the costs of writing more detailed contracts ex ante, the costs of rent-seeking (both ex ante in contractual negotiations and ex post once a dispute has arisen), the principal parties' ability to provide their legal and business agents with proper incentives to enter into contracts on efficient terms, the parties' attitudes toward risk and the distribution of information among potential tribunals, the need to make specific investments whose value depends on a particular contractual interpretation, and the need to induce complementary investments by third parties who may have differential access to the formal and substantive aspects of the principal parties' agreement. As a result, the formalist argument against substantive interpretation does not hold generally, but holds only in those cases where the interplay of these considerations renders the benefits of formality greater on balance than its costs. It is for this reason that I recommend that the choice between formal and substantive modes of interpretation be left to the contracting parties themselves, who are likely to be in a much better position to evaluate these considerations than are courts, legislatures, or diplomats negotiating international treaties.

Thus, when Gillette states that incorporation of trade usage makes sense where third-party tribunals can identify relevant usages and verify compliance with them at reasonable cost and accuracy, he focuses only on one of these considerations.[7] For his conclusion to be correct, his generalization needs to be understood in relative, or other-things-being-equal, terms—that is, that incorporating trade usage makes sense when tribunals can apply it at relatively reasonable cost and with relative accuracy, compared with all the other costs of using trade usage in the interpretative process.

II. Comparative Advantages of Substantive Interpretation in the International Setting

Starting from this more systematic framework for balancing the costs and benefits of formality, one can identify a more robust set of explanations that describe why sophisticated commercial parties engaging in international transactions are willing to tolerate more substantive methods of interpretation in general and freer use of trade usage evidence in particular. These explanations do not depend on the presumed grace or good judgment of arbitrators or judges—such a presumption might happen to be warranted in practice but surely is not in principle—nor on the peculiarities of the process by which international trade usage is developed. Rather, they stem from the different relative costs and benefits of dispute resolution and contract writing that obtain in the international setting.

Walt, *In Defense of the Incorporation Strategy*, in Kraus and Walt, eds, *The Jurisprudential Foundations of Corporate and Commercial Law* 193 (cited in note 2).

7 Gillette, 5 Chi J Intl L at 164 (cited in note 1).

Specifically, there are at least four overlapping reasons why the cost of considering trade usage and other contextual evidence will be lower in international sales transactions than in the US domestic setting out of which the new formalist scholarship has arisen. These are: first, a greater leeway for the parties to contract out of tribunals and usages that are likely to apply most inefficiently to their particular situation; second, the simpler and cheaper procedures available in international compared to US domestic litigation; third, the routine use of commercial letters of credit for international payment; and fourth, the relative unimportance of variable as opposed to fixed costs in international dispute resolution.

A. Freedom to Choose Governing Law and Venue for Litigation

In the arena of international sales contracts, it is relatively easy for the parties to opt out of substantive interpretative regimes if they wish, either through explicit choice of governing law, or through forum clauses that will ensure that any dispute is heard by a tribunal that is more responsive to their business concerns. The rules and culture of international private law have long taken a liberal attitude toward the parties' contractual choice of applicable law; and the CISG follows in this tradition, specifically authorizing parties in Article 6 to exclude the application of the entire convention from their contract, or, less drastically, to derogate from or vary the effect of any of its provisions, including the trade usage provision of Article 9(2).[8]

In contrast, while it is theoretically possible to exclude particular trade usages from sales contracts under UCC §§ 1-205 and 2-208, in practice it is often difficult for contracting parties to tell when and whether they have effectively done so. Under these provisions, courts are directed to construe express contractual terms as consistent with trade usages, courses of dealing, and courses of performance wherever possible, and to exclude the application of these

[8] There are some minor limitations on this power to derogate from the individual articles of the CISG. The parties may exclude the application of the convention or, subject to Article 12, derogate from or vary the effect of any of its provisions. Specifically, where one of the parties to the contract has its place of business in a state that has made a reservation under Article 96 relating to the question of whether a contract must be formally evidenced by a writing in order to be enforceable, the parties may not agree to dispense with the writing requirement that their home state has retained; in addition, the parties cannot derogate from the public international law provisions of Articles 89–101, as these provisions cover issues relevant to contracting states rather than private parties.

Additionally, the question has arisen in case law whether parties wishing to opt out of the CISG must do so explicitly or may do so implicitly. It has been generally held, however, that a clause which states that "this contract is governed by the laws of state X," where state X has joined the CISG, does not suffice to exclude the CISG's applicability, unless the clause refers specifically to state X's domestic law only.

supposed background norms only when they cannot reasonably be construed as consistent with express terms. Following the apparent intention of the statutory drafters, US courts have bent over backwards to find consistency between express terms and trade usage. For instance, they have denied summary judgment in cases where a litigant claimed that trade usages belied apparently clear contractual clauses providing for fixed quantity or fixed price terms.[9] Furthermore, UCC Article 2 offers no authorized way generally to exclude trade usages and courses of dealings in the manner of CISG Article 6; if the parties wish to exclude usages, they must do so explicitly and by specific reference, which is obviously much more costly and cumbersome.

Similarly, parties' ability to opt out of substantive interpretation regimes through choice of law and forum selection clauses is more limited in US domestic contracts than in the international arena. In addition to the more liberal tradition of freedom of contract that usually obtains in transnational cases, sales contracts in the domestic sales context are governed by a uniform statute in force in all fifty states and the District of Columbia. Thus, if US parties want to have their dispute heard by a court, they cannot avoid the application of the UCC in the way that transnational litigants can opt into a more formal regime by providing for their contract to be interpreted under the laws of England and enforced by a tribunal sitting in London.

This greater freedom of contract in the international setting both provides a safety valve for those parties who would be most disadvantaged by a substantive interpretative regime and gives international tribunals a competitive incentive to keep their interpretative inquiries within limits if they want to enjoy continued business. For both reasons, it is less costly, other things being equal, for international parties to operate under a trade usage regime than it would be in the US domestic setting.

B. Lower Procedural Costs in Considering Context Evidence

In addition to the possibility of opting into more formal substantive legal rules, transnational commercial litigation also gives the parties access to institutional proceedings that are generally less complicated and less costly than US legal forums. Commercial litigation under UCC Article 2 is governed by the standard set of American civil procedures, which include extensive pretrial

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[9] See *Columbia Nitrogen Corp v Royster Co*, 451 F2d 3, 8–11 (4th Cir 1971) (course of dealing and usage of trade admitted into evidence to show that express quantity terms in written contract were actually buyers' options); *Nanakuli Paving & Rock Co v Shell Oil Co*, 664 F2d 772, 805 (9th Cir 1981) (trade usage and course of dealing admitted into evidence to show that price was to be measured at time of contract despite express term fixing price as of delivery). See also cases discussed in Scott, *The Uniformity Norm in Commercial Law* at 149 (cited in note 2).

discovery and the constitutional right to a jury. Whatever their other merits, these procedures raise the cost of litigation by providing greater opportunity to develop and introduce evidence and by diminishing the likelihood that the case can be resolved on the pleadings or at summary judgment. They also increase the uncertainty of the outcome by committing critical factual determinations to an amateur tribunal that lacks both commercial and legal experience. For both reasons, US procedures make the incremental costs of substantive interpretation especially large.

In international litigation conducted outside United States courts, in contrast, the scope for investigating contextual matters is comparatively limited; and the relatively high cost of transporting witnesses or experts makes in-person testimony relatively infrequent, so that judgment can often be rendered based on written submissions. Under such circumstances, allowing trade usage and similar contextual evidence to be admitted may increase litigation costs by a relatively small amount. Additionally, since the agent charged with the task of interpreting the agreement will usually have extensive legal expertise (and in the arbitral setting, commercial expertise as well), the potential variance among tribunals in assessing such evidence, as well as its associated transaction costs of risk-bearing and settlement negotiations, will also be relatively low.

C. Letters of Credit as a Backup Enforcement Mechanism

In many, if not most, international sales cases, the threat of going to court is not the parties' primary enforcement device. This is because the parties typically arrange for payment through the device of a commercial letter of credit ("CLC"), under which a buyer of goods engages an issuing bank to promise to pay the seller upon presentation of documents showing that the goods have been shipped. In addition to providing a medium for transmission of funds, the CLC also affords an alternate, inexpensive, and formal method of dispute resolution because, given the costs of bringing a lawsuit in a distant and possibly inhospitable location, the seller's ability to obtain payment will often determine the outcome of any dispute. And, in contrast to the relatively contextual legal standards provided by the CISG, the law governing letters of credit is quite formalistic. According to the basic principle of letter-of-credit law (denoted the "independence principle" by scholars in the field), a beneficiary's rights against an issuing bank depend only on its compliance with the documentary conditions of the letter under which it seeks payment. The beneficiary does not otherwise have to prove its entitlement to payment, and the issuer does not have to (and in general is not allowed to) investigate the substance of the underlying transaction before paying. The formal nature of letter-of-credit law thus lowers the effective costs of substantive interpretation in cases going to trial or arbitration. Judges and arbiters in international disputes can thus better afford to apply substantive