asphaltic paving trade by either extending the old price for a period of time after a new one went into effect or charging the old price for a specified tonnage, which represented work committed at the old price. In addition, several months' advance notice was given of price increases.

included only two major materials, asphalt and aggregate; his familiarity with realities of the Hawaiian marketplace in which all government agencies refused to include escalation clauses in contract awards and thus pavers would face tremenduous losses on price increases if all their material suppliers did not routinely offer them price protection; and Shell's determination to build Nanakuli up to compete for those lucrative government contracts with the largest paver on the island, Hawaiian Bitumuls (H.B.), which was supplied by the only other asphalt company on the islands, Chevron, and which was routinely price protected on materials. We base our holding on the reading of the Code Comments as defining trade more broadly than transaction and as binding parties not only to usages of their particular trade but also to usages of trade in general in a given locality. This latter seems an equitable application of usage evidence where the usage is almost universally practiced in a small market such as was Oahu in the 1960's before Shell signed its 1969 contract with Nanakuli. Additionally, we hold that, under the facts of this case, a jury could reasonably have found that Shell's acts on two occasions to price protect Nanakuli were not ambiguous and therefore indicated Shell's understanding of the terms of the agreement with Nanakuli rather than being a waiver by Shell of those terms.

Lastly we hold that, although the express price terms of Shell's posted price of delivery may seem, at first glance, inconsistent with a trade usage of price protection at time of increases in price, a closer reading shows that the jury could have reasonably construed price protection as consistent with the express term. We reach this holding for several reasons. First, we are persuaded by a careful reading of the U.C.C., one of whose underlying purposes is to promote flexibility in the expansion of commercial practices and which rather drastically overhauls this particular area of the law. The Code would have us look beyond the printed pages of the contract to usages and the entire commercial context of the agreement in order to reach the "true understanding" of the parties. Second, decisions of other courts in similar situations have managed to reconcile such trade usages with seemingly contradictory express terms where the prior course of dealings between the parties, trade usages, and the actual performance of the contract by the parties showed a clear intent by the parties to incorporate those usages into the agreement or to give to the express term the particular meaning provided by those usages, even at times varying the apparent meaning of the express terms. Third, the delineation by thoughtful commentators of the degree of consistency demanded between express terms and usage is that a usage should be allowed to modify the apparent agreement, as seen in the written terms, as long as it does not totally negate it. We believe the usage here falls within the limits set forth by commentators and generally followed in the better reasoned decisions. The manner in which price protection was actually practiced in Hawaii was that it only came into play at times of price increases and only for work committed prior to those increases on non-escalating contracts. Thus, it formed an exception to, rather than a total negation of, the express price term of "Shell's Posted Price at time of delivery." Our decision is reinforced by the overwhelming nature of the evidence that price protection was routinely practiced by all suppliers in the small Oahu market of the asphaltic paving trade and therefore was known to Shell; that it was a realistic necessity to operate in that market and thus vital to Nanakuli's ability to get large government contracts and to Shell's continued business growth on Oahu; and that it therefore constituted an intended part of the agreement, as that term is broadly defined by the Code, between Shell and Nanakuli.

I.

History Of Nanakuli-Shell Relations Before 1973

Nanakuli, a division of Grace Brothers, Ltd., a Hawaiian corporation, is the smaller of the two major paving contractors on the island of Oahu, the larger of the two being Hawaiian Bitumuls (H.B.). Nanakuli first entered the paving business on Oahu in 1948, but it only began to move into the largest Oahu market, Honolulu, in the mid-1950's. Until 1964 or so, Nanakuli only got small paving jobs, such as service stations, driveways, and small subdivision streets; it was not in a position to compete with H.B. for government contracts for major roads, airports, and other large jobs. In the early sixties Nanakuli owner Walter Grace began to negotiate a mutually advantageous arrangement with Shell whereby Shell, which had a small market percentage and no asphalt terminals in Hawaii, would sign a long-term supply contract with Nanakuli that would commit Nanakuli to buy its asphalt requirements from Shell. On the other hand, Nanakuli would be helped to expand its paving business on Oahu through a guaranteed supply and a discount on its asphalt prices. Nanakuli's growth would expand the market for Shell's asphalt on the island, which would justify Shell's capital investment of a half a million dollars on Oahu, to which asphalt would be brought in heated tankers from Shell's refinery in Martinez, California.

Shell signed two five-year contracts in 1963: a supply contract with Nanakuli itself and a distributorship with Grace, which provided for a $ 2 commission on all Nanakuli's sales. In fact, almost all Nanakuli's sales were to itself and thus the commission operated, according to Shell's Hawaiian representative, Bohner, primarily as a discount mechanism. Lennox, who succeeded Grace as president in 1965 at Grace's death,· testified that its purpose was "to make us competitive in our paving operation with our competitor (H.B.) who is much larger than ourselves because they were a distributor for the Standard Oil Company's asphalt operation." …

[Nanakuli’s landlord, Lone Star,]requested that Nanakuli upgrade its plant facilities at the quarry, which Nanakuli estimated would cost between $ 250,000 to $ 300,000. Nanakuli, knowing Shell was eager to build up its paving business on Oahu, approached Shell for direct financing of the plant, an idea to which Shell was initially receptive. … Shell management philosophy later changed and it was decided not to finance the plant directly but rather to offer Nanakuli an additional $ 2 volume discount on all sales over five thousand tons to help finance the plant, according to Bohner. … In 1968 two top Shell asphalt officials came from the mainland to discuss Nanakuli's expansion: Blee from San Francisco and Lewis from New York. Together with Bohner and Nanakuli's Lennox and Smith, they met with officials of Nanakuli's bank to discuss the loan and repayment schedule. The three contracts were finally signed after long negotiations on April 1, 1969. They were to parallel the amortization schedule of the bank loan for the plant: a supply contract, a distributorship contract, and volume discount letter, all three to last until December 31, 1975, at which point each would have the option to cancel on six-months' notice, with a minimum duration of over seven years, April 1, 1969, to July 1, 1976. Such long-term contracts were certainly unusual for Shell and this one was probably unique among Shell's customers, at least by 1974.

Lennox' testimony, which was partially stricken by the court as inadmissible, was that Shell's agreement with Nanakuli in 1969 included a commitment by Shell never to charge Nanakuli more than Chevron charged H.B., in order to carry out the underlying purpose of the agreement to make Nanakuli competitive with H.B. and thus expand its and Shell's respective businesses on

Oahu. This testimony was ruled inadmissible as parol evidence. Shell, itself at the end of the trial, read in parts of Smith's earlier deposition in which he made a similar point. Smith's deposition testimony was that, although no written provision was included on price protection, he was led to believe by Shell's Bohner that he would get price protection. "I think there was a thought running between the two parties at that time that something would be done." It was only after the fact, he added, that Bohner told Nanakuli that he had to get permission for price protection from the mainland at the time of price increases; before that, "we had no idea how the pricing was done." Smith's comments on additional terms agreed to were not as probative as those of Lennox, who was president and chief negotiator for Nanakuli of the 1969 contract. Nanakuli's offer of proof by Lennox was that Shell agreed "to sustain that price during those contracts in the same way in which Standard Oil Company (Chevron) sustained its price to the principal paving contractor on the island, Hawaiian Bitumuls, if there was any price increase" and to "not exceed Standard Oil's (Chevron's) posted price for asphalt sold to Hawaiian Bitumuls." It was agreed that Nanakuli would have to submit bids on a fixed-price basis and be price protected to compete with H.B. "We understood that Shell gave us the same protection in our bidding and our purchase of asphalt from them to incorporate in our work," Lennox did testify, adding that by that means Nanakuli could compete with H.B. and Shell would thereby benefit. He said Nanakuli understood the price term to mean that Shell would not increase prices without advance notice and would hold the price on work bid for enough time to allow Nanakuli to use up the tonnage bid at the old price. Smith's testimony backed up that of Lennox: the price was to be "posted price as bid as was understood between the parties," further explaining that it was to be Shell's price at time and place of delivery, except for price increases, at which point the price was time and place of bid for a period of time or a specified tonnage.…

II

Trade Usage Before And After 1969

The key to price protection being so prevalent in 1969 that both parties would intend to incorporate it into their contract is found in one reality of the Oahu asphaltic paving market: the largest paving contracts were let by government agencies and none of the three levels of government-local, state, or federal-allowed escalation clauses for paving materials. If a paver bid at one price and another went into effect before the award was made, the paving company would lose a great deal of money, since it could not pass on increases to any government agency or to most general contractors. Extensive evidence was presented that, as a consequence, aggregate suppliers routinely price protected paving contractors in the 1960's and 1970's, as did the largest asphaltic supplier in Oahu, Chevron. …Nanakuli presented documentary evidence of routine price protection by aggregate suppliers as well as two witnesses: Grosjean, Vice-President for Marketing of Ameron H.C. & D., and Nihei, Division Manager of Lone Star Industries for Pacific Cement and Aggregate (P.C. & A.). Both testified that price protection to their knowledge had always been practiced: at H.C. & D. for many years prior to Grosjean's arrival in 1962 and at P.C.&A. routinely since Nihei's arrival in 1960. Such protection consisted of advance notices of increases, coupled with charging the old price for work committed at that price or for enough time to order the tonnage committed. The smallness of the Oahu market led to complete trust among suppliers and pavers. H.C. & D. did not demand that Nanakuli or other pavers issue purchase orders or sign contracts for aggregate before incorporating its aggregate prices into bids. Nanakuli would merely give H.C.

& D. a list of projects it had bid at the time H.C. & D. raised its prices, without documentation. "Their word and letter is good enough for us," Grosjean testified. Nihei said P.C. & A. at the time of price increases would get a list of either particular projects bid by a paver or simply total tonnage bid at the old price. "We take either one. We take their word for it." None of the aggregate companies had a contract with Nanakuli expressly stating price protection would be given; Nanakuli's contract with P.C. & A. merely set out that P.C. & A. would not charge Nanakuli more than it charged its other customers.

The evidence about Chevron's practice of price protection came in the form of an affidavit by Bery Jameyson, Chevron's Division Manager-Asphalt in California. He stated that Chevron had routinely price protected H.B. on work bid for many years, the last occasion prior to the signing of the 1969 contracts between Nanakuli and Shell being a price increase put into effect on March 7, 1969, with the understanding that H.B. would be protected on work bid, which amounted to 12,000 tons. In answer to Shell's protest that such evidence was not relevant without the contract itself, Nanakuli introduced the contract into evidence. Much like the contract at issue here, it provided that the price to H.B. would be a given percentage of the price Chevron set for a specified crude oil in California. No mention was made of price protection in the written contract between H.B. and Chevron.

In addition to evidence of trade usages existing in 1969 when the contract at issue was signed, the District Judge let in evidence of the continuation of that trade usage after 1969, over Shell's protest. He stated that, giving a liberal reading to Section 1-205, he felt that later evidence was relevant to show that the expectation of the parties that a given usage would be observed was justified. The basis for incorporating a trade usage into a contract under the U.C.C. is the justifiable expectation of the parties that it will be observed. That later evidence consisted here of more price protection by the aggregate companies on Oahu, as well as continued asphalt price protection. Chevron after 1969 continued price protecting H.B. on Oahu and, on raising prices in 1979, price protected Nanakuli on the island of Molokai, where Nanakuli purchased its asphalt from Chevron. Additionally, Shell price protected Nanakuli in 1977 and 1978 on Oahu.

III

Shell's Course Of Performance Of The 1969 Contract

The Code considers actual performance of a contract as the most relevant evidence of how the parties interpreted the terms of that contract. In 1970 and 1971, the only points at which Shell raised prices between 1969 and 1974, it price protected Nanakuli by holding its old price for four and three months, respectively, after announcing a price increase. In the late summer of 1970, Shell had announced a price increase from $ 35 to $ 40 a ton effective September 1, 1970. When Nanakuli protested to Bohner that it should be price protected on work already committed, Blee wrote Bohner an in-house memo that, if Bohner could not "convince" Nanakuli to go along with the price increase on September 1, he should try to "bargain" to get Nanakuli to accept the price raise by at least the first of the year, which was what was finally agreed upon. During that four-month period, Nanakuli bought 3,300 tons. Shell announced a second increase in October, 1970, from $ 40 to $ 42 effective December 31st. Before that increase went into effect, on November 25 Shell increased the raise to $ 4, making the price $ 44 as of the first of the year. Shell again agreed

to price protect Nanakuli by holding the price at $ 40, which had been the official price since September 1, for three months from January to March, 1971. Shell did not actually raise prices again until January, 1974, but at several points it believed that increases would be necessary and gave several months' advance notice of those possible increases. Those actions were in accord with Shell's own policy, as professed by Bohner, and that of other asphalt and aggregate suppliers: to give at least several months' advance notice of price increases. …

IV

Shell-Nanakuli Relations, 1973-74

Two important factors form the backdrop for the 1974 failure by Shell to price protect Nanakuli: the Arab oil embargo and a complete change of command and policy in Shell's asphalt management. The jury was read a page or so from the World Book about the events and effect of the partial oil embargo, which shortened supplies and increased the price of petroleum, of which asphalt is a byproduct. The federal government imposed direct price controls on petroleum, but not on asphalt. Despite the international importance of those events, the jury may have viewed the second factor as of more direct significance to this case. The structural changes at Shell offered a possible explanation for why Shell in 1974 acted out of step with, not only the trade usage and commercially reasonable practices of all suppliers to the asphaltic paving trade on Oahu, but also with its previous agreement with, or at least treatment of, Nanakuli.

Bohner testified to a big organizational change at Shell in 1973 when asphalt sales were moved from the construction sales to the commercial sales department. In addition, by 1973 the top echelon of Shell's asphalt sales had retired. Lewis and Blee, who had negotiated the 1969 contract with Nanakuli, were both gone. Their duties were taken over by three men: Fuller in San Mateo, California, District Manager for Shell Sales, Lawson, and Chippendale, who was Shell's regional asphalt manager in Houston. When the philosophy toward asphalt pricing changed, apparently no one was left who was knowledgeable about the peculiarities of the Hawaiian market or about Shell's long-time relations with Nanakuli or its 1969 agreement, beyond the printed contract.

Shell had begun rethinking its asphalt pricing policies several years before. Swanson, who succeeded Lewis in New York in 1970, wrote an internal memorandum on April 21, 1970, in which he discussed frankly the advantages and disadvantages of price protection of its asphalt buyers. Such a practice assured Shell of captive-volume sales, he wrote. The practice of granting carry-over pricing at times of price increases, however, had the unfortunate side effect of depressing prices in the asphalt market everywhere else, the memorandum concluded. This rethinking apparently led to a November 25, 1970, letter setting out "Shell's New Pricing Policy" at its Honolulu and Hilo terminals. The letter explained the elimination of price protection: "In other words, we will no longer guarantee asphalt prices for the duration of any particular construction projects or for the specific lengths of time. We will, of course, honor any existing prices which have been committed for specific projects for which we have firm contractual commitments." The letter requested a supply contract be signed with Shell within 15 days of the receipt of an award by a customer.

The District Judge based his grant of judgment n. o. v. largely on his belief that, had Nanakuli desired price protection, it should have complied with Shell's request in that 1970 letter, by which we assume he meant Nanakuli should have made a firm contractual commitment with Shell for each project on which its bid was successful within 15 days of award. That conclusion, however, ignores several facts. First, compliance by Nanakuli with the letter's demand that a contract be signed within 15 days of an award would have offered Nanakuli little, if any, protection. Nanakuli still would have been stuck with only charging the government the price incorporated into its bid if Shell raised its price between bid and award. The purpose of price protection was to guarantee the price in effect when a paver made a bid because of the often lengthy time span between bid and award. Second, if price protection was a part of Nanakuli's 1969 agreement with Shell, Shell had no right to terminate unilaterally that protection. …

Nanakuli's strongest argument as to its failure to comply with the letter was that there was no need to notify Shell, as Bohner already knew of each project as it was bid and each award as it was made. Lennox testified, "The Shell Oil representative was in our office frequently and knew what jobs we had successfully bid." At another point Lennox said, "The Shell representative was in the office and was fully aware of what we were doing and what jobs we had gotten. He was familiar and was more or less a partner in this thing; he even attended the bid openings at times. He was fully aware and congratulated us every time we got a nice big job because it was more for Shell." Bohner kept his principals informed of Nanakuli's projects, Lennox said. He added, "(W)e had always been protected and our understanding was that we were protected and it wasn't necessary to keep making notices." Smith in his deposition said that Bohner only told him that he lacked the authority to grant price protection "after the fact." Since he knew nothing about how Shell arrived at its pricing, Smith assumed Bohner could carry out Shell's agreement to price protect Nanakuli each time it was needed without consulting the mainland.

After Shell's December 31, 1973, letter arrived on January 4, 1974, Smith called Bohner, as he had done before at times of price increases, to ask for price protection, this time on 7200 tons. Bohner told Smith that he would have to get in touch with the mainland, but he expected that the response would be negative. Smith wrote several letters in January and February asking for price protection. After getting no satisfaction, he finally flew to California to meet with Lawson, Fuller, and Chippendale. Chippendale, from the Houston office, was acknowledged by the other two to be the only person with authority to grant price protection. All three Shell officials lacked any understanding of Nanakuli and Shell's long, unique relationship or of the asphaltic trade in Oahu. They had never even seen Shell's contracts with Nanakuli before the meeting. When apprised of the three and their seven-year duration, Fuller remarked on the unusual nature of Nanakuli's relations with Shell, at least within his district. Chippendale felt it was probably unique for Shell anywhere. Smith testified that Fuller admitted to knowing nothing, beyond the printed page of Nanakuli's agreement with Shell, of the background negotiation or Shell's past pricing policies toward Nanakuli. Chippendale could not understand why Nanakuli even had a distributorship contract giving it a $ 2 commission on sales; he thought Nanakuli had been paid "illegally." No one had ever heard about Shell giving price protection to Nanakuli before. Instead of asking Bohner directly, Chippendale told Fuller to search the files for something on paper. Fuller testified that Shell would not act without written proof of Shell's past price protection of Nanakuli. He admitted he was unable to find anything in the files before 1972 because the departments had been reorganized in that year, about which he informed Chippendale. Chippendale accordingly

decided to deny Nanakuli any price protection and wrote a draft of a letter for Fuller to send Nanakuli. He wrote a note to Fuller that he should adopt the "least said" approach with Nanakuli and check any letters with the legal department. When asked at trial if he had ever simply asked Bohner about Shell's past pricing practices toward Nanakuli, Fuller answered, "No, I didn't know we had it, other than the standard policy if we had one which we didn't." Chippendale told Smith in the California meeting that, although 7200 tons represented an infinitesimal amount for Shell, it would set a bad precedent for Shell, since price protection was not Shell's "current policy." (emphasis supplied). Shell people told him, Smith testified from contemporaneously made notes, that "any past practice was inapplicable at the present time." Smith testified from those same notes that he had left the meeting under the impression that Shell was going out of business in Hawaii.

We conclude that the decision to deny Nanakuli price protection was made by new Houston management without a full understanding of Shell's 1969 agreement with Nanakuli or any knowledge of its past pricing practices toward Nanakuli. If Shell did commit itself in 1969 to price protect Nanakuli, the Shell officials who made the decisions affecting Nanakuli in 1974 knew nothing about that commitment. Nor did they make any effective effort to find out. They acted instead solely in reliance on the 1969 contract's express price term, devoid of the commercial context that the Code says is necessary to an understanding of the meaning of the written word. Whatever the legal enforceability of Nanakuli's right, Nanakuli officials seem to have acted in good faith reliance on its right, as they understood it, to price protection and rightfully felt betrayed by Shell's failure to act with any understanding of its past practices toward Nanakuli.

V

Scope Of Trade Usage

The validity of the jury verdict in this case depends on four legal questions. First, how broad was the trade to whose usages Shell was bound under its 1969 agreement with Nanakuli: did it extend to the Hawaiian asphaltic paving trade or was it limited merely to the purchase and sale of asphalt, which would only include evidence of practices by Shell and Chevron? Second, were the two instances of price protection of Nanakuli by Shell in 1970 and 1971 waivers of the 1969 contract as a matter of law or was the jury entitled to find that they constituted a course of performance of the contract? Third, could the jury have construed an express contract term of Shell's posted price at delivery as reasonably consistent with a trade usage and Shell's course of performance of the 1969 contract of price protection, which consisted of charging the old price at times of price increases, either for a period of time or for specific tonnage committed at a fixed price in non-escalating contracts? Fourth, could the jury have found that good faith obliged Shell to at least give advance notice of a $ 32 increase in 1974, that is, could they have found that the commercially reasonable standards of fair dealing in the trade in Hawaii in 1974 were to give some form of price protection?

We approach the first issue in this case mindful that an underlying purpose of the U.C.C. as enacted in Hawaii is to allow for liberal interpretation of commercial usages. The Code provides, "This chapter shall be liberally construed and applied to promote its underlying purposes and policies." Haw.Rev.Stat. § 490:1-102(1). Only three purposes are listed, one of which is "(t)o

permit the continued expansion of commercial practices through custom, usage and agreement of the parties; …." Id. § 490:1-102(2)(b). …

The Code defines 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." Id. § 490:1-205(2) (emphasis supplied). We understand the use of the word "or" to mean that parties can be bound by a usage common to the place they are in business, even if it is not the usage of their particular vocation or trade. That reading is borne out by the repetition of the disjunctive "or" in subsection 3, which provides that usages "in the vocation or trade in which they are engaged or of which they are or should be aware give particular meaning to and supplement or qualify terms of an agreement." Id. § 490:1-205(3). The drafters' Comments say that trade usage is to be used to reach the "…. commercial meaning of the agreement…." by interpreting the language "as meaning what it may fairly be expected to mean to parties involved in the particular transaction in a given locality or in a given vocation or trade." Id., Comment 4 (emphasis supplied). The inference of the two subsections and the Comment, read together, is that a usage need not necessarily be one practiced by members of the party's own trade or vocation to be binding if it is so commonly practiced in a locality that a party should be aware of it. … This language indicates that Shell would be bound not only by usages of sellers of asphalt but by more general usages on Oahu, as long as those usages were so regular in their observanc.e that Shell should have been aware of them. This reading of the Code, in our opinion, achieves an equitable result. A party is always held to conduct generally observed by members of his chosen trade because the other party is justified in so assuming unless he indicates otherwise. He is held to more general business practices to the extent of his actual knowledge of those practices or to the degree his ignorance of those practices is not excusable: they were so generally practiced he should have been aware of them.

No U.C.C. cases have been found on this point, but the court's reading of the Code language is similar to that of two of the best-known commentators on the U.C.C. [Corbin on Contracts, and White & Summer, Uniform Commercial Code]….

[E]ven if Shell did not "regularly deal" with aggregate supplies, it did deal constantly and almost exclusively on Oahu with one asphalt paver. It therefore should have been aware of the usage of Nanakuli and other asphaltic pavers to bid at fixed prices and therefore receive price protection from their materials suppliers due to the refusal by government agencies to accept escalation clauses. Therefore, we do not find the lower court abused its discretion or misread the Code as applied to the peculiar facts of this case in ruling that the applicable trade was the asphaltic paving trade in Hawaii. An asphalt seller should be held to the usages of trade in general as well as those of asphalt sellers and common usages of those to whom they sell. Certainly, under the unusual facts of this case it was not unreasonable for the judge to extend trade usages to include practices of other material suppliers toward Shell's primary and perhaps only customer on Oahu. He did exclude, on Shell's motion in limine, evidence of cement suppliers. He only held Shell to routine practices in Hawaii by the suppliers of the two major ingredients of asphaltic paving, that is, asphalt and aggregate. Those usages were only practiced towards two major pavers. It was not unreasonable to expect Shell to be knowledgeable about so small a market. In so ruling, the judge undoubtedly took into account Shell's half-million dollar investment in Oahu strictly because of a long-term commitment by Nanakuli, its actions as partner in promoting Nanakuli's expansion on

Oahu, and the fact that its sales on Oahu were almost exclusively to Nanakuli for use in asphaltic paving. The wisdom of the pre-trial ruling was demonstrated by evidence at trial that Shell's agent in Hawaii stayed in close contact with Nanakuli and was knowledgeable about both the asphaltic paving market in general and Nanakuli's bidding procedures and economics in particular.

Shell argued not only that the definition of trade was too broad, but also that the practice itself was not sufficiently regular to reach the level of a usage and that Nanakuli failed to show with enough precision how the usage was carried out in order for a jury to calculate damages. The extent of a usage is ultimately a jury question. The Code provides, "The existence and scope of such a usage are to be proved as facts." Haw.Rev.Stat. § 490:1-205(2). The practice must have "such regularity of observance … as to justify an expectation that it will be observed…." Id. The Comment explains:

> The ancient English tests for "custom" are abandoned in this connection. Therefore, it is not required that a usage of trade be "ancient or immemorial," "universal" or the like …. (Full) recognition is thus available for new usages and for usages currently observed by the great majority of decent dealers, even though dissidents ready to cut corners do not agree.

Id., Comment 5. The Comment's demand that "not universality but only the described "regularity of observance' " is required reinforces the provision only giving "effect to usages of which the parties "are or should be aware' …." Id., Comment 7. A "regularly observed" practice of protection, of which Shell "should have been aware," was enough to constitute a usage that Nanakuli had reason to believe was incorporated into the agreement.[28]

Nanakuli went beyond proof of a regular observance. It proved and offered to prove that price protection was probably a universal practice by suppliers to the asphaltic paving trade in 1969. It had been practiced by H.C. & D. since at least 1962, by P.C. & A. since well before 1960, and by Chevron routinely for years, with the last specific instance before the contract being March, 1969, as shown by documentary evidence. The only usage evidence missing was the behavior by Shell, the only other asphalt supplier in Hawaii, prior to 1969. That was because its only major customer was Nanakuli and the judge ruled prior course of dealings between Shell and Nanakuli inadmissible. Shell did not point in rebuttal to one instance of failure to price protect by any supplier to an asphalt paver in Hawaii before its own 1974 refusal to price protect Nanakuli. Thus, there clearly was enough proof for a jury to find that the practice of price protection in the asphaltic paving trade existed in Hawaii in 1969 and was regular enough in its observance to rise to the level of a usage that would be binding on Nanakuli and Shell.

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[28] White and Summers write that Code requirements for proving a usage are "far less stringent" than the old ones for custom. "A usage of trade need not be well known, let alone "universal.' " It only needs to be regular enough that the parties expect it to be observed. White & Summers, supra § 3-3 at 87 (emphasis supplied). "Note particularly (in 1-205 (1) & (2)) that it is not necessary for both parties to be consciously aware of the trade usage. It is enough if the trade usage is such as to "justify an expectation' of its observance." Id. at 84.

Shell next argues that, even if such a usage existed, its outlines were not precise enough to determine whether Shell would have extended the old price for Nanakuli for several months or would have charged the old price on the volume of tonnage committed at that price. The jury awarded Nanakuli damages based on the specific tonnage committed before the price increase of 1974. Shell says the jury could not have ascertained with enough certainty how price protection was carried out to calculate such an award for Nanakuli. The argument is not persuasive. The Code provides, "The remedies provided by this chapter 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…." Id. § 490:1-106(1). The Comments list as one of three purposes of this section "to reject any doctrine that damages must be calculable with mathematical accuracy. Compensatory damages are often at best approximate: they have to be proved with whatever definiteness and accuracy the facts permit, but no more." Id., Comment 1. Nanakuli got advance notices of each but the disputed increase by Shell, as well as an extension of several months at the old price in 1970, 1971, 1977, and 1978. Shell protests that in 1970 and 1971 Nanakuli's protected tonnage only amounted to 3,300 and 1,100 tons, respectively. Chevron's price protection of H.B. in 1969 however, is also part of the trade usage; H.B.'s protection amounted to 12,000 tons. The increase in Nanakuli's tonnage by 1974 is explained by its growth since the 1970 and 1971 increases.

In addition, the scope of protection offered by a particular usage is left to the jury. … The manner in which the usage of price protection was carried out was presented with sufficient precision to allow the jury to calculate damages at $ 220,800.

VI

Waiver Or Course Of Performance

Course of performance under the Code is the action of the parties in carrying out the contract at issue, whereas course of dealing consists of relations between the parties prior to signing that contract. Evidence of the latter was excluded by the District Judge; evidence of the former consisted of Shell's price protection of Nanakuli in 1970 and 1971. Shell protested that the jury could not have found that those two instances of price protection amounted to a course of performance of its 1969 contract, relying on two Code comments. First, one instance does not constitute a course of performance. "A single occasion of conduct does not fall within the language of this section…." Haw.Rev.Stat. § 490:2-208, Comment 4. Although the Comment rules out one instance, it does not further delineate how many acts are needed to form a course of performance. The prior occasions here were only two, but they constituted the only occasions before 1974 that would call for such conduct. In addition, the language used by a top asphalt official of Shell in connection with the first price protection of Nanakuli indicated that Shell felt that Nanakuli was entitled to some form of price protection. On that occasion in 1970 Blee, who had negotiated the contract with Nanakuli and was familiar with exactly what terms Shell was bound to by that agreement, wrote of the need to "bargain" with Nanakuli over the extent of price protection to be given, indicating that some price protection was a legal right of Nanakuli's under the 1969 agreement.

Shell's second defense is that the Comment expresses a preference for an interpretation of waiver….Id., Comment 3. The preference for waiver only applies, however, where acts are

ambiguous. It was within the province of the jury to determine whether those acts were ambiguous, and if not, whether they constituted waivers or a course of performance of the contract. The jury's interpretation of those acts as a course of performance was bolstered by evidence offered by Shell that it again price protected Nanakuli on the only two occasions of post-1974 price increases, in 1977 and 1978.

VII

Express Terms As Reasonably Consistent With Usage In Course of Performance

Perhaps one of the most fundamental departures of the Code from prior contract law is found in the parol evidence rule and the definition of an agreement between two parties. Under the U.C.C., an agreement goes beyond the written words on a piece of paper. " "Agreement' means the bargain of the parties in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance as provided in this chapter (sections 490:1-205 and 490:2-208)." Id. § 490:1-201(3). Express terms, then, do not constitute the entire agreement, which must be sought also in evidence of usages, dealings, and performance of the contract itself. The purpose of evidence of usages, which are defined in the previous section, is to help to understand the entire agreement…. .Id. § 490:1-205, Comment 4. Course of dealings is more important than usages of the trade, being specific usages between the two parties to the contract. "(Course) of dealing controls usage of trade." Id. § 490:1-205(4). It "is a sequence of previous conduct between the parties to a particular transaction which is fairly to be regarded as establishing a common basis of understanding for interpreting their expressions and other conduct." Id. § 490:1-205(1). Much of the evidence of prior dealings between Shell and Nanakuli in negotiating the 1963 contract and in carrying out similar earlier contracts was excluded by the court.

A commercial agreement, then, is broader than the written paper and its meaning is to be determined not just by the language used by them in the written contract but "by their action, read and interpreted in the light of commercial practices and other surrounding circumstances. The measure and background for interpretation are set by the commercial context, which may explain and supplement even the language of a formal or final writing." Id., Comment 1. Performance, usages, and prior dealings are important enough to be admitted always, even for a final and complete agreement; only if they cannot be reasonably reconciled with the express terms of the contract are they not binding on the parties. "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." Id. § 490:1-205(4).

Of these three, then, the most important evidence of the agreement of the parties is their actual performance of the contract. Id. The operative definition of course of performance is as follows: "Where the contract for sale involves repeated occasions for performance by either party with knowledge of the nature of the performance and opportunity for objection to it by the other, any course of performance accepted or acquiesced in without objection shall be relevant to determine the meaning of the agreement." Id. § 490:2-208(1). "Course of dealing … is restricted, literally, to a sequence of conduct between the parties previous to the agreement. However, the

provisions of the Act on course of performance make it clear that a sequence of conduct after or under the agreement may have equivalent meaning (Section 2-208)." Id. 490:1-205, Comment 2. The importance of evidence of course of performance is explained: "The parties themselves know best what they have meant by their words of agreement and their action under that agreement is the best indication of what that meaning was. This section thus rounds out the set of factors which determines the meaning of the "agreement' …" Id. § 490:2-208, Comment 1. "Under this section a course of performance is always relevant to determine the meaning of the agreement." Id., Comment 2.[33]

Our study of the Code provisions and Comments, then, form the first basis of our holding that a trade usage to price protect pavers at times of price increases for work committed on nonescalating contracts could reasonably be construed as consistent with an express term of seller's posted price at delivery. Since the agreement of the parties is broader than the express terms and includes usages, which may even add terms to the agreement,[34] and since the commercial background provided by those usages is vital to an understanding of the agreement, we follow the Code's mandate to proceed on the assumption that the parties have included those usages unless they cannot reasonably be construed as consistent with the express terms.

[The court reviewed cases from other jurisdictions.]

Some guidelines can be offered as to how usage evidence can be allowed to modify a contract.[44] First, the court must allow a check on usage evidence by demanding that it be

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[33] Section 2-208, much like 1-205, provides "(t)he express terms of the agreement and any such course of performance, as well as any course of dealing and usage of trade, shall be construed whenever reasonable as consistent with each other; but when such construction is unreasonable, express terms shall control course of performance and course of performance shall control both course of dealing and usage of trade (section 490:1-205)." Id. § 490:2-208(2).

[34] "The agreement of the parties includes that part of their bargain found in course of dealing, usage of trade, or course of performance. These sources are relevant not only to the interpretation of express contract terms, but may themselves constitute contract terms." White & Summers, supra, § 3-3 at 84.

[44] White and Summers write that usage and dealings evidence "may not only supplement or qualify express terms, but in appropriate circumstances may even override express terms." White & Summers, supra, § 3-3 at 84. "(T)he provision that express terms control inconsistent course of dealing and (usages and performance evidence) really cannot be taken at face value." Id. at 86. That reading, although at odds with the actual wording of the Code, is a realistic reading of what some of the cases allow. A better formulation of the Code's mandate is offered by R. W. Kirst, Usage of Trade and Course of Dealing: Subversion of the UCC Theory, 1977 Law Forum 811:

> The need to determine whether the parties intended a usage … to be part of the contract does not end if the court finds that the commercial practice is inconsistent with or contradicts the express language of the writing. If an inconsistency exists, the intention of the parties remains unclear. The parties may have intended either to include or exclude the practice. Determining the intent of the parties requires that the court attempt to construe the written term consistently with the commercial practice, if that is reasonable. If consistent construction is unreasonable the Code directs that the written term be taken as expressing the parties' intent. Before concluding that a jury could not reasonably find a

sufficiently definite and widespread to prevent unilateral post-hoc revision of contract terms by one party. The Code's intent is to put usage evidence on an objective basis. J. H. Levie, Trade Usage and Custom Under the Common Law and the Uniform Commercial Code, 40 N.Y.U.L.Rev. 1101 (1965), states:

> When trade usage adds new terms to cover matters on which the agreement is silent the court is really making a contract for the parties, even though it says it only consulted trade usage to find the parties' probable intent. There is nothing wrong or even unusual about this practice, which really is no different from reading constructive conditions into a contract. Nevertheless the court does create new obligations, and perhaps that is why the courts often say that usage … must be proved by clear and convincing evidence.…

Id. at 1102. Although the Code abandoned the traditional common law test of nonconsensual custom and views usage as a way of determining the parties' probable intent, id. at 1106-07, thus abolishing the requirement that common law custom be universally practiced, trade usages still must be well settled, id. at 1113. …

Evidence of a trade usage does not need to be protected against perjury because, as one commentator has written, "an outside standard does exist to help judge the truth of the assertion that the parties intended the usage to control the particular dispute: the existence and scope of the usage can be determined from other members of the trade." Kirst, supra, at 839. Kirst sets out guards on jury determination of usage evidence:

> Questions of the parties' intentions concerning an asserted trade usage or course of dealing will not always require a jury determination. If the evidence fails to show a practice is regularly observed, the judge can exclude the evidence because it does not show a course of dealing or usage of trade as defined in the Code. If the members of the trade confirm an actual usage but do not support the assertion that the usage applies to the particular facts in litigation, the judge will exclude evidence of the usage as irrelevant. If the parties used new and different language to convey their agreed intention to abandon the past practice, the court will recognize that practice under the old language is irrelevant to the contract containing the new language and, consequently, will exclude the evidence.

… That formulation of relevance of the usage evidence seems a fair one to follow in this case. Here the evidence was overwhelming that all suppliers to the asphaltic paving trade price protected customers under the same types of circumstances. Chevron's contract with H.B. was a similar long-term supply contract between a buyer and seller with very close relations, on a form supplied by the seller, covering sales of asphalt, and setting the price at seller's posted price, with no mention of price protection. The same commentator offers a second guideline:

> consistent construction, the judge must understand the commercial background of the dispute.

Id. at 824.

> Because the stock printed forms cannot always reflect the changing methods of business, members of the trade may do business with a standard clause in the forms that they ignore in practice. If the trade consistently ignores obsolete clauses at variance with actual trade practices, a litigant can maintain that it is reasonable that the courts also ignore the clauses. Similarly, members of a trade may handle a particular subset of commercial transactions in a manner consistent with written terms because the writing cannot provide for all variations or contingencies. Thus, if the trade regards an express term and a trade usage as consistent because the usage is not a complete contradiction but only an occasional but definite exception to a written term, the courts should interpret the contract according to the usage.

Kirst, supra, at 824. Levie, supra, at 1112, writes, "Astonishing as it will seem to most practicing attorneys, under the Code it will be possible in some cases to use custom to contradict the written agreement…. Therefore usage may be used to "qualify' the agreement, which presumably means to "cut down' express terms although not to negate them entirely." Here, the express price term was "Shell's Posted Price at time of delivery." A total negation of that term would be that the buyer was to set the price. It is a less than complete negation of the term that an unstated exception exists at times of price increases, at which times the old price is to be charged, for a certain period or for a specified tonnage, on work already committed at the lower price on nonescalating contracts. Such a usage forms a broad and important exception to the express term, but does not swallow it entirely. Therefore, we hold that, under these particular facts, a reasonable jury could have found that price protection was incorporated into the 1969 agreement between Nanakuli and Shell and that price protection was reasonably consistent with the express term of seller's posted price at delivery.

VIII

Good Faith In Setting Price

Nanakuli offers an alternative theory why Shell should have offered price protection at the time of the price increases of 1974. Even if price protection was not a term of the agreement, Shell could not have exercised good faith in carrying out its 1969 contract with Nanakuli when it raised its price by $ 32 effective January 1 in a letter written December 31st and only received on January 4, given the universal practice of advance notice of such an increase in the asphaltic paving trade. The Code provides, "A price to be fixed by the seller or by the buyer means a price for him to fix in good faith," Haw.Rev.Stat. § 490:2-305(2). For a merchant good faith means "the observance of reasonable commercial standards of fair dealing in the trade." Id. 490:2-103(1)(b). The comment to Section 2-305 explains, "(I)n the normal case a "posted price' … satisfies the good faith requirement." Id., Comment 3. However, the words "in the normal case" mean that, although a posted price will usually be satisfactory, it will not be so under all circumstances. In addition, the dispute here was not over the amount of the increase-that is, the price that the seller fixed-but over the manner in which that increase was put into effect. It is true that Shell, in order to observe the good faith standards of the trade in 1974, was not bound by the practices of aggregate companies, which did not labor under the same disabilities as did asphalt suppliers in 1974. However, Nanakuli presented evidence that Chevron, in raising its price to $ 76, gave at least six weeks' advance notice, in accord with the long-time usage of the asphaltic paving trade. Shell, on the other hand,

gave absolutely no notice, from which the jury could have concluded that Shell's manner of carrying out the price increase of 1974 did not conform to commercially reasonable standards. In both the timing of the announcement and its refusal to protect work already bid at the old price, Shell could be found to have breached the obligation of good faith imposed by the Code on all merchants. "Every contract or duty within this chapter imposes an obligation of good faith in its performance or enforcement," id. § 490:1-203, which for merchants entails the observance of commercially reasonable standards of fair dealing in the trade. The Comment to 1-203 reads:

> This section sets forth a basic principle running throughout this Act. The principle involved is that in commercial transactions good faith is required in the performance and enforcement of all agreements or duties. Particular applications of this general principle appear in specific provisions of the Act…. It is further implemented by Section 1-205 on course of dealing and usage of trade.

Id. § 490:1-203, Comment. Chevron's conduct in 1974 offered enough relevant evidence of commercially reasonable standards of fair dealing in the asphalt trade in Hawaii in 1974 for the jury to find that Shell's failure to give sufficient advance notice and price protect Nanakuli after the imposition of the new price did not conform to good faith dealings in Hawaii at that time.

Because the jury could have found for Nanakuli on its price protection claim under either theory, we reverse the judgment of the District Court and reinstate the jury verdict for Nanakuli in the amount of $ 220,800, plus interest according to law.

REVERSED AND REMANDED WITH DIRECTIONS TO ENTER FINAL JUDGMENT.

KENNEDY, Circuit Judge, concurring specially:

The case involves specific pricing practices, not an allegation of unfair dealing generally. Our opinion should not be interpreted to permit juries to import price protection or a similarly specific contract term from a concept of good faith that is not based on well-established custom and usage or other objective standards of which the parties had clear notice. Here, evidence of custom and usage regarding price protection in the asphaltic paving trade was not contradicted in major respects, and the jury could find that the parties knew or should have known of the practice at the time of making the contract. In my view, these are necessary predicates for either theory of the case, namely, interpretation of the contract based on the course of its performance or a finding that good faith required the seller to hold the price. With these observations, I concur.