



2023

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An earlier version of this paper is available here: "Contract Exposition and Formalism" (2017).

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Formalism in Contract Exposition

Gregory Klass*

Draft: November 2023

Introduction

When courts are asked to adjudicate disputes about what contractual agreements mean, they often recite lists of familiar maxims so general and sometimes conflicting that they can appear meaningless. “The fundamental, neutral precept of contract interpretation is that agreements are construed in accord with the parties’ intent.”¹ “The best evidence of what parties to a written agreement intend is what they say in their writing.”² “The intent of the parties as expressed in writing is determined from the language used interpreted in the light of the situation of the parties and the circumstances connected with the transaction.”³ “The meaning of a contract is found by examination of the entire instrument and not by viewing clauses or phrases in isolation.”⁴ “In reviewing contract language for other possible interpretations, we are required to interpret the language in an ordinary and popular sense as would a person of average intelligence and experience.”⁵ “[S]trong extrinsic evidence indicating an intent contrary to the plain meaning of the agreement’s terms can create an ambiguity—provided that the evidence is objective.”⁶

This article locates these and other rules within a theory contract exposition generally. For over a century scholars and jurists have been debating the choice between formalist and contextualist rules of contract exposition. Early in the twentieth century, Oliver Wendell Holmes and Samuel Williston advocated interpreting written contractual agreements according to their plain meaning.⁷ Arthur Linton Corbin, Karl Llewellyn,

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¹ *Greenfield v. Philles Records, Inc.*, 98 N.Y.2d 562, 569 (2002).

² *Slamow v. Del Col*, 79 N.Y.2d 1016, 1018 (1992).

³ *19 Perry St., LLC v. Unionville Water Co.*, 294 Conn. 611, 623 (2010) (internal punctuation omitted).

⁴ *U.S. Fid. & Guar. Co. v. Budget Rent–A–Car Sys., Inc.*, 842 P.2d 208, 213 (Colo.1992).

⁵ *Funeral Fin. Sys. v. United States*, 234 F.3d 1015, 1018 (7th Cir. 2000).

⁶ *Bock v. Computer Associates Int'l, Inc.*, 257 F.3d 700, 708 (7th Cir. 2001).

⁷ See Oliver Wendell Holmes, *The Theory of Legal Interpretation*, 12 Harv. L. Rev. 417, 420 (1899); Samuel Williston, 2 *The Law of Contracts*, Chapter XXI: General Rules for the Interpretation or Construction of Contracts and the Parol Evidence Rule, 1157-1278 (1920).

and a generation of Legal Realists criticized such formalism, arguing that courts should attempt to discern what parties' words meant in the context in which they were used.⁸ The anti-formalist arguments influenced the drafting of both Article Two of the Uniform Commercial Code and the Second Restatement of Contracts. The last decades of the twentieth century saw a resurgence of formalism in contract law among both academics and jurists. Under the banner of the "New Formalism," scholars marshaled economic analysis and empirical studies to argue that sophisticated parties often preferred more formalist approaches, and that existing rules stood in their way.⁹ At the same time, other scholars and jurists continued to press for more contextualist rules.¹⁰

This Article does not attempt to declare a winner in the formalist-anti-formalist debate. It provides instead a general analysis of the rules of contract exposition—the rules for determining the legal effects of parties' words and actions—and based on that theory examines the choice between formalist and non-formalist rules. Too often the design question is framed as a simple choice between Willistonian formalism and Corbinite contextualism. Although that choice is central, it is not simple.

"Formalism" is used with different meanings in different legal contexts. When the subject is not the interpretation of a legal text, the word is used to describe a jurisprudential temperament that prefers rules to standards, abjures consequentialist legal reasoning in favor of deductive systems, would limit the discretion of judges when deciding cases, and

⁸ See Arthur Linton Corbin, 3 *Corbin on Contracts: A Comprehensive Treatise on the Rules of Contract Law* §§ 535-37 (1951); Arthur L. Corbin, *The Interpretation of Words and the Parol Evidence Rule*, 50 *Cornell L.Q.* 161 (1965); K.N. Llewellyn, *On Our Case-Law of Contract: Offer and Acceptance I & II*, 48 *Yale L.J.* 1 & 779 (1938); K.N. Llewellyn, *What Price Contract?—An Essay in Perspective*, 40 *Yale L.J.* 704 (1931).

⁹ For an early example, see Robert E. Scott, *A Relational Theory of Default Rules for Commercial Contracts*, 19 *J. Legal Stud.* 597 (1990). For a recent example, see Ronald J. Gilson, Charles F. Sabel & Robert E. Scott, *Contract and Innovation: The Limited Role of Generalist Courts in the Evolution of Novel Contractual Forms*, 88 *N.Y.U. L. Rev.* 170 (2013). For a good critical overview, see David Charny, *The New Formalism in Contract*, 66 *U. Chi. L. Rev.* 842 (1999). Perhaps the best-known judicial statement of the formalist position is Judge Kozinski's criticism of *Pacific Gas* in *Trident Center v. Connecticut Gen. Life Ins. Co.*, 847 F.2d 564, 569–70 (9th Cir. 1988). Judge Easterbrook has penned his share, for example in *Empro Mfg. Co., Inc. v. Ball-Co Mfg., Inc.*, 870 F.2d 423 (7th Cir. 1989).

¹⁰ See, e.g., Melvin Aron Eisenberg, *The Emergence of Dynamic Contract Law*, in 2 *Theoretical Inq. L.* 1 (2001); Eyal Zamir, *The Inverted Hierarchy of Contract Interpretation and Supplementation*, 97 *Colum. L. Rev.* 1710 (1997). Courts in England have recently taken a sharply antiformalist turn, most significantly in *Investors Compensation Scheme v. West Bromwich Building Society*, [1998] 1 WLR 896; [1998] 1 All ER 98. For a domestic example of judicial antiformalism, see *Teachers Insurance and Annuity Association v. Tribune Co.*, 670 F.Supp. 491, 499 (S.D.N.Y. 1987).

would have legal rules operate independently of moral considerations, customs, and other nonlegal norms.¹¹ In the context of legal interpretation, the term is used more narrowly. Interpretive formalism is commonly described in one of two ways: as an interpretive approach that limits the evidence adjudicators may consider when determining the meaning of legal actors' words and actions, or one that treats meaning as relatively context independent.¹² The definitions are connected. Limiting the interpretive evidence usually means focusing on written texts and excluding more contextual data. In practice, evidentiary parsimony results in interpretations that are more invariant.

These generic definitions are fine as far as they go. But they fail to disaggregate several ways of restricting interpretive evidence and identifying invariant meanings. This Article distinguishes two basic forms of formalism one finds in the law of contract. The first is the use of legal *formalities*, such as the seal, "as is," and "F.O.B." Properly understood, a formality works by obviating interpretation or relegating it to a subsidiary role. What matters is the words or symbols the parties use, not what those words or symbols mean. The second form is *evidentiary formalism*. Evidentiary formalism limits the evidence decision makers may consider when interpreting a text's meaning. Plain meaning rules are examples of evidentiary formalism. Whereas formalities avoid interpretation, evidentiary formalism constrains it.

This Article argues that the choice of where and how to adopt formalism in contract exposition is more complex than commonly recognized. There are several reasons why this is so. First, the design choice includes an oft neglected choice between the above two forms of formalism. Second, contract law addresses a remarkably broad range of transactions—everything from agreements between family members to long-term supply contracts between multinational corporations. The law

¹¹ See Richard H. Pildes, *Forms of Formalism*, 66 U. Chi. L. Rev. 607 (1999) (describing the many meanings of "formalism"); Eric A. Posner, *The Decline of Formality in Contract Law*, in *The Fall and Rise of Freedom of Contract* 61, 63-64 (F.H. Buckley ed., 1999) (describing ways in which Holmes can be viewed as a formalist); Cass R. Sunstein, *Must Formalism Be Defended Empirically?*, 66 U. Chi. L. Rev. 636, 638-39 (1999) (describing the formalist attitude).

¹² See, e.g., Sunstein, *supra* note 11 at 639 (defining "evidentiary formalism" in terms of the amount of evidence considered); Avery Weiner Katz, *The Economics of Form and Substance in Contract Interpretation*, 104 Colum. L. Rev. 496, 516 (2004) (same); Lon L. Fuller, *Consideration and Form*, 41 Colum. L. Rev. 799 (1941) (describing a "formal transaction" as one that is "abstracted from the causes which gave rise to it and which has the same legal effect no matter what the context of motives and lay practices in which it occurs"); Henry E. Smith, *The Language of Property: Form, Context, and Audience*, 55 Stan. L. Rev. 1105, 1112 (2003) (treating an expression as "formal to the extent that its meaning is invariant under changes in context").

properly applies different rules to different transaction types.¹³ Third, the parties' legal relationship commonly depends on a variety of meaningful acts taking place at different times in the transaction. Most theorists focus on formation. But a theory of contract exposition should also address precontractual information sharing, requests for modification, agreements to modify, waivers, repudiations, demands for adequate assurance, and other acts that affect the parties' legal relationship. A theory of contract construction should be able to explain why courts apply different levels of formalism to these different types of contractual acts. Fourth, contracts include a many different types of terms. In addition to first-order duties to perform, a contract might include conditions on those obligations, terms that determine the force of a writing, terms that indicate how the parties' words and actions should be interpreted, limitations on how the contract can be modified, remedial rights and obligations, and so forth. It is not obvious that the same degree of formalism should apply to acts affecting each type of term.

This complexity means that lawmakers do not need generic arguments for or against formalism, but an account of what type of formalism are likely to serve the law's purposes when. This Article provides such a theory. It first describes the tools that the law has at its disposal: formalities, evidentiary formalism, and nonformalist interpretive approaches. It then examines what each tool can do: what purposes formalism can serve and in what conditions it works best, and when it is more likely to fail.

The remainder of this article proceeds as follows. Part One elucidates basic concepts: the distinction between interpretation and construction; the categories of mandatory rules, default rules and altering rules; the distinction, new to the literature, between formalistic and interpretive altering rules; and the distinction, also new to the literature, between juristic and nonjuristic altering rules. Part Two identifies six factors to consider in the design of altering rules, formalist or otherwise: accuracy, predictability, compliance costs, adjudication costs, relational costs, and other social goals. Parts Three and Four describe two forms of formalism in contract law and based on the criteria in Part Two examines when and how the law should employ each. The first form is the use of legal formalities, which obviate interpretation altogether. The second, typified by plain meaning rules, limits the evidence that goes into interpretation. Prior arguments for or against formalism in contract law have largely failed to recognize this distinction, leaving those theories incomplete. And whereas many other scholars have argued for or against formalism writ large, this Article seeks to understand where and how different formal rules of contract exposition can be usefully deployed and where they are likely to misfire.

¹³ For more on this point, see Hanoch Dagan & Michael Heller, *The Choice Theory of Contract* (2017).

Part Five applies the analysis to critically examine the parol evidence rule, focusing on the rules for determining whether a writing is integrated.

1 Legal Exposition

A large portion of the law of contracts comprises rules governing how parties' words and actions effect changes to their legal relationship. These include *inter alia* rules that govern when a contract comes into existence, such as the rules for what constitutes an offer, acceptance, counteroffer, rejection or agreement; rules for determining from parties' agreement the scope of their contractual duties, rights, privileges, powers, and so forth; rules for contract modifications and waivers; rules for anticipatory repudiation and adequate assurances; and rules governing the remedies available for breach, such as the *Hadley* rule and the rules for election of remedies. These and other rules specify how parties' words and actions can alter the legal situation between them.

This radical mutability of parties' legal relationship is one of contract law's defining features. Sophisticated parties have enormous control over when contractual obligations attach, what those obligations are, and the consequences of their breach. Parties can even change the rules that govern how future changes can be made and how their agreement will be interpreted. An offer can stipulate what counts as an acceptance; a no-oral-modification clause can alter how parties can make changes to their contract; an integration clause can limit the evidence that will go into determining the scope of the parties' contractual obligations.

To avoid confusion, I will use *exposition* to refer to the process of identifying the legal effect of one or more persons' words and actions.¹⁴ Legal exposition is not limited to contracts. The term's definition also covers statutory interpretation, constitutional interpretation, the interpretation of wills, the interpretation of deeds, and so forth. Though this Article focuses on contract exposition, many of its conclusions apply to other areas of law.

This Part identifies three structural features of legal exposition generally and one substantive distinction within contract law. Theories of contract exposition that fail to take account of these features are likely to go astray.

¹⁴ In a previous publication I followed Francis Lieber and used the term "exegesis." Gregory Klass, *Contracts, Constitutions, and Getting the Interpretation-Construction Distinction Right*, 18 *Geo. J. L. & Pub. Pol'y* 13, 17 (2020). See Francis Lieber, *Legal and Political Hermeneutics, or Principles of Interpretation and Construction in Law and Politics* 64 (enlarged ed. 1839/1970).

1.1 Interpretation and Construction

Exposition comprises two distinct activities: interpretation and construction.¹⁵ Arthur Linton Corbin's description of these two activities in the first edition of his contracts treatise remains one of the best:

By "interpretation of language" we determine what ideas that language induces in other persons. By "construction of the contract," as the term will be used here, we determine its legal operation—its effect upon the action of courts and administrative officials. If we make this distinction, then the construction of a contract starts with the interpretation of its language but does not end with it; while the process of interpretation stops wholly short of a determination of the legal relations of the parties.¹⁶

Interpretation identifies the meaning of some words or actions, *construction* their legal effect. For example, it is one thing to determine that a reasonable person would understand an offer made over drinks to be a joke, another to determine whether the purported offer created the power of acceptance.¹⁷ It is one thing to determine whether the parties agreed to liquidate damages in a certain amount for breach, another to determine whether that amount is a penalty and therefore cannot be awarded.¹⁸ It is one thing to determine that the parties adopted a writing as "a complete and exclusive statement of the terms of their agreement," another to determine what evidence they can therefore use to prove the terms of the contract and how they may use it.¹⁹ In each example, the first activity is interpretation, the second construction. Rules of interpretation govern the identification of meaning; rules of construction the determination of legal effect. Legal exposition, as I am using the term, comprises interpretation and construction.

1.2 Rules of Construction: Mandatory, Default, and Altering

The rules of contract construction divide into three broad types: mandatory rules, default rules and altering rules.

A *mandatory rule* specifies a legal state of affairs that applies no matter what legal actors say and do.²⁰ When the Second Restatement observes that "[e]very contract imposes upon each party a duty of good

¹⁵ For more on the differences between interpretation and construction, see Klass, *id.*

¹⁶ Corbin on Contracts, *supra* note 8 §§ 534, 7 (1951).

¹⁷ See, e.g., *Lucy v. Zehmer*, 196 Va. 493 (1954).

¹⁸ Restatement (Second) of Contracts § 356 (1981).

¹⁹ *Id.* § 210(1).

²⁰ For a comprehensive discussion of mandatory rules in contract law, see Eyal Zamir (featuring Ian Ayres), *A Theory of Mandatory Rules: Typology, Policy, and Design*, 99 Tex. L. Rev. 283, 302-10 (2020).

faith and fair dealing in its performance and its enforcement,” it says that the parties who have entered into a contract have a duty of good faith no matter what.²¹ The duty cannot be disclaimed. Some areas of private law recognizing voluntary obligations, such as marriage and laws governing fiduciary obligations, contain many mandatory rules. So too do local areas of contract law, such as employment law and landlord tenant law. The general law of contract includes relatively few mandatory rules, which is another way of saying that, generally speaking, contracts are highly mutable.

A *default rule* specifies the legal state of affairs absent the right person’s or persons’ act or expression to the contrary.²² Familiar contract examples include the revocability of an offer absent reliance;²³ the implied warranty of merchantability that attaches to a merchant’s sale of goods;²⁴ and most rules governing the calculation of damages for breach.²⁵

Scholars often speak of default rules as “rules of interpretation,” and commonly use terms like “default interpretations” or “interpretive defaults.”²⁶ But if we attend to the distinction between interpretation and construction, it is clear that defaults are rules of construction. A default rule says what the *legal* state of affairs is when the associated altering rule is not satisfied. As Corbin observes, “[w]hen a court is filling gaps in the terms of an agreement, with respect to matters that the parties did not have in contemplation and as to which they had no intention to be expressed, the judicial process . . . may be called ‘construction’; it should not be called ‘interpretation.’”²⁷

An *altering rule* specifies whose doing of what suffices to effect a change from an associated default legal state of affairs.²⁸ A merchant selling goods, for example, can make their offer irrevocable for up to three months

²¹ Restatement (Second) of Contracts § 205 (1981). This is not to say that the parties cannot alter the specific requirements of that obligation through their words and actions. The point is only that they cannot escape the duty altogether.

²² Scholars have paid considerable attention to the design of default rules. For a good overview of the design considerations, see Ian Ayres & Robert Gertner, *Majoritarian vs. Minoritarian Defaults*, 51 Stan. L. Rev. 1591 (1999).

²³ Restatement (Second) of Contracts § 42 cmt. a (1981).

²⁴ U.C.C. § 2-314(1).

²⁵ Restatement (Second) of Contracts §§ 346-52 (1981).

²⁶ A search of Westlaw’s Law Reviews and Journals database finds 277 articles using “default interpretation,” “interpretive default,” or “default rule of interpretation.” Search run on August 1, 2023.

²⁷ Corbin on Contracts, *supra* note 8 § 534, 9.

²⁸ I take this term from Ian Ayres’s important work, *Regulating Opt-Out: An Economic Theory of Altering Rules*, 121 Yale L.J. 2032 (2012). See also Brett McDonnell, *Sticky Defaults and Altering Rules in Corporate Law*, 60 SMU L. Rev. 383 (2007). In earlier work, I have analyzed altering rules under the heading of “opt-out” rules. Gregory Klass, *Intent to Contract*, 95 Va. L. Rev. 1437 (2009).

by expressing their intent to do so in a signed writing;²⁹ a seller can disclaim the implied warranty of merchantability by using words like “as is” or “with all faults”;³⁰ and parties can generally agree to liquidate or limit damages for breach by expressing their shared intent to do so.

Every default comes with an altering rule. To describe a legal state of affairs as a default is to say that some legal actor or actors might change it by saying or doing the right thing in the right way. Who must say or do what how is determined by an altering rule. Some altering rules specify the use of particular words or phrases, such as “as is.” Others are more open ended. The basic formation rule under Article Two of the Uniform Commercial Code, for example, provides: “A contract for sale of goods may be made in any manner sufficient to show agreement.”³¹ This rule requires only that parties express their agreement to the transaction, not that they do so in a specified way.

1.3 Types of Altering Rules: Formalistic and Interpretive, Pure and Mixed

All altering rules share a tripartite structure. An altering rule provides that if (1) the right actors (2) do the right type of act, then (3) a specified nondefault legal state of affairs will pertain. The Article Two rule for firm offers provides a useful example. The default rule for offers is that they are revocable. Section 2-205 provides the altering rule:

An offer by a merchant to buy or sell goods in a signed writing which by its terms gives assurance that it will be held open is not revocable, for lack of consideration, during the time stated or if no time is stated for a reasonable time, but in no event may such period of irrevocability exceed three months.

The rule establishes:

- (1) the actor: a merchant buyer or seller of goods;
- (2) the act: a signed written assurance that the offer will be held open;
and
- (3) the effect: irrevocability for the time stated or, if no time is stated, for a reasonable time, but in no case for more than three months.

This Article focuses on the second element of altering rules: the specification of acts sufficient to displace the default, which I will call *altering acts*. Later parts also address how the first and third components, actor and effect, figure into the design of altering rules.

²⁹ U.C.C. § 2-205.

³⁰ *Id.* § 2-316(3)(a).

³¹ *Id.* § 2-204(1).

Interpretation enters legal exposition by way of altering rules, which again are rules of construction. More specifically, interpretation enters in the specifications of altering acts. Consider again the Article Two rule for firm offers. Section 2-205 provides that to be effective, a merchant's firm offer must satisfy three requirements. It must

- (1) "by its terms gives assurance that it will be held open,"
- (2) be in writing, and
- (3) be signed.

Determining whether the first requirement is met—whether the right sort of assurance was given—requires interpretation, even if only to ascertain the literal meaning of the offeror's words. Determining whether the second and third requirements are satisfied—whether the assurance was in writing and whether it was signed—does not require interpretation. The first requirement is that the offeror perform an act with the right meaning, the second and third that the act be of the right form.

I will use *interpretive components* to describe parts of an altering rule that condition legal outcomes on the meaning of altering acts, such as whether an offer gave assurances it would be kept open. Application of an interpretive component requires interpretation of the parties' words and actions. A *formal component* of an altering rule conditions legal outcomes on formal qualities of altering acts, facts that can be ascertained without interpretation, such as whether an offer was in a signed writing. Application of a formal component does not require interpretation.

Any given altering rule might have only interpretive components, only formal components, or a mix. I will say that an altering rule that includes only formal components is a *formalistic altering rule* and that the altering act it specifies is a *formality*. Consider section 2-319 of the Code: "when the term is F.O.B. the place of shipment, the seller must at that place ship the goods in the manner provided in this Article . . . and bear the expense and risk of putting them into the possession of the carrier." According to this rule, the letters "F.O.B." together with the name of a place suffice to effect the legal change. No further inquiry into what the parties or their words meant is required. The rule is a formalistic one and "F.O.B." a formality. The section 2-316 rule for "as is" and "with all faults" is another formalistic altering rule. It provides that, *ceteris paribus*, the mere use of those words is enough to exclude all implied warranties. So too are the common law and statutory rules governing the legal effect of the seal.

I will say that an altering rule that is not formalistic is *interpretive*. Interpretive altering rules always include an interpretive component. Their application requires interpretation of the meaning of the parties' words and actions.

An interpretive altering rule might or might not also include formal components. Interpretive rules that also have one or more formal

components are *mixed rules*. The section 2-205 rule for firm offers is a mixed interpretive rule. It requires both that a merchant seller say words with the right meaning—that the offer “by its terms gives assurances that it will be held open”—and that those words be in the right form—“in a signed writing.” *Pure interpretive rules* have no formal component. The Second Restatement, for example, defines an offer as any “manifestation of willingness to enter into a bargain.”³² The rule does not condition the existence of an offer on any formal qualities of the act, such as the production of a writing, a signature, or the use of certain words. Or consider the Second Restatement’s treatment of waivers: “It is immaterial how the promisor manifests his intention to fulfill the prior duty without the performance of the condition. Words of promise or waiver, though often used, are unnecessary; in many situations non-verbal conduct is enough.”³³ The rules for offers and for waivers are pure interpretive altering rules.

The difference between formal and informal components results in a typology of altering rules:

Figure 1: Typology of Altering Rules

		Interpretive Component	
		Yes	No
Formal Component	Yes	mixed interpretive rules (UCC rule for firm offers)	formalistic rules (“as is,” “F.O.B.”)
	No	pure interpretive rules (generic rules for agreement)	

1.4 Types of Altering Rules: Juristic and Nonjuristic

Many contract altering acts are what German legal theorists term “*Rechtsgeschäfte*,” or *juristic acts*:

The juristic act . . . is a declaration of private will directed at the realization of a legal effect, an effect that follows on the authority of the legal system because it is willed. The essence of the juristic act

³² Restatement (Second) of Contracts § 24 (1981).

³³ *Id.* § 84(1) cmt. e.

is found in the fact that a will directed at the realization of the legal effect is confirmed, and that the legal system issues a judgment, in recognition of that will, that gives legal effect to the desired legal arrangement.³⁴

A juristic act is one that can be translated into a sentence that begins, “I/we hereby determine that . . .,” where the ellipsis is replaced by a proposition that describes a legal change, such as, “We the Congress of the United States hereby enact that . . .” or “I hereby determine that upon my death, my property shall be distributed as follows . . .” Although Anglo-American legal theorists have not paid much attention to the category of juristic acts,³⁵ they are as common as are legal powers. Examples include legislative votes, executive orders, judicial decrees, marriage licenses, formal wills, and transfer deeds. All are expressions of the speaker’s intent to change the legal state of affairs by the very expression of that intent.

Entering a contract can be a juristic act. When two companies negotiate, draft, and execute a merger or acquisition agreement, they express their intent to alter the legal relationship between them and by expressing that intent they do just that. The same is true when a homeowner and homebuyer execute a contract of sale, or even when a software user clicks a HTML button indicating their agreement to an unread end user license agreement.³⁶ And formation is not the only point at which the parties might perform a juristic act. During negotiations they might draft a preliminary agreement that includes a TINALEA clause (“This is not a legally enforceable agreement”), avoiding legal liability by expressing their intent to do just that. After formation, a party who has reasons to doubt the other side’s performance might, invoking Second Restatement section 251, make a formal request for adequate assurances of performance, thereby putting the onus on the other side to provide such assurances else find itself in breach. Contract law gives parties a range of legal power to alter their legal situation by simply expressing their intention to do so—by performing a juristic act.

That said—and this is crucial—many contractual altering acts are not juristic, and many contract altering rules do not require parties to express or even manifest an intent to effect the associated legal change.

³⁴ 1 Motive zu dem Entwurfe eines Bürgerlichen Gesetzbuches für das Deutsche Reich, 126 (Berlin & Leipzig, J. Guttentag 1888) (Ger.) (author’s translation).

³⁵ An important exception was John Henry Wigmore. See 5 John Henry Wigmore, *A Treatise on the Anglo-American Law of Evidence in Trials at Common Law*, § 2401, 238 (2d ed. 1924) (describing the category of “jural acts”). The idea of a juristic act is essential to Wigmore’s account of the parol evidence rule.

³⁶ See Tess Wilkinson-Ryan, *Intuitive Formalism in Contract Law*, 163 U. Pa. L. Rev. 2109 (2015) (empirical evidence that consumers believe themselves to be legally bound by unread terms to which they have manifested assent).

Consider the most fundamental of contract altering rules: those governing formation. In the United States, all that is required to create a contract is mutual agreement to an exchange. As section 21 of the Second Restatement observes, “[n]either real nor apparent intention that a promise be legally binding is essential to the formation of a contract.”³⁷ Corbin explains:

There seems to be no serious doubt that a mutual agreement to trade a horse for a cow would be an enforceable contract, even though it is made by two ignorant persons who never heard of a legal relation and who do not know that society offers any kind of a remedy for the enforcement of such an agreement.³⁸

Restatement formulations do not always capture everything in a rule’s application, and some scholars have argued that in fact US contract law sorts for parties’ contractual intent. And the black letter rules in England and other common law countries is that an intent to contract is necessary.³⁹ That said, there is no question but that the altering acts that generate contracts need not include express or indicate the parties’ intent to effect a legal change.

Implied-in-fact contracts prove the point. The Second Restatement suggests the following example:

A, on passing a market, where he has an account, sees a box of apples marked “25 cts. each.” A picks up an apple, holds it up so that a clerk of the establishment sees the act. The clerk nods, and A passes on. A has promised to pay twenty-five cents for the apple.⁴⁰

Here there is no “declaration of private will directed at the realization of a legal effect.” In fact, as I discuss in Part Four, there is not even an express agreement. All we have are two nonverbal but in context meaningful acts—holding the apple up and a nod in response—that together establish that an agreement has been reached. That is enough to create a contract.

The point applies to other contract altering rules as well. The *Hadley* rule, for example, provides that damages are not recoverable except in an amount reasonably foreseeable at the time of formation.⁴¹ A party who is likely to experience atypically high losses from breach can increase recoverable damages by informing the other side of that fact. The rule is an

³⁷ Restatement (Second) of Contracts § 21 (1981).

³⁸ Corbin on Contracts, *supra* note 8 vol. 1 § 34, at 135.

³⁹ For detailed discussions, see Klass, *Intent to Contract*, *supra* note 28, at 1443-60; Prince Saprai, *Contract Law Without Foundations: Toward a Republican Theory of Contract* 71-101 (2019).

⁴⁰ Restatement (Second) of Contracts § 4 cmt. a, ill. 2 (1981).

⁴¹ *Id.* § 351.

altering rule: by performing an act with the right meaning a party can increase recoverable damages. It does not, however, require a juristic act, but only the sharing of information. Or consider section 2-313 of the Code, which stipulates that any affirmation of fact, description of goods, or sample or model made by the seller that is part of the basis of the bargain is enough to create a warranty. That section expressly provides that “[i]t is not necessary . . . that the seller use formal words such as ‘warrant’ or ‘guarantee’ or that he have a specific intention to make a warranty.”⁴² Post formation altering acts can also be nonjuristic. A party waives a condition on their obligation merely by expressing an intention to perform despite its nonoccurrence.⁴³ They need not express an intent to waive the condition or change the legal situation. And a party can commit anticipatory breach simply by stating that they will be unable to perform, whether or not they know that the statement constituted a repudiation.⁴⁴

The distinction between juristic and nonjuristic altering acts corresponds to a difference amongst altering rules. I will say that a *juristic altering rule* is an altering rule that requires the performance a juristic altering act to effect the relevant legal change, and a that a *nonjuristic altering rule* is an altering rule that does not require a juristic altering act. Examples of juristic altering rules include those governing TINALEA clauses, indemnification clauses, choice of law or venue clauses, liquidated damage clauses, and agreements to limit consequential damages. Examples of nonjuristic altering rules include those governing offer, acceptance and formation generally, the rule for warranties, the *Hadley* rule, the rule for waivers of a condition, and the rules governing anticipatory breach.

The prevalence of nonjuristic altering rules in contract law distinguishes contracts from constitutions, statutes, regulations, oaths of office, deeds, wills, and other power-conferring laws. Although contract law often gives parties the power to effect a legal change by expressing an intent to do so, just as often it does not require that they express such an intent. A juristic act is often sufficient to effect a contractual change, but it is rarely necessary.⁴⁵ This fact, I will argue, is essential to thinking about the role of formalism in contract exposition.

1.5 Summary

Much of contract law concerns the exposition of parties’ words and action. Legal exposition involves two separate activities: interpretation, which identifies the meaning of what parties say and do, and construction,

⁴² U.C.C. § 2-313(2).

⁴³ Restatement (Second) of Contracts § 84(1) (1981)

⁴⁴ *Id.* § 250.

⁴⁵ I have argued elsewhere that this distinctive feature says something important about the reasons for contractual liability. Gregory Klass, *Three Pictures of Contract: Duty, Power and Compound Rule*, 83 N.Y.U. L. Rev. 1726 (2008).

which identifies legal effect. Rules of construction include mandatory, default and altering rules. A mandatory rule says what the legal state of affairs is no matter what the parties say or do. A default rule says what the legal state of affairs is absent the parties' contrary act or expression. An altering rule identifies contrary acts or expressions sufficient to effect a change from a default. Altering rules can have interpretive and formal components. Interpretive components condition legal change on the performance of acts with the right meaning; formal components condition legal change on the performance of acts of the right form. Formalistic altering rules have only formal components; pure interpretive rules have only interpretive components; mixed interpretive rules have both formal and interpretive components. Cutting across these structural differences is the substantive difference between juristic and nonjuristic altering rules. A juristic altering rule requires the expression of an intent to effect the legal change by the very expression of that intent. It requires a juristic act. Nonjuristic altering rules do not look to the parties' intent to effect the associated legal change.

2 Design Goals

This Article asks how formalist should rules of contract exposition be. When do formalist altering rules serve contract law's ends? And how should they be structured to best serve them? These are design questions. The answers therefore depend on what we want altering rules to do, when they succeed and when they fail.

I suggest that contract altering rule should be evaluated along four broad dimensions: whether the rule permits third-party adjudicators to accurately identify parties' intentions; transaction costs, which comprise adjudication costs, compliance costs, and relational costs; the predictability of legal outcomes; and whether the rule advances other social goals.⁴⁶

Accuracy. As courts regularly intone, "[t]he fundamental, neutral precept of contract interpretation is that agreements are construed in accord with the parties' intent."⁴⁷ This is not to say that party intent always

⁴⁶ For other lists of relevant factors, see Katz, *supra* note 12 at 522-36; Eric A. Posner, *The Parol Evidence Rule, The Plain Meaning Rule, and The Principles of Contractual Interpretation*, 146 U. PA. L. REV. 533, 543-47 (1998).

⁴⁷ *Greenfield v. Philles Records, Inc.*, 98 N.Y.2d 562, 569 (2002). A few other examples: "The primary goal in interpreting contracts is to determine and enforce the parties' intent." *Old Kent Bank v. Sobczak*, 243 Mich. App. 57, 63 (2000). "Under statutory rules of contract interpretation, the mutual intention of the parties at the time the contract is formed governs interpretation." *AIU Ins. Co. v. Superior Court*, 51 Cal. 3d 807, 821 (1990) (*citing* Cal. Civ. Code § 1636). "The cardinal rule for interpretation of contracts is to ascertain the intention of the parties and to give effect to that intention, consistent with legal principles." *Bob Pearsall Motors, Inc. v. Regal Chrysler-Plymouth, Inc.*, 521 S.W.2d 578, 580 (Tenn. 1975). For

controls, or that the terms of a contract will always perfectly mirror the parties' intentions. Default terms exist because parties sometimes do not have or properly express an intent one way or another; mandatory terms because the law sometimes refuses to give effect to their choice. But the parties' intent, subjectively or objectively understood, is generally the starting point. Because contractual obligations are, by and large, chosen obligations, contract law is designed to condition parties' legal obligations on their actual intentions and understandings. The first goal in designing an altering rule is accuracy in the identification of those intentions and understandings. A contract altering rule should be designed to enable both third-party adjudicators to identify the parties' intent and parties to express their intent.

Theorists disagree on the value of accuracy. Schwartz and Scott, for example, argue that sophisticated risk-neutral firms do not care much about accuracy in any given case. "A risk-neutral party cares about the mean of the interpretation distribution but not the variance."⁴⁸ So long as interpretive errors are as likely to benefit as to harm the firm, the cost of those inaccuracies will in the long run even out. From the perspective of a risk-neutral firm, "it is good enough that courts get things right on average."⁴⁹ Schwartz and Scott deploy this argument in support of formalist rules of interpretation. For risk-neutral firms, the accuracy gains from admitting additional evidence are unlikely to justify the additional costs in litigation. "Therefore, the best interpretive default for firms is textualist when the issue is what their contract language meant."⁵⁰

Schwartz and Scott's argument has among its premises not only that firms are risk neutral, but also that the primary goal in enforcing contracts between them is to maximize the joint gains of trade. "The contract law of commercial parties is about efficiency."⁵¹ But this is hardly the only function contract enforcement might serve, whether for contracts between firms or for contracts among other types of parties. A theorist who considers an important function of contract law to be enforcing parties' moral obligations, achieving a just outcome between the parties, or supporting the moral culture of making and keeping agreements is likely to attach greater value to interpretive accuracy than do Schwartz and Scott. Of course it is no surprise that the optimal rules of contract law depend in part on the broader functions that contract law is meant to serve. But it is worth

defenses of this claim, see Lawrence M. Solan, *Contract as Agreement*, 83 *Notre Dame L. Rev.* 353 (2007); E. Allen Farnsworth, "Meaning" in the Law of Contracts, 76 *Yale L.J.* 939 (1967).

⁴⁸ Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 *Yale L.J.* 541, 576 (2003).

⁴⁹ *Id.* at 577.

⁵⁰ *Id.* at 583.

⁵¹ *Id.* at 550-56.

keeping in mind that the value of interpretive accuracy depends also on purpose of contract enforcement more generally.

Transaction costs: adjudication, compliance, relational. Even if accuracy is valuable, it does not follow that adjudicators should always do everything in their power to achieve it. One reason is that the costs of accurately identifying the parties' intent might be higher than either society or the parties want to pay. The law does not and should not seek accuracy at all costs.

The costs of correctly identifying the parties' intentions come in three forms. First and most obvious are the costs of *adjudication*, both to the parties and to society. Flipping a coin to decide a dispute is cheap but low accuracy; a trial in which both sides are represented by counsel and introduce testimonial and other evidence can be more accurate but also more costly. Second are the out-of-pocket costs to the parties of *complying* with an altering rule. A formality can be cheaper or more expensive to produce. It is cheaper to create a writing than to get a notarized writing. And it is a familiar fact that interpretive rules that permit less evidence of context tend to drive up drafting costs. Finally, satisfying an altering rule can sometimes negatively affect the parties' extra-legal *relationship*. Saying you want a legal protection, for example, can erode extralegal forms of trust. Though such relational costs can be viewed as a type of compliance cost, it will be useful in the analysis that follows to separate them out.

Predictability. Contract law is both backward and forward looking. After a possible breach, it serves to resolve disputes and provide relief to nonbreaching parties. Earlier in a transaction, it helps parties structure their relationship and achieve their individual and shared goals. The latter function requires that parties be able to know their legal obligations. More specifically, parties must be able to predict the legal effects of their words and actions. To return to the above example, a flip of a coin, though a cheap method of adjudication, is not only relatively inaccurate but is also highly unpredictable. Altering rules are preferable to the extent that their outcomes are predictable.

Other social interests. Although contract law is designed to enable parties to achieve their chosen ends, that need not be its only purpose. A contract law might also seek to support the moral practice making and keeping promises or other social norms; it might seek to protect vulnerable parties and prevent harm to third parties; it might try to guide parties to valuable forms of relationships; it might seek to promote fairness, whether between the parties or in society as a whole.

Altering rule can be designed to promote social interests other than enabling parties to achieve their individual and joint ends. A relatively simple example is the rule that in cases of ambiguity, courts prefer a construction that is in the public interest to one that is not.⁵² But altering

⁵² Restatement (Second) of Contracts § 207 (1981).

rules that apply to cases of ambiguity are the easy cases. Altering rules can also be designed to nudge parties towards socially preferred choices, or impede them from making a socially disfavored ones.

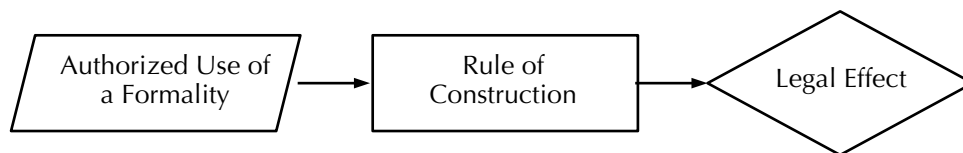
3 Formalities

Scholars and jurists commonly describe contract formalism as if it were just one thing. “Formalism” is defined either as an approach that limits the evidence that goes into interpretation or as one that treats meaning as context independent.⁵³ Part One provides the materials for a more complex account. In fact, one finds two very different forms of formalism in the law of contract: formalities and plain meaning rules. This Part provides an analysis of formalities, then next Part of plain meaning rules.

A formalistic altering rule conditions legal change only on the formal properties of what the parties say and do, as distinguished from the meaning of those acts. A *formality* is an altering act that satisfies a formalistic altering rule. A formality effects a legal change solely by virtue of its formal qualities, as distinguished from its meaning. Legal formalities are familiar creatures. Ian Ayres calls them “passwords”; Charles Goetz and Robert Scott refer to them as “invocations”; and Karl Llewellyn terms them “formal acts.”⁵⁴ In Rudolf von Ihering’s canonical explanation, “legal formalities relieve the judge of an inquiry *whether* a legal transaction was intended, and—in case different forms are fixed for different legal transactions—*which* was intended.”⁵⁵

The process of exposition under a formalistic altering rule is relatively simple, and can be represented as follows:

Figure 2: Structure of Formalistic Exposition



⁵³ See *supra* n. 12.

⁵⁴ Ayres, *supra* note 28 at 2080-83; Charles J. Goetz & Robert E. Scott, *The Limits of Expanded Choice: An Analysis of the Interactions Between Express and Implied Contract Terms*, 73 Cal. L. Rev. 261, 282 (1985); K.N. Llewellyn, *What Price Contract*, *supra* note 8 at 711.

⁵⁵ Rudolf von Ihering, *II Geist des Römischen Rechts* 494 (8th ed. 1923) (quoted in Fuller, *supra* note 12 at 801). See also Joseph Raz, *Voluntary Obligations and Normative Powers* (pt. 2), in 46 Proc. Aristotelian Soc’y 79, 81 (Supp. 1972) (describing the function of legal formalities).

The relationship between formalistic altering rules and generic senses of “formalism” should be obvious. Legal formalities work by circumventing interpretation altogether. To determine the legal state of affairs, a third-party adjudicator need look only to the use of the formality, not at its ordinary meaning or the user’s intent. The application of a formalistic altering rule therefore requires little evidence beyond what was said, and the outcome is largely context insensitive. This is not to say extrinsic evidence cannot enter the case. Except in the most extremely formalistic altering rules, use of a contract formality does not preclude the introduction of context evidence to show duress, fraud, mistake or another invalidating cause. And as will be discussed below, a defeasible formalistic altering rule creates only a presumption of legal change that might be overcome by evidence of the parties’ contrary intent. In all these cases, however, the evidence is relevant to show only that the formality has malfunctioned, has been redesigned, or is rebutted. In the first instance, formalities support, and even demand, a high degree of formalism.

Although in their application formalities relieve courts from interpreting the parties’ intent, the function of a legal formality is to provide a cheap and effective tool parties can use to realize their intent. As Lon Fuller observes, “form offers a legal framework into which the party may fit his actions, or, to change the figure, it offers channels for the legally effective expression of intention.”⁵⁶ As discussed in the next Part, interpretation of the parties’ words or intentions can be prone to error and its results difficult to predict. By obviating the need for interpretation, a formalistic altering rule gives parties an instrument they can use to realize their legal intentions, a tool for getting the legal result they want. So long as parties are adept at using the tool, mechanical application of the formalistic rule is likely to capture the results they intend.

The first section of this Part provides a descriptive analysis of contract formalities. The second examines their utility—when and how they serve the purposes of contract law.

3.1 Contract Formalities

Formalistic altering rules can be further distinguished along two dimensions: the form of the required altering act and the nature of the legal effect.

3.1.1 *Pure Formalities and Ordinary Language Formalities*

Consider the primordial contract formality: the seal. The form of the seal has changed over time. Originally the seal was an impression in wax affixed to the writing. Later a paper wafer glued to the writing also sufficed. Still later, the words “seal” or the letters “L.S.” (*locus sigilli*) opposite a

⁵⁶ Fuller, *supra* note 12 at 801.

signature were enough.⁵⁷ Although the forms differed, none had an obvious non-legal meaning.

I will call an altering act that does not have a nonlegal meaning a *pure formality*. Contract law still contains a number of pure formalities. Although the Uniform Commercial Code renders the seal inoperative in the sale of goods,⁵⁸ it includes several other pure formalities. For example, Article Two attaches to “F.O.B.,” “F.A.S.,” “C.I.F.” and “C.&F.” precisely defined effects on the seller’s legal obligations to ship.⁵⁹ Although the terms originated in ordinary language (“free on board,” “free alongside,” etc.), the initialisms operate as pure formalities; they do not wear their meanings on their sleeves. The fact that they do not have ordinary language meanings puts the user on notice that each is a technical term, to which specific legal consequences are likely to attach. This is the advantage of a pure formality: a person is unlikely to use it unless they intend to perform a legal act, as the formality has no nonlegal meaning. At the same time, a pure formality does not inform the user of its legal effects. A buyer who encounters “F.O.B.” in a seller’s offer must already know its legal meaning or consult a lawyer, a law book, or the Internet to discover it.

Other formalities are built out of ordinary language. I will call a formality that has a non-legal meaning an *ordinary-language formality*. The Code includes ordinary-language formalities as well. Examples include “as is” and “with all faults,” each of which operates to exclude all implied warranties,⁶⁰ and “net landed weights,” “payment on arrival,” and “no arrival, no sale,” which govern payment and shipping terms.⁶¹ The advantages and disadvantages of ordinary-language formalities can be the reverse of those of pure formalities. Because an ordinary-language formality is constructed out of words with non-legal meanings, it might not put a user on notice that they are performing an act with a specified legal effect. A nonsophisticated buyer might not know that there exist implied warranties of title, merchantability and fitness, much less that the appearance of “as is” in the contract functions to extinguish all three. But the ordinary-language formality can use words that describe the relevant legal consequences. “As

⁵⁷ Frederick E. Crane, *The Magic of the Private Seal*, 15 Colum. L. Rev. 24, 24-25 (1915).

⁵⁸ U.C.C. 2-203.

⁵⁹ U.C.C. 2-319 -320.

⁶⁰ U.C.C. 2-316(3)(a). Although the rule is written as if the phrases are mere examples, in practice it establishes these ordinary-language terms as sufficient to achieve the relevant legal effect. See, e.g., *Meyer v. Alex Lyon & Son Sales Managers & Auctioneers, Inc.*, 889 N.Y.S.2d 166 (1st Dept. 2009) (holding that “as is” clause disclaimed all implied warranties without further inquiry); *Welwood v. Cypress Creek Estates, Inc.*, 205 S.W.3d 722 (Tex.App.—Dallas 2006) (same); *Prudential Ins. Co. of America v. Jefferson Associates, Ltd.*, 896 S.W.2d 156 (Tex. 1995) (same); *Warner v. Design and Build Homes, Inc.*, 114 P.3d 664 (Wash. App. Div. 2 2005).

⁶¹ U.C.C. 2-321 & 324.

is” and “with all faults” at least tell the unsophisticated user something about their legal effects.

The above ordinary language formalities, though based on customary usage, are today established by statute. Several scholars have suggested that the judicial construction of boilerplate contract language—strings of words that appear unchanged in many separate contractual writings—can be usefully employed to create new formalities. In an influential 1985 article, Charles Goetz and Robert Scott call formalities “invocations”⁶² and suggest that “[s]killful use of the [plain-meaning] presumption by courts will, over time, increase the supply of officially recognized invocations and other express conventions.”⁶³ Marcel Kahan and Michael Klausner have argued that “[i]nterpretation of standard terms should be treated like the interpretation of laws: Judges, not juries, should interpret them, and their interpretation should have precedential value.”⁶⁴ More radically, Ian Ayres has suggested that “[i]n deciding interpretation disputes, and in fact in deciding any contractual issue concerning defaults, judges should presumptively provide in their decisions contractual language that would allow future contractors to achieve the results desired by the losing party.”⁶⁵ The suggestion is that such dicta would generate new formalities—new boilerplate language parties could employ to get the legal outcomes they desire.

I will call an ordinary language formality generated by the judicial construction of standard language a *boilerplate formality*. I discuss the advantages and disadvantages of boilerplate formalities in the next section. For the moment I simply note that except in a few specialized areas of law, boilerplate formalities are rare. One court’s interpretation of contract language usually does not bind future courts.⁶⁶ The reasons are both

⁶² Goetz & Scott, *supra* note 54 at 282 (defining “invocations” to mean “terms that, once deliberately called upon, have a legally circumscribed meaning that will be heavily—perhaps even irrebuttably—presumed”).

⁶³ *Id.* at 316. See also *id.* at 288 (“A . . . critically important benefit of standardized formulations is the reliability that results from the process of ‘recognition.’ A term is recognized when it is identified through adjudication or statutory interpretation and blessed with an official meaning. . . . Contract interpretation therefore serves to determine and announce relatively reliable definitions of contractual formulations that are protected by official acceptance.”).

⁶⁴ Marcel Kahan & Michael Klausner, *Standardization and Innovation in Corporate Contracting (Or “The Economics of Boilerplate”)*, 83 Va. L. Rev. 713, 765 (1997). See also Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 Va. L. Rev. 757, 776 (1995) (arguing that network benefits accrue from the fact that “[a] judicial opinion that interprets one corporation’s contract term in effect embeds that interpretation in the contracts of all firms that use the same term.”).

⁶⁵ Ayres, *supra* note 28 at 2055.

⁶⁶ As the Fifth Circuit observed: “[T]he determination of ambiguity, like other fact questions, will sometimes be a question to be answered by the judge and not the

substantive and procedural. The substantive reason is a recognition that the primary goal in contract exposition is to determine and enforce the parties' intent. Because we know that parties to different transactions often attach different meanings to the same words, the interpretation of even boilerplate language is generally unsuitable for the application of *stare decisis*. Several aspects of US procedural law also render judicial decisions ill-suited to the creation of widely applicable formalities. The decision of a court in one jurisdiction does not bind courts in another. Boilerplate formalities are especially difficult to create in a federal system. And even within a single jurisdiction one trial court's decision of law court is not binding another's. One finds splits even within a jurisdiction on the plain meaning of some boilerplate clauses. Add to this the familiar fact of linguistic drift in many boilerplate clauses—lawyers' relentless tinkering with them—and the idea of boilerplate formalities begins to look somewhat far-fetched.

That said, judicially created formalities do appear in a few areas of law.⁶⁷ Where a statute or regulation requires that certain language be included in a contract, courts have suggested that it should be interpreted uniformly and in accord with the purpose of the law requiring that language.⁶⁸ Where all or nearly all transactions in a market employ standard language drafted by an industry association and where there are significant gains from uniform terms, courts tend to rely on one another's interpretations of that standard language.⁶⁹ And courts certifying consumer contract class actions have recently found common issues of law to predominate by applying section 211(2) of the Second Restatement, which provides that a standardized agreement "is interpreted wherever reasonable as treating alike all those similarly situated, without regard to their knowledge or understanding of the standard terms of the writing."⁷⁰ Boilerplate formalities, while not common, are also not unknown.

To summarize: There are two broad categories of formalities. Pure formalities such as the seal or "F.O.B." are signs, signals or acts that have

jury. The determination, however, does not become imbued with *stare decisis* effect just because a judge made it." *S. Hampton Co. v. Stinnes Corp.*, 733 F.2d 1108, 1115 n.5 (5th Cir. 1984).

⁶⁷ For a much more detailed mapping of judicially created formalities, see Gregory Klass, *Boilerplate and Party Intent*, 82 *Law & Contemp. Probs.* 105 (2019).

⁶⁸ See, e.g., *Kolbe v. BAC Home Loans Servicing, L.P.*, 738 F.3d 432, 437 (1st Cir. 2013) ("When dealing with uniform contract language imposed by the United States, it is the meaning of the United States that controls.") (opinion of Lynch, J.) (*dicta*).

⁶⁹ See, e.g., *In re Lehman Bros Holdings Inc.*, No. 08-13555 SCC, 2015 WL 7194609 (S.D.N.Y. Sept. 16, 2015) ("To the extent they have adopted the ISDA standard forms, it is reasonable to infer that the parties have no quarrel with ISDA's intention that transactions that use ISDA standard form documents and definitions ... are enforced so as to promote legal certainty and hence, market stability." (internal quotation marks omitted)).

⁷⁰ Restatement (Second) of Contracts § 211(2) (1981).

no obvious nonlegal meaning. Ordinary language formalities, such as “as is” or “with all faults”, attach legal effects to words that also have non-legal meanings. Within the category of ordinary language formalities one can further distinguish between, on the one side, those created by legislation or ancient custom and, on the other, those created by the application *stare decisis* to the judicial interpretation of boilerplate.

3.1.2 *Defeasible and Nondefeasible Formalities*

A second way of categorizing formalities looks to the legal effects they produce. Those effects can be defeasible or nondefeasible.

The history of the private seal provides a useful example. The early rules governing the seal suggest that at one time, no evidence of a party’s contrary intent would alter the seal’s legal effect. Thus Williston reported in the first edition of his treatise: “If the forms are observed, the obligation is binding. . . . [A]t common law mutual assent or any intention on the part of either obligor or obligee was entirely unnecessary.”⁷¹ Even fraud and duress were no defense. In fact, “one whose seal was attached to an obligation was bound, even though the seal had been stolen and attached to the instrument without his consent.”⁷² I will call such a rule *nondefeasible*: the legal effects of the formality are mandatory. Evidence of the legal actor’s contrary intent will not alter the formality’s legal effect.

Over time, the effects of the seal became increasingly defeasible. By the late twentieth century, the Second Restatement could state, “[t]he adoption of a seal may be shown or negated by any relevant evidence as to the intention manifested by the promisor.”⁷³ At this point, the formality operated only to establish a new default legal state of affairs; its use effected the legal change absent evidence of its user’s contrary intent. Altering rules of this type are *defeasible*: the altering act’s effect is a new default legal state of affairs, which might be modified by additional altering acts or other evidence of the parties’ contrary intent.

Keeping with its broader strategy of preferring default to mandatory rules,⁷⁴ Article Two’s formalistic altering rules are all expressly defeasible.

⁷¹ Williston, *supra* note 7 vol. 1 § 205, 412. See also J. Ames, Lectures on Legal History 98 (1913).

⁷² *Id.*

⁷³ Restatement (Second) Contracts § 98 cmt. a (1981). See also *id.* § 96 cmt. b (“[A] document which bears a seal does not establish its own authenticity. Evidence of extrinsic circumstances may be necessary to show that a promisor affixed or adopted a seal and that the document was delivered.”); 1 Williston on Contracts § 2:2 n.11 (4th ed. 2016) (citing cases); Eric Mills Holmes, *Stature & Status of a Promise Under Seal as a Legal Formality*, 29 Willamette L. Rev. 617, 636-37 (1993) (discussing the modern requirement of a party’s intent to deliver the sealed instrument).

⁷⁴ U.C.C. § 1-302(a) (“Except as otherwise provided . . . the effect of provisions of [the Code] may be varied by agreement.”).

“As is” and “with all faults” operate to exclude all implied warranties “[u]nless the circumstances indicate otherwise.”⁷⁵ And each of the provisions providing legal meanings of various shipment terms—“F.O.B.”, “F.A.S.”, etc.—is qualified by the words, “unless otherwise agreed.”⁷⁶ These altering rules are both formalistic and defeasible. The use of words of the right form suffices to effect a change in the legal state of affairs, and each leaves the door open for further interpretive inquiry into the parties’ actual intent.

The distinction between defeasible and nondefeasible altering rules is independent of that between pure and ordinary language formalities. A pure or ordinary language formality might be defeasible or nondefeasible.

3.2 When and How Formalities Work

Having provided a typology of formalistic altering rules, I now turn to when and how formalities can be of use in contract law in light of the considerations identified in Part Two.

3.2.1 *Formalities Enable a Juristic Acts*

A formality is a tool parties can use to achieve the legal effects they wish. Recall that a juristic act is the expression of an intent to achieve a legal change by that very expression of intent. The knowing use of a formality is just such an expression. Because a formality is just a tool for performing a juristic act, formalistic altering rules are always also juristic altering rules.

Nonjuristic altering rule conditions legal change on factors other than the parties’ intent to effect that change. Because formalities are only tools for expressing the parties’ legal intent, nonjuristic altering rules never employ pure formalities. Nonjuristic altering rules are therefore always interpretive.

Nor do all juristic altering rules employ formalities. The decline of the seal prompted the National Conference of Commissioners on Uniform State Laws in 1925 to promulgate the Model Written Obligations Act, which provides: “A written release or promise, hereafter made and signed by the person releasing or promising, shall not be invalid or unenforceable for lack of consideration, if the writing also contains an additional express statement, in any form of language, that the signer intends to be legally bound.”⁷⁷ The rule is a juristic altering rule, as it requires the signer’s “express statement . . . that the signer intends to be legally bound.” And it

⁷⁵ *Id.* § 2-316(3)(a).

⁷⁶ *Id.* 2-319-325.

⁷⁷ Model Written Obligations Act § 1, *in* Handbook of the National Conference of Commissioners on Uniform State Laws and Proceedings of the Thirty-Fifth Annual Meeting 584 (1925).

includes a formal component: the expression must be in a signed writing. But the rule expressly abjures a requisite formality. The statement may be “in any form of language.” All that is necessary is that the statement have the right meaning.

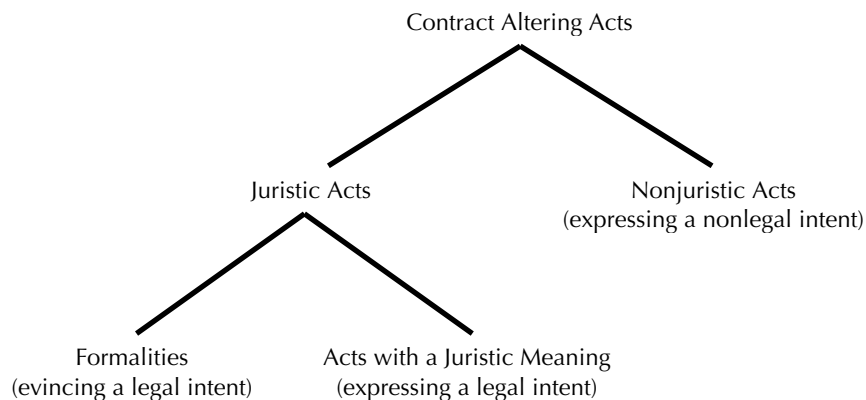
Few states enacted the Model Written Obligations Act. But a contemporary example can be found in the rules for the enforcement of preliminary agreements.⁷⁸ It is not uncommon during negotiations for parties to memorialize their agreement to some material terms with the expectation that they will continue to negotiate others. If negotiations later break down, the question arises whether their preliminary agreement created a duty to negotiate in good faith. In a foundational case, Judge Leval described altering rule:

There is a strong presumption against finding binding obligation in agreements which include open terms, call for future approvals and expressly anticipate future preparation and execution of contract documents. Nonetheless, if that is what the parties intended, courts should not frustrate their achieving that objective or disappoint legitimately bargained contract expectations.⁷⁹

This is a juristic altering rule. Whether the preliminary agreement is legally binding turns on whether the parties intended it to be. But the rule provides no formality. To determine that intent the court must interpret the parties’ words and actions. with. The rule is not formalistic but interpretive.

The above discussion can be summarized in a taxonomy of altering acts:

Figure 3: Taxonomy of Altering Acts



⁷⁸ For a more detailed discussion of the rule for preliminary agreements, see Klass, *Intent to Contract*, *supra* note 28, at 1480-88.

⁷⁹ *Teachers Ins. and Annuity Ass’n v. Tribune Co.*, 670 F. Supp. 491, 499 (S.D.N.Y. 1987).

3.2.2 *Adjudication Costs, Compliance Costs, Predictability*

The most obvious advantages of formalities are low adjudication, costs, low compliance costs, and high predictability. Formalities can be designed to be cheap for knowledgeable parties to produce. Parties need only use the magic words or symbols to achieve the desired legal effect. And they are cheap for adjudicators to construe. Parties' use of a formality can obviate the need for additional evidence or interpretation of the parties' legal intent. And formalities provide highly predictable outcomes. Contracts casebooks are filled with opinions in which the best interpretation of the parties' words and actions is uncertain. By avoiding interpretation altogether, formalities achieve high predictability. Parties who know the code know the legal effect of their words and actions.

In short, when everything goes right, formalities make it easy for parties to predictably achieve the legal effects they desire.

3.2.3 *Accuracy*

If there is a worry about formalities, it concerns their accuracy. Because we are in the world of juristic altering rules, "accuracy" here refers to the ability to correctly identify when a legal actor intends to effect the legal change associated with the altering act. A formality misfires when a legal actor's intent does not correspond to the formality's legal effect. Ayres observes that an altering rule can be inaccurate due to either Type I or Type II errors, false positives or false negatives.⁸⁰ In this context, a Type I error is use of a formality absent an intent to effect the associated legal change; a Type II error occurs when parties wish to achieve a certain legal result but fail to perform the requisite formality to secure it.

3.2.3.1 *Type I Errors*

The accuracy of any formality depends in large part on parties' sensitivity to legal rules. I will say that parties are *responsive* when they are aware of a law and craft their words and actions in response to it. Responsive parties are sometimes described as "sophisticated." But responsiveness is not a personality trait. A party might, for example, be more responsive to governing law during some stages of a transaction and less responsive at others. And as every corporate counsel knows, even experienced businesspeople, whom we might think of as sophisticated, sometimes do not take the legal effects of their words and actions into account.⁸¹ Formalities work best when parties are responsive to the legal

⁸⁰ Ayres, *supra* note 28 at 2066.

⁸¹ Consider recent experience with judicial interpretations of *pari passu* clauses in sovereign debt contracts. In the immediate aftermath of judicial rulings on the legal meaning of the standard clause that went against the understanding of most lawyers in the field, those lawyers did not redraft their standard contracts to clarify the

rule. Responsive parties can use legal formalities to their benefit; unresponsive parties are less likely to notice the formality, understand its legal effect, or know to use it.

Type I errors are especially likely when unresponsive parties sign agreements drafted by responsive parties—when only one side knows the code. Just this risk appears to have been the impetus for the early twentieth century wave of state legislation limiting the legal effects the seal or abolishing it entirely.⁸²

We do not yet have a good history of the decline of the private seal.⁸³ But in a 1915 essay in the *Columbia Law Review*, New York Supreme Court Judge Fredrick Crane suggests two interconnected arguments for its abolition. First, the formality had become less and less noticeable. Crane quotes Chancellor Kent from an early nineteenth century opinion:

A scrawl with a pen is not a seal, and deserves no notice. The calling a paper a deed will not make it one, if it want the requisite formalities . . . The policy of the rule consists in giving ceremony and solemnity to the execution of important instruments, by means of which the attention of the parties is more certainly and effectually fixed, and frauds less likely to be practiced upon the unwary.⁸⁴

As the wax seal was replaced by a wafer and then by mere notation, it became less likely that users would notice that they were performing an act with a specific legal effect. Second, at the same time the seal's legal effects became increasingly baroque. As a result, Crane argued, "[w]hile the necessity for the private seal has virtually gone, its use still remains, with many serious and ensnaring effects. A study of the cases will convince one that people make use of the printed or written 'L.S.' without fully appreciating its effect."⁸⁵

Crane's diagnosis is of a piece with the idea that a formality is a tool the law gives parties to achieve the legal effects they wish. For the tool to work, users must know two things: that they are performing a legally effective act and the act's legal effects. As the seal lost its ceremonial quality, the first was less likely to pertain. Users were less likely to realize that they were performing a legally significant act. And as the seal's legal effects became increasingly complex, there was an additional decline in the

clauses' meaning. See Mitu Gulati & Robert E. Scott, *The Three and a Half Minute Transaction: Boilerplate and the Limits of Contract Design* 45-72 (2013).

⁸² The private seal is still operative in many US jurisdictions, although its legal effect has changed over time. See Holmes, *supra* note 73 *passim*.

⁸³ See 1 Restatement (Second) of Contracts, Topic 3, Stat. Note 255 (1981) (summarizing relevant statutes).

⁸⁴ Crane, *supra* note 57 at 24 (quoting *Warren v. Lynch*, (N.Y. 1810) 5 Johns. 238).

⁸⁵ *Id.* at 25.

second type of awareness. Users who knew they were performing a legal act became less likely to fully understand its consequences. Both increased the risk of Type I errors.

This double requirement, that users know both that they are performing a legally effect act and what the effects are, suggests the relative advantages and disadvantages of pure and ordinary language formalities.

Joseph Raz describes the advantages of a pure formality as follows.

[The choice-promoting function of legal powers] explains why they are exercised either by special formal and ceremonial acts as in making a deed or getting married . . . It also explains why most legal powers are exercised by acts with only negligible non-normative consequences, like signing, so that there are few reasons for or against doing them apart from their legal or other normative consequences.⁸⁶

Because it has no non-legal meaning, a pure formality puts the user on notice that they are performing a legally significant act. And as Crane suggests, the more ceremonial a pure formality, the more likely it is to have this effect. A pure formality does not, however, tell users what those legal effects are. This was the problem with the seal. Although it put users on notice that they were performing a legal act, it did not tell them what its effects were. And as the legal effects became more baroque, users were less likely to understand them.

A well-designed ordinary language formality can address both problems. Depending on the words it is composed of, an ordinary language formality can convey information to its users, turning unresponsive parties into responsive ones.⁸⁷ Although not a formality in the strict sense, the Consumer Finance Protection Bureau's model mortgage disclosure form provide an example.⁸⁸ Through empirical study, regulators identified a form of expression that is more likely to inform consumers of the terms of the transaction.⁸⁹ If pure formalities are problematic because some users do not

⁸⁶ Raz, *supra* note 55 at 81.

⁸⁷ For more on the design error-reducing altering rules generally, see Ayres, *supra* note 28 at 2068-84.

⁸⁸ The mortgage form is not a formality in my sense of the term because failure to use it does not render the loan invalid, but merely subjects the lender to potential legal liability. 12 U.S.C. §§ 2605(f) & 2615.

⁸⁹ Available at: <http://www.consumerfinance.gov/owning-a-home/closing-disclosure/>. For background on the form's design, see Federal Trade Commission, Report: Improving Consumer Mortgage Disclosures: An Empirical Assessment of Current and Prototype Disclosure Forms: A Bureau of Economics Staff Report (June 13, 2007), available at: <https://www.ftc.gov/reports/improving-consumer-mortgage-disclosures-empirical-assessment-current-prototype-disclosure>.

know their legal effect, the solution would seem to be to require words that say, in ordinary language, just what those legal effects are.

That said, the more information lawmakers attempt to pack into a formality, the more expensive it is to use. This is an example of a common dynamic Ayres identifies in the design of altering rules: a tradeoff between transaction costs and error reduction.⁹⁰ Even more concerning is empirical evidence many parties do not respond to information. If consumers or other nonresponsive parties do not read the agreements they sign, it does not matter what words the law requires for their effectiveness.⁹¹ Whether, when and how formalities might be designed to avoid Type I errors is an empirical question that is likely to receive different answers in different contexts, depending on factors such as the identity of the parties and the nature of the transaction between them.

A second and more common strategy for avoiding Type I errors is defeasibility. A formality is defeasible if parties are permitted introduce interpretive evidence that they did not in fact intend the legal effect associated with the formality. In effect, parties are given the opportunity to show that the formality was used by mistake, and adjudicators are given the opportunity to fix such mistakes. Assuming the evidence of error is reliable, defeasibility should reduce Type I errors. This explains why few if any contemporary contract formalities are nondefeasible.

Those gains in accuracy, however, come at the expense of more costly adjudication and reduced predictability. When a formality is nondefeasible, its use ends the inquiry. That advantage is lost if parties are permitted to introduce interpretive evidence that the formality was used by mistake.

3.2.3.2 Boilerplate Formalities

The risk of Type I errors is especially salient in the case of boilerplate formalities, which merit special consideration.

A historical example illustrates. For several centuries, the standardized language in a Lloyd's marine insurance policy used the following words to describe covered risks:

Touching the Adventures and Perils which we the Assurers are contented to bear and do take upon us in this Voyage, they are, of the Seas, Men-of-War, Fire, Enemies, Pirates, Rovers, Thieves, Jettisons, Letters of Mart and Counter-mart, Surprisals, Takings at

⁹⁰ Ayres, *supra* note 28, at 2061-63.

⁹¹ See Yannis Bakos, Florencia Marotta-Wurgler & David R. Trossen, *Does Anyone Read the Fine Print? Consumer Attention to Standard Form Contracts*, 43 J. Legal Stud. 1 (2014) (finding that virtually no consumers read online end user license agreements); Omri Ben-Shahar & Carl E. Schneider, *More Than You Wanted to Know: The Failure of Mandated Disclosure* (2014) (discussing the limited effectiveness of disclosure rules).

Sea, Arrests, Restraints and Detainments of all Kings, Princes, and People, of what Nation, Condition or Quality soever, Barratry of the Master and Mariners, and of all other Perils, Losses and Misfortunes that have or shall come to the Hurt, Detriment, or Damage of the said Goods and Merchandises and Ship, &c., or any Part thereof.⁹²

In his 1914 treatise, Sir Douglas Owen observed of the Adventures and Perils clause:

It is an ancient and incoherent document, occasionally the subject of judicial remarks in the highest degree uncomplimentary. But nobody minds this or dreams of altering the ancient form, nor, one may imagine, is it ever likely to be altered. Insurance experts know—or very often know—exactly what it means, and with generations of legal interpretations hanging almost to every word, and almost certainly to every sentence, in it, it would be highly dangerous to tamper with it.⁹³

Translated into the language in this Article, Owen is saying that the Adventures and Perils clause is a boilerplate formality. To understand its purpose and legal effects, one does not need to interpret the words in it. In fact, attention to the words' meaning is likely to lead the user astray. The clause's purpose and legal effect lies entirely in the judicial opinions construing it.

There is a way in which a boilerplate formality like the Lloyd's Adventures and Perils clause is the worst of both worlds. Because the clause is cast in ordinary language, it does not put the user on notice that it is a formality—that the law attaches specific legal effects to it. And due to the gap between the clause's ordinary meaning and its legal effects, it fails to inform the user of what they are doing by agreeing to it.

This was perhaps not much of a problem in the eighteenth and nineteenth century British marine insurance market. The Lloyds policy was used by a small group of highly responsive repeat players.⁹⁴ But boilerplate

⁹² I am grateful to Jim Oldham for bringing this example to my attention. See James C. Oldham, *Insurance Litigation Involving the Zong and other British Slave Ships, 1780-1807*, 28 *J. Legal Hist.* 299, 300 (2007).

⁹³ Sir Douglas Owen, *Ocean Trade and Shipping* 155 (1914).

⁹⁴ For a detailed description of the British marine insurance market in the late eighteenth century as it related to the development of the Lloyd's standard policy, see Charles Wright & C. Ernest Fayle, *A History of Lloyd's: From the Founding of Lloyd's Coffee House to the Present Day* 126-152 (1928). During that period, only twelve judges comprised the entirety of the central courts of London—the Court of Kings Bench, the Court of Common Pleas and the Court of Exchequer—and only some twenty or thirty barristers practiced at the Court of Kings Bench. See James Oldham, *English Common law in the Age of Mansfield* 12-16 (2004).

also appears in contracts with nonresponsive parties.⁹⁵ Michele Boardman, for example, observes that years of judicial construction given the effect of *stare decisis* have rendered standard clauses in contemporary consumer insurance contracts “a private conversation between drafters and the courts” that consumers who rely on the written contract’s literal meaning are likely to misunderstand.⁹⁶ Boilerplate formalities creates a special risk of Type I errors.

It is also worth considering the capacity of courts of general jurisdiction to establish useful boilerplate formalities. Responding to Lisa Bernstein’s studies of trade associations, David Charny expresses doubts:

As Bernstein reports, [trade association] tribunals frequently include in their opinions drafts of contract terms that should be incorporated into contracts to avoid future disputes. Note how this procedure lays the foundation for formalism in the next round: the trade association adjudicator can now insist that the dispute be resolved decisively by the presence or absence of a particular term, which, for the tribunal, has a built-in imprimatur and a preannounced meaning. In contrast, common law courts lack the institutional machinery for this prospective rulemaking: they are inexpert, they do not face contract cases from any specific industry often enough to mold practice, and they lack the means to communicate their decisions in a way that would reach the full range of transactors.⁹⁷

Not only was the Lloyd’s covered-risk clause used by a close-knit community of sophisticated repeat players, but courts interpreting it regularly empaneled special expert juries to advise them on commercial practices.⁹⁸ The conditions for the creation of successful boilerplate

⁹⁵ Although the line between sophisticated and nonsophisticated users is an obvious and important one, recent experience with *pari passu* clauses in sovereign debt contracts suggests even sophisticated parties not always responsive to judicial construction. In the immediate aftermath of judicial rulings on the legal meaning of the standard clause that went against the understandings of most lawyers in the field and the interests of their clients, those lawyers did not redraft their standard contracts to clarify the clauses’ meaning. See Mitu Gulati & Robert E. Scott, *The Three and a Half Minute Transaction: Boilerplate and the Limits of Contract Design* 45-72 (2013).

⁹⁶ Michelle E. Boardman, *Contra Proferentem: The Allure of Ambiguous Boilerplate*, 104 Mich. L. Rev. 1105, 1105 (2006).

⁹⁷ Charny, *supra* note 9 at 848.

⁹⁸ See James C. Oldham, *The Origins of the Special Jury*, 50 U. Chi. L. Rev. 137, 173-75 (1983). In *Wright v. Shiffner*, for example, upon the legal effect of a clause in an insurance policy, Lord Ellenborough emphasized that “Mr. Taylor, a special Juryman, said, that this was the construction universally put upon these policies in the city of London.” 2 Camp. 247, 249, 170 ER 1145, 1146 (1809). See also *Borough v. Witmore*, 4 T.R. 207, 100 ER 976 (1791) (determining the meaning of

formalities might not be present in a country the size of the United States that uses courts of general jurisdiction.

This is not to say that boilerplate formalities are never appropriate. I have listed three examples where they can be: when the inclusion of a boilerplate clause is mandated by statute or regulation; when contractual writings are highly standardized and uniformity is important to the market; and to enable consumer class actions on contract claims. In these circumstances, the benefits of treating boilerplate as a formality can be worth the added risk of Type I errors.

3.2.3.3 *Type II errors*

A Type II error is a false negative. In the case of altering rules, a Type II error occurs when parties wish to achieve a certain legal result but fail to perform an altering act that secures it. In the case of formalistic altering rules, a Type II error occurs when parties who want to achieve a legal outcome fail to say the magic words, whether because they do not know them or because they make a mistake in expression.

Type II errors can be reduced by a rule that provides that correct use of the formality is sufficient but not necessary to effect the legal change, in other words, by supplementing formalistic altering rules with interpretive ones. By providing that parties can achieve the desired legal effect without using the formality—by stipulating that it is also enough to say words with the right meaning—lawmakers can make it easier for nonresponsive parties to achieve the legal effects they want.⁹⁹

Consider Code's rule for the implied warranty of merchantability. Section (3)(a) provides the formalistic altering rule: a seller can disclaim all implied warranties by using the formalities "as is" or "with all faults." Section (2) provides a second way to alter a default warranty: "to exclude or modify the implied warranty of merchantability or any part of it [under this section] the language must mention merchantability and in case of a writing must be conspicuous." The section (2) rule has both formal and interpretive components. The language must mention of "merchantability" and, if in a writing, be conspicuousness. The rule does not, however, identify magic

the word "furniture" in a marine insurance policy based on the special jury's judgment as to merchant usage).

⁹⁹ Ayres provides a similar explanation of why altering rules commonly identify acts that are sufficient but not necessary to achieve legal change.

Giving effect to a multiplicity of methods [to avoid the default] reduces the costs of learning the law—especially the necessity to learn the altering rules themselves. A contract law that includes necessary elements for displacement will tend to increase the cost of becoming (and remaining) informed of the requisite procedures for displacement.

Ayres, *supra* note 28 at 2055 (footnote omitted). See also *id.* at 2081-82 (arguing that the best "password altering rules . . . are nonexclusive means—and are merely sufficient safe harbors—for achieving particular contractual concerns").

words sufficient to disclaim the implied warranty. The seller must make a statement with the right meaning—one that says that the seller does not warrant merchantability. The formalistic “as is” altering rule in section (3)(a) is accompanied by a mixed interpretive one in section (2).

Again there are tradeoffs. Requiring use of the formality means greater predictability and lower costs of adjudication. If the parties have not said the magic words, they have not effected the legal change. This is no longer the case if the formality but one way to achieve the legal change. Moreover, if it is possible to design an ordinary language formality to educate nonresponsive parties, we might want to require its use. In that case, the advantage from reducing Type I errors—misunderstanding of the legal effects—might outweigh the costs of any resulting Type II errors—failing to use the right words to achieve those legal effects.

3.2.4 *Relational costs*

In addition to costs of adjudication and costs of compliance, an altering rule can also come with relational costs.

Exchange transactions, even when at arms-length, often depend on a mix of legal and nonlegal forms of trust. A party who expects to engage in multiple transactions with their counterpart might choose to perform because breach would jeopardize that future income stream. A party who engages in similar transactions with others might worry about the reputational effects of breach. Parties in close-knit communities or in longstanding relationships might trust in one another’s honor, good will or moral sensitivity. These extralegal incentives can be as strong or stronger than legal ones, are often of instrumental value in exchange transactions, and in some cases are intrinsically valuable.

Juristic altering rules that require parties to say that they want legal enforcement can in some circumstances interfere with and erode extralegal forms of trust.¹⁰⁰ As Stuart McCauley famously observes, “[b]usinessmen often prefer to rely on ‘a man’s word’ in a brief letter, a handshake, or ‘common honesty and decency’—even when the transaction involves exposure to serious risks.”¹⁰¹ This does not mean that they prefer no legal liability for breach. But expressing that preference, especially in a legal formality, might signal mistrust, and perhaps also untrustworthiness. Altering rules that require the use of a legal formality can come with relational costs.

Here theory again hits empirics. The existence and size of such relational costs are likely to differ between different types of contractual transactions. A merger agreement between two multi-national corporations is not the same as a long-term supply contract between two local

¹⁰⁰ Klass, *Intent to Contract*, *supra* note 28, at 1474.

¹⁰¹ Stuart Macaulay, *Non-contractual Relations in Business: A Preliminary Study*, 28 *Am. Soc. Rev.* 55, 58 (1963).

businesses, which in turn differs from a promissory exchange between friends or family members. When formalities will impose relational costs and how large those costs will be are empirical questions that theory can identify but not answer.

Where formalities come with such relational costs, we can expect even more Type II errors. Parties who prefer legal liability might choose not to employ a requisite formality because each is concerned about the signal it will send the other. The design solution here is the same as above: supplementing the formalistic altering rule with an interpretive rule that provides an alternative path to the desired legal change. That rule might be a juristic one, permitting the parties to use less formal words to express or indicate their legal intent. Or it might be a nonjuristic one, identifying certain acts that make legal liability appropriate even though the parties have not expressly asked for it.¹⁰²

3.2.5 Other Social Goals

The analysis so far has focused solely on accuracy and the costs of achieving it. But contract law is designed to do more than help parties realize their individual and shared preferences, resolve disputes between them, and provide remedies for breach. Contract formalities might be designed to serve other social goals in either of two ways.

First, requiring an ordinary language formality might be designed not only to inform users of its legal effects, but to instruct or influence them in other ways. The US Presidential Oath of Office, for example, requires a president elect to recite specific words solemnly swearing or affirming that they will to the best of their ability preserve, protect, and defend the U.S. Constitution.¹⁰³ The Catholic marriage requires the bride and groom to memorize and recite precisely worded promises and prayers.¹⁰⁴ Both operate not only to inform users that they are effecting a normative change, but to force them to perform an act with separate normative significance. Although contemporary contract law does not include formalities of this type, one can imagine them.

Second, required formalities can serve a sorting function. Ayres makes this point: “An altering rule with arbitrary language operates as a password that allows knowledgeable parties to achieve a desired result without running the risk that unknowledgeable parties will mistakenly invoke the sufficient condition.”¹⁰⁵ Type II errors by nonresponsive parties are desirable when society wants to limit who can exercise a legal power.

¹⁰² For examples of the latter, see the analysis of spousal agreements in *Klass, Intent to Contract*, *supra* note 28, at 1488-97.

¹⁰³ U.S. Const. Art. II, § 1, cl. 8.

¹⁰⁴ The Order for the Celebration of Holy Matrimony.

¹⁰⁵ Ayres, *supra* note 28 at 2081.

Third, and more generally, formalities can be designed to make it costly to alter the default state of affairs. As Ayres also points out, sometimes there is a social interest in ensuring that a default sticks—that parties do not contract around it.¹⁰⁶ Requisite costly formalities like recitations, waiting periods, recording taxes, and the like can ensure that only those who attach a high value to the resulting legal change will take the trouble.¹⁰⁷

3.2.6 Summary

Formalities are useful when and only when the goal is to give parties the power to intentionally alter their legal situation. Formalities therefore belong to juristic altering rules. When lawmakers seek to condition the legal state of affairs on parties' nonlegal acts and expressions, formalities do not serve. And even when lawmakers want to give parties the power to change their legal obligations, formalities are not the only option. Interpretive juristic altering rules can supplement or provide alternatives to formalistic ones.

A nondefeasible formality provides responsive parties—parties who know and respond to legal rules—legal tool that is cheap to use and has predictable results. One might worry, however, about unresponsive parties—parties who do not know the rule and might therefore be unaware that they are using a formality or if its legal effects, or who might fail to use a formality to achieve the effects they want. The first category of errors can be addressed in either of two ways. Ordinary language formalities might be designed to inform users of their legal effect. But this approach can be expensive and might not always work. Alternatively, the formality might be made defeasible, allowing parties to introduce evidence that they did not in fact intend the associated legal effects. This approach comes at the price of higher adjudication and compliance costs and reduced predictability. The second category of errors, failure to use a requisite formality, can be addressed by pairing formalistic altering rules with interpretive ones, thereby giving parties who do not know the rule alternative and more accessible paths to effect legal change. Again this is at a cost in predictability. Pairing a formalistic altering rule with interpretive ones can also address the relational costs of formalities.

Finally, formalities can be used to help achieve other social goals, including forcing parties to perform a separately meaningful act, preventing nonresponsive parties from making certain changes, and making a socially desirable default stick.

¹⁰⁶ *Id.* at 2084-96.

¹⁰⁷ Similar advantages can be secured by adding formal requirements to interpretive altering rules.

4 Interpretive Formalism and Plain Meaning Rules

Contract law has its share of formalities. But they hardly dominate. First, the list of contract formalities is relatively short. There are no formalities associated with important acts such as making an offer, accepting an offer, expressly warranting the quality of goods, liquidating damages, waiving a condition, or committing anticipatory breach. These legal changes can be made only when one or both parties say or do something with the right meaning. Second, where formalistic altering rules exist, they are today almost always accompanied by interpretive altering rules. Words or actions with the right meaning often also suffice to effect the legal change. And if the formality is defeasible, its legal effect might be altered by words or actions with the right meaning. In short, interpretive altering rules are everywhere in contract law.

Whereas formalistic altering rules are always formal, an interpretive altering rule can be more or less formal. The first section of this Part identifies two types of interpretive formalism, *semantic* and *evidentiary*. For reasons I discuss, contract law more commonly deploys evidentiary than semantic formalism, usually in the form of a plain meaning rule. The second section address when and how plain meaning rules advance the goals of contract law.

4.1 Interpretive Formalism

Wigmore identifies two questions any law of interpretation must answer: “The first question must always be, What is the *standard* of interpretation? The second question is, In what *sources* is the tenor of that standard to be ascertained?”¹⁰⁸ By “standard of interpretation” Wigmore means the *type* of meaning the rule seeks to identify; by “sources” he means the *evidence* that the rule permits an interpreter to use. The answers to either can result in an interpretive rule that are more or less formal. A number of constitutionalist originalists, for example, argue that constitutional interpretation should focus on only one type of meaning, original public meaning. This is a form of semantic formalism, and is not the type of formalism one finds in contemporary contract law. Formalism in contract law comes from restricting the evidence that goes into interpretation. It is an evidentiary formalism. This section considers these two forms of interpretive formalism and explains why evidentiary formalism is more common in contract law.

4.1.1 *The Varieties of Meaning and Semantic Formalism*

An interpretive altering rule requires that one or both parties say or do something with the right meaning. But the word “meaning” has multiple

¹⁰⁸ Wigmore, *supra* note 35 vol. 5 § 2458, 367.

meanings. People interpret the meanings of historical events, social institutions, novels, metaphors, dreams, a moment of silence, a slip of the tongue, a glance across the room, a constitution, a statute, a judicial opinion, and of course the words and actions of persons who might or might not have entered a contract. Although these interpretive activities share family resemblances, they involve very different types of inquiry and seek out different types of meaning.

Even within contract interpretation one finds a variety of legally relevant meanings of “meaning.” Contract law does not have a single, master altering rule, but contains a collection of rules, many tailored to the type of transaction, to who the parties are, to the type of legally relevant act, and to the legal question at issue. Different interpretive altering rules within contract law call for different forms of interpretation of different sorts of meaning.¹⁰⁹ Here I emphasize three core differences: between communicative content and propositional attitudes; between semantic meaning and pragmatic meaning; and between common meaning and local meaning. I also briefly address the legal distinction between subjective meaning and objective meaning. An interpretive altering rule must identify *inter alia* the type of meaning that is legally relevant; different types of meaning can produce to more or less formal forms of interpretation.

4.1.1.1 *Communicative Content and Propositional Attitudes*

Some contract altering rules condition a legal change on the parties’ apparent beliefs and intentions, or what philosophers call their *propositional attitudes*.¹¹⁰ Others condition legal change on what parties say, or the *communicative content* of their words and actions.¹¹¹ The

¹⁰⁹ Lawrence Solum has argued that “the determination of communicative content proceeds differently in different legal contexts,” but focuses primarily on differences between broad areas of law—constitutional law, statutory law, the application of judicial precedent, contract law, etc. Lawrence B. Solum, *Communicative Content and Legal Content*, 89 *Notre Dame L. Rev.* 479, 482 (2013). As distinguished from the intermural differences that Solum emphasizes, I am pointing to intramural differences within the law of contract.

¹¹⁰ A propositional attitude is, roughly speaking, a mental state that can be expressed with a verb that takes a that-clause, such as “believes that...”, “intends that...”, “wishes that...”

¹¹¹ For more on this distinction, see the discussion of “manifest intent” and “express statement” opt-out rules in Klass, *Intent to Contract*, *supra* note 28.

Again Wigmore anticipates the point: “The distinction between ‘intention’ and ‘meaning’ is vital,” and “[t]he rules for the two things may be different.” Wigmore, *supra* note 35 vol. 5 § 2459, 369, 370. Wigmore’s distinction is not identical to the one I will be drawing, as Wigmore is especially interested in the mental state of intending the act, whereas I am interested in parties’ intentions and understandings more generally. For Wigmore, “[t]he contrast is between the Will, or volition to utter, which, as the intuitive element of an act, makes a person responsible for a particular utterance of his, and that Sense or meaning which

difference can be seen in the fundamental contract altering rule: the formation requirement that the parties *agree* to a transaction.

In our everyday talk we use “agreement” to refer to different things on different occasions. Sometimes we use the word to refer to the words people use to reach an accord, as in, “The parties each signed the agreement.” Other times we use it to refer to the mental states of being in accord, as David Hume does when he writes, “Two men, who pull the oars of a boat, do it by agreement or convention, tho’ they have never given promises to each other.”¹¹² Agreements in the former sense, which I will call *acts of agreement*, take the form of communicative acts, such as an offer followed by an acceptance. Agreements in the latter sense, which I call *states of agreement*, are sets of interlocking beliefs and intentions that two or more persons have or appear to have about what each shall do.¹¹³ Acts of agreement are communications and have communicative content; states of agreement are states of mind and involve propositional attitudes.

These two meanings of “agreement” are closely related. People typically arrive at a state of agreement by performing acts of agreement. They use words to achieve the shared intentions and beliefs that put them in agreement: “Shall we go?” “Yes, Let’s go.” “Good. We’re in agreement.” And for third-party adjudicators, parties’ acts of agreement are usually the best evidence both of whether they have reached a state of agreement and if so of its terms.

But the two types of agreement are not coextensive. A state of agreement can sometimes exist even when one or both sides have not communicated their agreement to it. Courts have held, for example, that where a seller has a history of fulfilling a buyer’s orders without further communication, an order from the buyer together with the seller’s silence might mean that both should reasonably understand the seller to have accepted the order and that shipment is forthcoming.¹¹⁴ The parties are found to be in a state of agreement, though one of them has not performed an act of agreement. And implied-in-fact contract can exist where neither party performs an act of agreement, though their actual agreement is manifest by other behavior.¹¹⁵ As the Michigan Supreme Court has explained, a contract is implied in fact “where the intention as to it is not manifested by direct or explicit words between the parties, but is . . .

involves the fixed association between the uttered word and some external object.” *Id.* at 369-70.

¹¹² David Hume, *Of Morals*, in *A Treatise on Human Nature* 291, 315 (David Fate Norton & Mary J. Norton eds., Oxford Univ. Press 2000) (1739-1740).

¹¹³ For more on the relationship between agreements and the parties’ intentions, see Michael E. Bratman, *Shared Cooperative Activity*, in *Faces of Intention: Selected Essays on Intention and Agency* 93 (1999).

¹¹⁴ Restatement (Second) of Contracts § 69 ill. 5 (1981) (*based on Ammons v. Wilson*, 176 Miss. 645 (1936)).

¹¹⁵ *Id.* § 4 (1981)

gathered by implication or proper deduction from the conduct of the parties, language used, or things done by them, or other pertinent circumstances attending the transaction.”¹¹⁶ Though it is rarely put this way, contemporary contract law provides that either an act of agreement (for example, an offer followed by an acceptance) or by a state of agreement (for example, a contract implied in fact) satisfies the agreement requirement.

Contract law also recognizes that content of the parties’ state of agreement sometimes extends beyond their acts of agreement. This is the case, for example, when the parties’ shared understanding of their agreement comes from past dealings between them, from common industry practices, and as time passes from the course of performance of the agreement itself. Courts have found, for example, that a seller and buyer who have an established practice of setting the price according to the seller’s profits on resale might, in their act of agreement to a new transaction, say nothing about the price, yet be in agreement on how the buyer will be paid.¹¹⁷ Here the state of agreement is richer than what is said in the act of agreement.

The distinction between acts of agreement and states of agreement illustrates two types of interpretation one finds in contract cases: interpretation of what the parties said and interpretation, based on evidence, of what the parties actually or apparently believed or intended.¹¹⁸ The first aims to discern the *communicative content* of the parties’ words and action; the second the parties’ legally relevant *propositional attitudes*—their beliefs and intentions. Again, the inquiries are related. What the parties intend and believe—whether they are, for example, in a state of agreement—turns in part on the communicative content of their words and actions. And what parties say is often the best evidence of what they believe and intend. Contrariwise, interpreting the meaning of what the parties have said can involve asking what they intended to communicate. But the inquiries pose different questions, and their answers require different types of reasoning and evidence. Two more examples further illustrate.

A party whose contractual obligations are conditioned on the occurrence or nonoccurrence of some event can in some circumstances waive that condition, rendering their obligation unconditional. The Second Restatement describes a waiver as a “*promise to perform . . . in spite of the nonoccurrence of the condition.*”¹¹⁹ A promise is, of course, a communicative act. But a party’s apparent *intention* to perform despite the

¹¹⁶ Miller v. Stevens, 224 Mich. 626, 632, 195 N.W. 481, 482 (1923).

¹¹⁷ See Restatement (Second) of Contracts § 223 ill. 1 (1981) (based on California Lettuce Growers, Inc. v. Union Sugar Co., 45 Cal.2d 474, 289 P.2d 785 (1955)).

¹¹⁸ For more on this distinction, see the discussion of “manifest intent” and “express statement” opt-out rules in Klass, *Intent to Contract*, *supra* note 28.

¹¹⁹ Restatement (Second) of Contracts § 84(1) (1981) (emphasis added).

nonoccurrence of the condition can also suffice to waive it. In *Tenneco v. Enterprise Products*, the Texas Supreme Court considered whether nonbreaching co-owners of a natural gas processing plant could sue an owner who had violated their contract by transferring its interest to a subsidiary and then failing to provide contractually required raw materials.¹²⁰ The court held that the nonbreaching owners had waived their right to pursue a remedy by failing to complain about the noncompliance for over three years and apparently accepting the subsidiary as a co-owner. “Silence or inaction, for so long a period as to show an intention to yield the known right, is . . . enough to prove waiver” of a contractual right.¹²¹ The outcome turned not on the meaning of what the plaintiff owners said, but on the reasonable interpretation of their intentions to enforce their contractual rights. As the current edition of *Williston* observes, a waiver can be found based solely on “a party’s conduct inconsistent with the assertion of the right to the performance allegedly waived, or by conduct that indicates that strict compliance with the contract will not be required.”¹²² Whether a party has waived a condition turns not only on what they *said*, but on what they *appeared to intend* with respect to their own performance.

The old rule for reviving a debt discharged in bankruptcy, in distinction, required a communicative act with the right meaning. Before the 1978 Bankruptcy Reform Act, a debt discharged in bankruptcy could be revived without consideration only by the debtor’s “express promise to pay all or part” of it.¹²³ In *Service Finance Company of Baton Rouge v. Daigle*, a Louisiana appellate court held that three payments on a debt after its discharge, plus the debtor’s statement “that he was going to continue to pay this account,” were insufficient to revive the debt.¹²⁴

In order to revive a liability on a debt discharged in bankruptcy or to create a new enforceable obligation, there must be an express promise to pay the specific debt, made to the creditor or his agent, and while no particular form of language is necessary, to constitute such a new promise there must be a clear, distinct, and unequivocal

¹²⁰ *Tenneco Inc. v. Enter. Products Co.*, 925 S.W.2d 640 (Tex. 1996).

¹²¹ *Id.* 643.

¹²² 13 *Williston on Contracts* § 39:30 (4th ed.). See also Restatement (Second) of Contracts § 84(1) cmt. e (1981) (“It is immaterial how the promisor manifests his intention to fulfill the prior duty without the performance of the condition. Words of promise or waiver, though often used, are unnecessary; in many situations non-verbal conduct is enough.”).

¹²³ Restatement (Second) of Contracts § 83 (1981). For changes introduced by the 1978 Bankruptcy Reform Act and subsequent legislation, see 4 *Williston on Contracts* § 8:21 (4th ed. 2016).

¹²⁴ *Serv. Fin. Co. of Baton Rouge v. Daigle*, 342 So. 2d 1192, 1193 (La. Ct. App. 1977).

recognition and renewal of the debt as a binding obligation, anything short thereof being insufficient, as, for example, the mere acknowledgment of the discharged debt, or the expression of hope, desire, expectation, or intention to pay or revive the same.¹²⁵

According to this rule, it is not enough that a debtor intended or appeared to intend to pay the debt. A court must look to the communicative content of what the debtor said.

4.1.1.2 *Semantic Meaning and Pragmatic Meaning*

A communicative act can itself have different types of meaning, different types of communicative content. An especially important distinction is that between what philosophers and linguists term *semantic meaning* and *pragmatic meaning*.

As I will use the terms,¹²⁶ the *semantic meaning* of a word or string of words is its conventional meaning, or what is sometimes referred to as its “literal” or “dictionary” meaning, whereas the *pragmatic meaning* of a text or utterance is the meaning the speaker or writer intends the words to convey. Sometimes the two coincide; people often say just what they mean. They come apart when a speaker intends their words to convey something other than those words’ semantic meaning. This might be intentional, as when a speaker employs irony, metaphor, or elision. Pragmatic meaning can also diverge from semantic meaning when the a speaker makes an error in grammar or usage, such as a malaprop.

Contracting parties often use words in their literal senses. It would be extremely unusual for a drafting attorney to choose to employ metaphor, irony, hyperbole, humor, or another nonliteral forms of communication. That said, when interpreting contractual communications, courts almost never limit the inquiry to the semantic meanings of the parties’ words.

This is most obvious when a contract is formed without the participation of lawyers and through relatively informal communications. In *Embry v. Hargadine, McKittrick Dry Goods*, for example, a company president allegedly said to an employee threatening to quit if not given a new contract, “Go ahead, you’re all right; get your men out and don’t let that worry you.”¹²⁷ The words’ literal meaning was that the employee was

¹²⁵ *Id.* (quoting *Irwin v. Hunnewell*, 207 La. 422, 435, 21 So.2d 485, 489 (1945)).

¹²⁶ The below definitions of “semantic meaning” and “pragmatic meaning” are the ones I believe are most useful for legal analysis. Theorists have suggested others. Robyn Carston identifies five separate ways scholars have tried to draw the distinction between semantic meaning and pragmatic meaning. *Linguistic Communication and the Semantics/Pragmatics Distinction*, 165 *Synthese* 321, 322 (2008). See also Börjesson, Kristin, *The Semantics-Pragmatics Controversy* (2014); Kent Bach, *The Semantics/Pragmatic Distinction: What It Is and Why It Matters*, *Linguistische Berichte, Sonderheft 8*, 33 (1997).

¹²⁷ 127 Mo. App. 383, 105 S.W. 777, 777 (1907).

to get back to work and should not worry about the contract. The court found, however, that in context “no reasonable man would construe that answer to Embry’s demand that he be employed for another year, otherwise than as an assent to the demand.”¹²⁸ Although the court did not put it this way, the pragmatic meaning of the manager’s words departed from their semantic meaning, and it was the pragmatic meaning that legally controlled. Or recall *Leonard v. Pepsico*, which considered a television advertisement showing various items that could be purchased with promotional “Pepsi Points,” including a Harrier Jet with the words, “HARRIER FIGHTER 7,000,000 PEPSI POINTS.”¹²⁹ Here the court held that in the context of the advertisement, which employed “zany humor,” “no reasonable, objective person would have understood the commercial to be an offer.”¹³⁰ Again, the communicative act’s pragmatic meaning departed from their semantic meaning, and the former controlled.

Even when the parties have reduced their agreement to an integrated writing drafted by lawyers, courts sometimes find that the writing as a whole suggests an interpretation other than its semantic meaning. In everyday speech, a listener typically recognizes the intended meaning of someone who commits a malaprop.¹³¹ When Archie Bunker says, “We need a few laughs to break up the monogamy,” we know he means monotony. Similarly, when a written agreement contains an apparent error in drafting—when its literal meaning does not correspond to the parties’ apparent purpose—a court will aim at the parties’ intended meaning, rather than limiting itself to the literal meaning of their words. Williston, in the first edition of his treatise, formulated the rule:

[I]n giving effect to the general meaning of a writing particular words are sometimes wholly disregarded, or supplied. Thus “or” may be given the meaning of “and,” or vice versa, if the remainder of the agreement shows that a reasonable person in the position of the parties would so understand it.¹³²

When the whole of a writing evinces a purpose contrary to the semantic meaning of one of its clauses, the parties’ apparent intentions—the writing’s pragmatic meaning—controls.

None of this is to say that semantic meaning is irrelevant. A speech act’s pragmatic meaning almost always depends on its semantic content, even when it departs from it. This is why rules governing common meaning

¹²⁸ *Id.* at 779.

¹²⁹ 88 F. Supp. 2d 116, 119 (S.D.N.Y. 1999), *aff’d*, 210 F.3d 88 (2d Cir. 2000).

¹³⁰ *Id.* at 131.

¹³¹ See Donald Davidson, *A Nice Derangement of Epitaphs*, in R. Philosophical Grounds of Rationality 157 (R. Grandy & R. Warner, eds. 1986).

¹³² Williston, *supra* note 7 vol. 2 § 619, 1199.

and use meaning, discussed below, are important. But semantic meaning rarely governs in contract exposition.

4.1.1.3 *Common Meaning and Local Meaning*

A third distinction among types of meaning concerns different types of semantic meaning. A communicative act's semantic meaning depends on the language being spoken. Contract law has long recognized that parties do not always speak in ordinary English. Wigmore distinguishes between "the standard of the community, or *popular* standard, meaning the common and normal sense of words; [and] the *local* standard, including the special usages of a religious sect, a body of traders, an alien population, or a local dialect."¹³³ I will call semantic meaning in ordinary dictionary English *common meaning* and semantic meaning in more localized dialects *local meaning*. In the Uniform Commercial Code, local meaning belongs to usage of trade. "The language used is to be interpreted as meaning what it may fairly be expected to mean to parties involved in the particular commercial transaction in a given locality or in a given vocation of trade."¹³⁴

Alan Schwartz and Robert Scott suggest that there are only two possible answers to the which-language question: "majority talk" or "the parties' private language."¹³⁵ It is strange that they ignore the well-

¹³³ Wigmore, *supra* note 35 vol. 5 § 2460, 372 (emphasis in the original). Williston quotes the same from the first edition of Wigmore, Williston, *supra* note 7 vol. 2 § 604, 1162.

Wigmore identifies two additional categories of meaning: "the *mutual* standard, covering those meanings which are peculiar to both or all the parties to a transaction, but shared in common by them; and the *individual* standard of one party to an act, as different from that of the other party or parties, if any." *Id.* These are forms of pragmatic meaning, though Wigmore did not have the conceptual tools to identify them as such.

¹³⁴ U.C.C. 1-303 cmt. 3. The Code's definition of "usage of trade" includes more than local meaning. "A 'usage of trade' is 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.* § 1-303(c). Under this definition, usages of trade include not only linguistic conventions but also transactional ones. Hence my choice of the term "local meaning" rather than "usage of trade."

¹³⁵ Schwartz & Scott, *supra* note 48 at 584 ("The issue is whether, if the contract is silent on the matter, a court should take the parties to have written in majority talk. The alternative judicial assumption would hold that, in case of a dispute, the parties prefer to have the opportunity to introduce extrinsic evidence that relevant parts of the contract were written in the parties' private language."). By "majority talk," Schwartz and Scott mean a rule "that restricts the court to the interpretive base B_{\min} ," *id.* at 585, which they define as "the parties' contract, a narrative concerning whether the parties performed the obligations that the contract appears

established distinction between common and local meanings. Public semantic meaning can be common or local, and both should be distinguished from pragmatic meaning—which appears to be what Schwartz and Scott mean by “the parties’ private language.”

Williston observes that the choice between common and local meanings depends in part on the type of altering act. When interpreting contractual acts, including contractual writings, “[t]he local standard is preferable to the normal [i.e., common] standard.”

[A] reasonable degree of certainty is attained if words are construed according to a standard not peculiar to the parties, but customary among persons of their kind under the existing circumstances. The certainty obtained by enforcing always the normal standard would be but little greater, and would be obtained at the expense of a rigidity which would frequently do violence to the actual intention of the parties. That the local standard would be applied unless at any rate under the normal standard the words were extremely clear seems to have been early settled. Even though the local standard led to a construction opposed to the literal meaning of the language this was true.¹³⁶

Williston suggests that “in case of deeds of conveyance, or of negotiable instruments, which are relied upon not simply by the parties to them, but by others, the normal rather than the local standard may be defensible.”¹³⁷ Whether interpretation should use a common or a local standard cannot be decided *a priori*. It is a design choice that should be made based on a law’s goals and salient empirical facts.¹³⁸

4.1.1.4 Subjective Meaning and Objective Meaning

To this point I have largely ignored the lawyerly distinction between subjective and objective meaning. In contract speak, *subjective meaning* refers to one or more party’s individual, perhaps idiosyncratic, and probably undisclosed understandings of an altering act, whereas *objective meaning* refers to the act’s publicly available meaning, or what a reasonable person standing in a party’s shoes would understand it to mean.

My own view is that the above typology of meanings is more important to a perspicacious understanding of contract interpretation than is the distinction between subjective and objective meaning and the so-called objective theory of contract, though the latter are important for first-year

to require, a standard English language dictionary, and the interpreter’s experience and understanding of the world,” *id.* at 572.

¹³⁶ Williston, *supra* note 7 vol. 2 § 608, 1171-72.

¹³⁷ *Id.* at 1172.

¹³⁸ See *Id.* § 604, 1162 (“The standard of interpretation adopted by the law depends on the character of the contract under consideration.”)

law students to understand. That said, I will say a few words about how the above categories line up with the distinction between subjective and objective meaning.

The interpretation of a person's beliefs or intentions—their propositional attitudes—can seek either their actual attitudes or the attitudes a reasonable person would attribute them based on their behavior. Which is relevant depends on the altering rule. The mistake defense, for example, requires that a showing that one or both parties actually held a false belief at the time of formation.¹³⁹ The test is subjective. The rule for implied waivers, in distinction, looks to a party's apparent intention to perform despite the failure of the condition. The test is objective.

Many interpretive altering rules, including the rule for agreement and most rules that turn on communicative meaning, look to a mix of subjective and objective meanings. Oversimplifying a bit, when the parties' subjective understanding converge, subjective meaning governs; when the parties attach different meanings to their words and actions, objective meaning does.¹⁴⁰ As Corbin observes, this rule serves a dual purpose. First, it advances contract law's overarching goal giving legal effect to parties' intent; when subjective understandings converge, they control. Second, when the parties' subjective understandings do not align, the rule assigns responsibility to the party at fault; because the party with the objectively unreasonable understanding is at fault for the misalignment, the other's reasonable understanding governs.¹⁴¹

Semantic meaning is always objective. The conventional meaning of words in some language is a fact about the social world, not about any person's or persons' belief about it. But as I have observed, the ultimate goal of contract interpretation is rarely semantic meaning. It is the meaning intended by the parties, or pragmatic meaning, which, like their beliefs and intentions, can be understood either subjectively or objectively.

4.1.1.5 *Semantic Formalism*

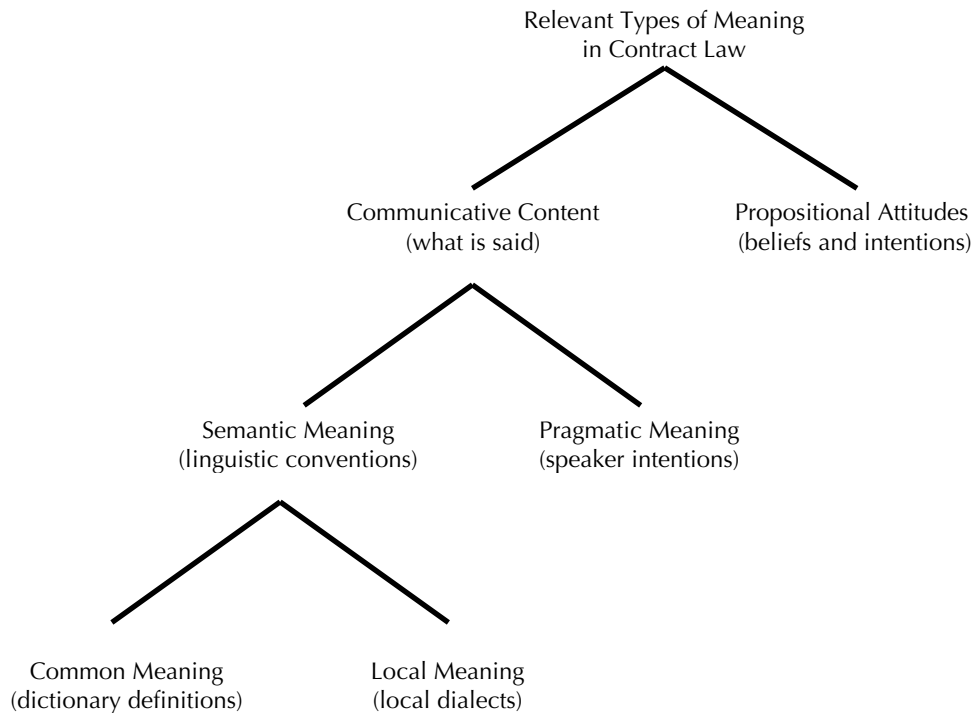
The above discussion has produced the following taxonomy:

¹³⁹ Restatement (Second) of Contracts §§ 151-153 (1981).

¹⁴⁰ *Id.* § 201(1). For a detailed account, see Lawrence M. Solan, *Contract as Agreement*, 83 Notre Dame L. Rev. 353 (2007).

¹⁴¹ Corbin on Contracts, *supra* note 8 vol. 1 § 106 ("In the process of making a contract, the actual and proved intent of either of the parties should not be disregarded, unless he knowingly or negligently has misled another person to his injury. If no other person has been so misled, it should make no difference what expressions would have been chosen by other reasonable or intelligent users of language or what meaning the expressions actually used would have conveyed to such third persons.")

Figure 4: Typology of Meaning in Contract Law



Depending on the altering rule, contract interpretation might aim at any of the endpoints on the tree: the parties' propositional attitudes as evinced by their words and actions, the pragmatic meaning of their communicative acts, the local semantic meaning of their words, or the common semantic meaning of those words. Although the picture suggests that the branches are independent, the types of meaning interact. Most importantly, a speech act's pragmatic meaning often depends both on the speaker's apparent beliefs and intentions and the semantic meaning of the words they use.

Meanings further to left on the tree require less context evidence for their interpretation, and so are more invariant. An interpretive altering rule might therefore be said to be more or less formal depending on what sort of meaning it identifies as legally relevant. An altering rule that conditions legal change on the common semantic meaning of the parties' words and actions, for example, is more formal than one that conditions a change on the parties' apparent beliefs and intentions. I call this *semantic formalism*.

As I have noted, semantic formalism is not a feature of contemporary contract law. Contract interpretation today generally seeks out the pragmatic meaning of the parties' communicative acts or the parties' propositional attitudes. Though a few theorists have advocated semantic formalism,¹⁴² courts almost never rely on a communication's

¹⁴² For example Alan Schwartz and Robert Scott in Schwartz & Scott, *supra* note 48.

semantic meaning to defeat clear evidence that they intended something else. Formalism in contract interpretation does not come from a focus on semantic meaning, but as described in the next section, from rules that limit the evidence of pragmatic meaning.

This distinguishes contract interpretation from the interpretation of public laws. Consider various reasons for construing a constitution, statute, regulation, executive order, or judicial opinion according to its semantic meaning. The text of a public law is addressed to the population at large and to persons far in the future, for whom semantic meaning is the more effective method of communication.¹⁴³ Many contractual agreements, on the contrary, are communications between two parties and take place against a shared background understanding, where the pragmatic meaning is clear. A focus on semantic meaning in statutory interpretation can also serve as a means of limiting judicial discretion, on the theory that the conventional meaning of words is more certain than the purpose they are used for. Semantic formalism might therefore serve to shift power to the legislature rather than the judiciary.¹⁴⁴ Contract interpretation raise no such separation-of-powers issues. Finally, contract law takes account of interests that have no public law analogs. These include the parties' autonomy interest in controlling their legal relationship and in some transactions society's interest in congruence between parties' legal and moral obligations. A contracting party whose words are legally interpreted in a way neither party anticipated suffers a type of legal wrong a legislator cannot.

4.1.2 *Evidentiary Formalism*

If semantic formalism is rare in contract law, a second type of interpretive formalism is common. Interpretive contract altering rules can achieve many of the goals of formalism by limiting the evidence of meaning an interpreter may consider, what Wigmore labels the "sources" of interpretation. I will call this *evidentiary formalism*.

¹⁴³ See William N. Eskridge, Jr., *The New Textualism*, 37 UCLA L. Rev. 621, 667 (1990) ("By focusing on the literal meaning a statute would have for the ordinary, reasonable reader, the new textualism has the intuitive appeal of looking at the most concrete evidence of legislative expectations and at the material most accessible to the citizenry. The statutory text is what one thinks of when someone asks what the 'law' requires.").

¹⁴⁴ *Id.* at 648.

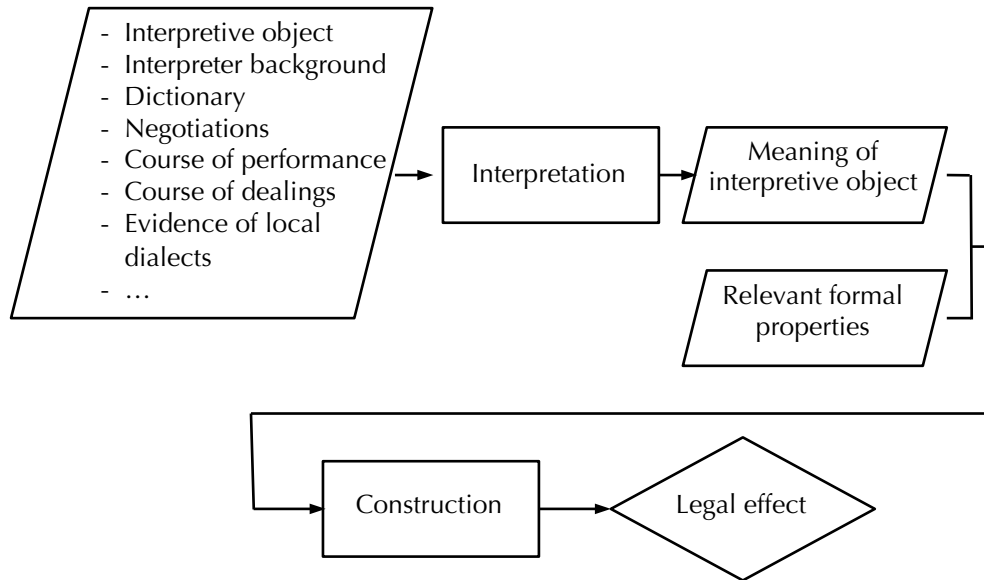
4.1.2.1 *Interpretation Thick and Thin*

A rule of interpretation is like a function that maps a domain of interpretive inputs onto a range of interpretive outputs.¹⁴⁵ The inputs always include the direct object of interpretation: the text, spoken words, gesture, or other act or omission whose meaning is at issue. They also always include the interpreter's background understanding of the language and the world. Other possible but not necessary inputs include dictionary definitions and rules of grammar; evidence of local linguistic practices; information about who the parties are and the commercial setting of the transaction; other communications among or by the parties, before, during or after formation; the parties' earlier or subsequent dealings with one another; and other surrounding circumstances relevant to the production and the parties' understanding of the interpretive object.¹⁴⁶ The interpretive output is a meaning associated with the interpretive object. In legal interpretation, that meaning, together with any relevant formal features of the interpretive object (for example, whether it is a signed writing), serve as inputs for construction, which is the determination of legal effects. The process of applying an interpretive altering rule can therefore be represented as follows:

¹⁴⁵ The indeterminacy of interpretation renders this helpful analogy also imperfect. See Donald Davison, *Radical Interpretation and Belief and the Basis of Meaning, in Inquiries into Truth and Interpretation* 125 & 141 (1984).

¹⁴⁶ For other lists of possible interpretive inputs, see Schwartz & Scott, *supra* note 48 at 572 (listing "the parties' contract, a narrative concerning whether the parties performed the obligations that the contract appears to require, a standard English language dictionary, and the interpreter's experience and understanding of the world," plus "(1) the parties' practice under prior agreements; (2) the parties' practice under the current agreement; (3) testimony as to what was said during the negotiations; (4) written precontractual documents (memoranda, prior drafts, letters); and (5) industry custom relevant to determining what the agreement's words meant to the contracting parties"); 11 Williston on Contracts § 32:7 (4th ed. 2016) (arguing that even when a writing is integrated the interpreter should consider surrounding circumstance such as "the commercial or other setting in which the contract was negotiated and other objectively determinable factors that give a context to the transaction between the parties," including "whether one or both parties was new to the trade, whether either or both had counsel, and the nature and length of their relationship, as well as their age, experience, education, and sophistication").

Figure 4: Structure of Interpretive Exposition



What inputs should go into contract interpretation? With respect to contractual writings, scholars have mounted general defenses of both textualist and contextualist approaches. But the choice of interpretive inputs is not binary. Any given rule of interpretation can permit more or less evidence depending on the types of evidence it authorizes (a rule of contract interpretation might permit, for example, usage of trade but not course of performance), on when that evidence is allowed in (always, only when the semantic meaning is ambiguous, only in informal or nonintegrated communications, etc.), on who may consider the evidence (only the judge, also the jury), and so forth. The question is not simply whether to limit the interpretive domain to the text and a dictionary, but how much evidence of what type to allow under what circumstances, where the possible answers include “None ever,” “All always,” and many points between.¹⁴⁷

I will use the terms *thick* and *thin* to describe the relative quantity of inputs a legal rule of interpretation permits. Rules of interpretation that permit more interpretive inputs are *thicker*, those that permit fewer interpretive inputs are *thinner*. Textualist rules of interpretation are at the far thin end of the spectrum. Schwartz and Scott suggest that the minimum interpretive inputs are “the parties’ contract, a narrative concerning whether the parties performed the obligations that the contract appears to require, a

¹⁴⁷ See Smith, *supra* note 12 at 1157-66 (identifying ways that rules can be designed to achieve a “differential formalism”); Katz, *supra* note 12 at 515-19 (observing several ways in which courts can permit more or less evidence in interpretation).

standard English language dictionary, and the interpreter's experience and understanding of the world."¹⁴⁸ Fully contextualist approaches lie at the thick end of the spectrum and permit any or all of the above-listed forms of additional interpretive evidence and more.

4.1.2.2 *Thin Interpretation and Plain Meaning Rules*

Although the debate over how formalist contract interpretation should be is an important one, no one advocates thin interpretation for every type of contract altering act. I will use *contractual writing* to denote a writing or other verbal record that parties use to reach a contractual agreement or to memorialize one. Those who argue for formalist approaches to contract interpretation focus almost exclusively on contractual writings. Courts typically apply evidentiary formalism to an even narrower category: integrated contractual writings, or writings that the parties intend as a final expression of some or all of their agreement. New York's plain meaning rule provides a useful example.

Plain meaning rules are sometimes called *four corners rules*. In *W.W.W. Associates, Inc. v. Giancontieri*, the New York Court of Appeals formulated the New York rule as follows.

[W]hen parties set down their agreement in a clear, complete document, their writing should as a rule be enforced according to its terms. Evidence outside the four corners of the document as to what was really intended but unstated or misstated is generally inadmissible to add to or vary the writing.¹⁴⁹

Note that the rule applies only to "complete documents," which is to say those that are integrated. The New York rule is that extrinsic evidence may be introduced to interpret an integrated writing only when the writing is ambiguous. In New York's relatively formalist version of the rule, ambiguity is also to be determined from the text alone. "[E]xtrinsic and parol evidence is not admissible to create an ambiguity in a written agreement which is complete and clear and unambiguous upon its face."¹⁵⁰ The interpreter of an integrated contractual writing may consider extrinsic evidence only if the writing is ambiguous on its face.

This thin interpretive base gives a contractual writing's semantic meaning greater role in its interpretation, which leads to the question: Which semantic meaning should provide the starting point? Should it be the common meaning found in dictionaries or, where the evidence supports it,

¹⁴⁸ Schwartz & Scott, *supra* note 48 at 572.

¹⁴⁹ *W.W.W. Assocs., Inc. v. Giancontieri*, 77 N.Y.2d 157, 162 (1990). See also *R/S Assocs. v. N.Y. Job Dev. Auth.*, 98 N.Y.2d 29, 32 (2002).

¹⁵⁰ 77 N.Y.2d at 163 (*quoting* *Intercontinental Planning v. Daystrom, Inc.*, 24 N.Y.2d 372, 379 (1969)).

local meaning? Although there is not a great deal of case law on the question, New York courts appear to hold that when local meaning departs from common meaning, local meaning controls.¹⁵¹ As noted above, this is also Williston's position. "That the local standard would be applied . . . seems to have been early settled. Even though the local standard led to a construction opposed to the literal meaning of the language this was true."¹⁵² New York's plain meaning rule does not therefore lie at the thinnest end of the evidentiary spectrum. The interpretive inputs can also include available evidence of local dialects. Williston again: "Neither, in the construction of a contract among merchants, tradesmen, or others, will the evidence [of local usage] be excluded because the words are in their ordinary meaning unambiguous."¹⁵³

Although evidentiary formalism gives more weight to semantic meanings, New York courts do not adhere to semantic formalism. *Giancontieri* also provides that a writing is to be "read as a whole to determine its purpose and intent."¹⁵⁴ Or as the Court of Appeals explained in another decision:

¹⁵¹ *Nau v. Vulcan Rail & Constr. Co.*, 286 N.Y. 188, 198 (1941) ("Technical words in a contract must be taken in a technical sense unless the context of the instrument or a usage which is applicable clearly indicates a different meaning.") (construing several terms used in patents and patent practice and concluding that the agreement "was plain and unambiguous on its face"). See also *HNC Realty Co. v. Bay View Towers Apartments, Inc.*, 409 N.Y.S.2d 774, 780 (1978) ("Parol evidence would have been admissible to introduce proof of usage and custom and to define the meaning intended by the parties of the term 'surety payment bond' as used in the contract."); *Estate of Hatch by Ruzow v. Nyco Minerals Inc.*, 666 N.Y.S.2d 296, 298 (1997) ("Moreover, technical words are to be interpreted as usually understood by the persons in the profession or business to which they relate, and must be taken in the technical sense unless the context of the instrument or an applicable usage or the surrounding circumstances clearly indicate a different meaning." (dicta, internal quotation marks omitted)). But see *Mazzola v. Cty. of Suffolk*, 533 N.Y.S.2d 297, 297 (1988) ("The words and phrases used in an agreement must be given their plain meaning so as to define the rights of the parties, and in this regard, it is common practice for the courts of this State to refer to the dictionary to determine the plain and ordinary meaning of words to a contract." (internal citation omitted)).

¹⁵² Williston, *supra* note 7 vol. 2 § 608, 1172.

¹⁵³ *Id.* at 1172 (quoting *Brown v. Byrne*, 3 E. & B. 703). In fact, Williston suggests expanding it beyond even this. See, e.g., *id.* at § 618, 1198 ("The circumstances under which a writing was made may always be shown. The question the court is seeking to answer is the meaning of the writing at the time and place when the contract was made; and all the surrounding circumstances at that time necessarily throw light upon the meaning of the contract." (citation omitted)). Although there are strong formalist elements in the first edition of his treatise, Williston focuses more on difference between meaning and intent, and he does not espouse a plain meaning rule in the contemporary sense.

¹⁵⁴ 77 N.Y.2d at 162.

The meaning of a writing may be distorted where undue force is given to single words or phrases. We read the writing as a whole. We seek to give to each clause its intended purpose in the promotion of the primary dominant purpose of the contract.¹⁵⁵

This emphasis on interpreting the contractual writing as a whole in light of its apparent purpose takes interpretation beyond semantic meaning to considerations of probable intent and the text's pragmatic meaning.

The New York Court of Appeals decision in *William C. Atwater & Co. v. Panama Railroad Co.* illustrates how semantic and pragmatic meaning can come apart even under the New York plain meaning rule. At issue was the correct interpretation of an installment contract for the sale of coal with the following provision: "Any portion of the tonnage remaining unshipped at the date of expiration of this agreement shall be considered cancelled without notice."¹⁵⁶ The sentence's literal meaning would have released both parties from liability for any coal unshipped by the end of the installment period. The buyer therefore attempted to invoke the provision to avoid liability for coal unshipped due to the buyer's own unexcused refusal to accept earlier shipments. Reading the agreement as a whole, however, and in light of the seller's option to reduce installments after a buyer breach, the court concluded that the clause was intended to apply only to coal that remained unshipped as a result of the seller's exercise of that option. "Reason, equity, fairness—all such lights on the probably intention

¹⁵⁵*Empire Properties Corp. v. Manufacturers Trust Co.*, 43 N.E. 2d 25 (N.Y. 1942). See also *Fleischman v. Furgueson*, 119 N.E. 400, 401 (N.Y. 1918) ("In construing a contract the whole instrument must be considered and from such consideration a conclusion reached as to what the parties intended to do or sought to accomplish."); *Wolkind v. Berman*, 232 A.D. 47, (N.Y. App. Div. 1931) ("The intent of the parties is determined by considering the instrument which memorializes the agreement of the parties as a whole."). Even more radical are early statements by the Illinois Supreme Court:

The rule is that the intention of the parties must govern, but that intention is not to be sought merely in the apparent meaning of the language used, but that the meaning of the language used may be enlarged or limited according to the true intent of the parties, as made manifest by the various provisions of the contract considered as a whole.

Street v. Chicago Wharfing and Storage Co., 41 N.E. 1108, 1111 (Ill. 1895). And: "Particular expressions will not control where the whole tenor or purpose of the instrument forbids a literal interpretation of the specific words." *McCoy v. Fahrney*, 55 N.E. 61, 63 (Ill. 1899).

¹⁵⁶ 159 N.E. 418 (N.Y. 1927).

of the parties—show what the real agreement was.”¹⁵⁷ In short, the writing’s pragmatic meaning controlled, at the expense of its semantic meaning.¹⁵⁸

In sum, New York’s plain meaning rule for integrated contractual writings has three components. The first is a high degree of evidentiary formalism. Absent ambiguity on the face of an integrated contractual writing, interpretive inputs should include only the contractual writing, a dictionary, any extrinsic evidence of local conventional meanings, and the interpreter’s background understanding of the English language and the world. Second, when interpreting the contractual writing, priority should be given to demonstrable local conventional meanings over common ones. That said, and third, the goal of interpretation is to identify the writing’s pragmatic meaning, to the extent it can be gleaned from the thin evidentiary base and the text as a whole. Although a contractual writing’s plain meaning often is its semantic meaning, sometimes the writing as a whole indicates a purpose at odds with that meaning, in which case the parties’ probable intentions and the text’s pragmatic meaning control. The output of this interpretive process is the text’s *plain meaning*. Only when the plain meaning is ambiguous or otherwise fails to determine the legal state of affairs may the interpreter look to other interpretive evidence of the words’ pragmatic meaning or the parties’ relevant beliefs and intentions.

There is more to say about plain meaning rules. I have not, for example, discussed the respective roles of the judge and jury.¹⁵⁹ Nor do other states follow New York in all the details of the above rule, or are New York courts completely consistent in the rule’s application or articulation. But the above version serves as a useful example for thinking about when and where lawmakers should adopt evidentiary formalism, which belongs to the project of the next section.

4.1.2.3 *Thick Interpretive Rules: Contextualism*

Although integrated contractual writings often play a key role in formation and in the determination of contract terms, they are only one type of contract altering act. Absent an integrated writing, formation might happen through an oral exchange, in non-integrated writings, by an act like the shipment of goods, or in some circumstances through a party’s silence and inaction. Other altering acts occur before or after formation. One side’s precontractual communications can render an offer irrevocable, can generate express warranties, and can affect recoverable damages. Post-formation acts that affect the parties’ legal relationship include

¹⁵⁷ *Id.* at 419.

¹⁵⁸ For other examples, see *Washington Construction Co. v. Spinella*, 84 A.2d 617 (N.J. 1951); *Motorsports Racing Plus v. Arctic Cat Sales*, 666 N.W.2d 320 (Minn. 2003).

¹⁵⁹ See, e.g., *Nucci v. Warshaw Const. Corp.*, 12 N.Y.2d 16, 20 (1962) (“The interpretation of written contracts ordinarily presents a question of law for the court.”).

modifications, waivers, repudiations, demands for adequate assurance, cancellations, and insistences on performance. None of these altering acts involves a contractual writing, and many are effective regardless of whether the parties have or will produce an integrated writing.

If we expand the inquiry beyond integrated contractual writings to altering acts generally, it is apparent that thick interpretation is everywhere in contract law. Consider the casebook classic, *Lucy v. Zehmer*, which concerned the legal effect of an agreement to sell a farm for \$50,000 that was written on the back of a restaurant check.¹⁶⁰ At issue was whether a seller's agreement to the transaction was in jest. In concluding the transaction appeared to be serious, the court addressed inter alia: the buyer's past offers to purchase the farm; that the parties signed the instrument after 30-40 minutes of negotiations and some redrafting; the fact that the parties were drinking; testimony that the seller negotiating the transaction told his wife that it was a joke; the buyer's offer, immediately after signing, of five dollars "to seal the deal," and the negotiating seller's rejection of that offer; and the buyer's subsequent actions in reliance on the transaction. Although the court's conclusion might be described "formalist," in the sense that it held that the writing was binding, the opinion nowhere suggests that evidence beyond the writing should not be considered. The interpretative approach is nonformalist.

4.2 When and How Plain Meaning Rules Work

Having described the primary form of interpretive formalism in contract law, plain meaning rules, I now turn to of when and how those rules can be of use in contract law in light of the considerations identified in Part Two. First, however, it will be helpful to return to the topic of juristic and nonjuristic altering rules, and a corresponding difference between rules that are designed to provide instructions to parties and rules designed to interpret their words and actions.

4.2.1 *Instructions and Interpretations*

Ian Ayres likens the design of altering rules to the design of software interfaces.¹⁶¹ A legal default is comparable to word processing program's default margins; the associated altering rule to the commands a user can execute to change the margins. Both altering rules and software commands provide users tools to effect changes in the relevant environment. "An altering rule in essence says that if contractors say or do this, they will achieve a particular contractual result."¹⁶² Ayres therefore suggests that altering rules that do not "give guidance about either the non-default

¹⁶⁰ 196 Va. 493 (1954).

¹⁶¹ Ayres, *supra* note 28 at 2039-42, 2063-66, 2069-71.

¹⁶² *Id.* at 2036.

options or the mechanisms for achieving them” are characteristic of “immature” regimes where the accretion of precedent has not provided judicial disclosure guidance about particular mechanisms that are sufficient to achieve particular alternatives.”¹⁶³

Ayres’s conception of altering rules as instructions is of a piece with economic approaches to contract law. Much economic analysis of law focuses on how legal rules influence decision-making. In contractual transactions, that influence appears not only in the decision to perform or breach, but also in decisions made at and around the time of formation.¹⁶⁴ Ayres’s theory of altering rules, like his earlier theory of defaults,¹⁶⁵ explores the incentives that the rules of contract construction create at the time of formation and suggests how lawmakers can design those rules to take advantage of those incentives. Add to this a recognition that our contract law is designed to empower parties to get the legal obligations they want, and it is a short step to imagining altering rules as instructions telling parties how to get desired legal outcomes.

But this captures only part of the altering rules story—the juristic part. Because juristic altering rules aim to give persons the power to effect legal change when they wish, they are designed to give guidance as to how to achieve those changes. Juristic altering rules are like instructions.

Nonjuristic altering rules, however, are different. When the goal is to condition legal outcomes on the nonlegal meaning of what the parties said and did—whether they entered into an agreement, whether a seller made a representation about the quality of the goods, whether a party expressed an intention to perform despite the nonoccurrence of a condition—the altering rule is not merely a set of instructions. Because a nonjuristic altering rule does not assume that the parties intend to effect a legal change, there is no expectation that they will use the rule instrumentally. Although it is possible and perhaps even predictable that some parties will use it that way—responsive parties will craft their words and actions in light of all relevant legal rules—the rule’s purpose is not only to provide such guidance.

All this is relevant in this context because an interpretive altering rule might or might not be a juristic altering rule. The Model Written

¹⁶³ *Id.* at 2053.

¹⁶⁴ Economic theories of contract remedies, for example, have addressed their effects not only on the perform-breach decision, but also on many other decisions in the transaction, from pre-formation investment to post-breach mitigation. See, e.g., John H. Barton, *The Economic Basis of Damages for Breach of Contract*, 1 J. LEGAL STUD. 277 (1972); Richard Craswell, *Contract Remedies, Renegotiation, and the Theory of Efficient Breach*, 61 S. CAL. L. REV. 629 (1988); Daniel Markovits and Alan Schwartz, *The Myth of Efficient Breach: New Defenses of the Expectation Interest*, 97 Va. L. Rev. 1939 (2011).

¹⁶⁵ Beginning with Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 Yale L.J. 87 (1989).

Obligations Act, for example, is a juristic interpretive altering rule. To determine whether there is an “express statement . . . that the signer intends to be legally bound,”¹⁶⁶ a court must interpret the words in the writing. The rule also serves to tell the parties how to get the legal results they want. Like all juristic altering rules, interpretive or formalistic, it functions as instructions to parties.

The Article Two rule for express warranties, in distinction, is a nonjuristic altering rule. The question is only whether the seller has made a claim about or provided a sample of the goods, not whether the seller has expressed their intent to create a warranty.¹⁶⁷ Although sophisticated sellers might use the rule to guide their behavior, the rule does not presuppose that parties do so, for the altering act need not be intended to effect a legal change. The rule need not, therefore, be designed to provide instructions to parties.

This difference is crucial to the design of interpretive altering rules. A juristic altering rule works only when users know the rule and can use it as a set of instructions to get the legal outcomes they wish. A nonjuristic interpretive altering rule, in distinction, can succeed even if the speaker is ignorant of that rule.

This is not to say that interpretive altering rules cannot or should not be designed with responsive parties in mind. Parties are often aware of applicable interpretive altering rules and choose their words and actions accordingly. And such responsiveness, I will argue, is especially important to assessing the accuracy of interpretive formalism. We can expect parties who know that their words will be interpreted with a limited evidentiary base or according to their semantic meaning to invest extra effort to clearly express their intentions on words. Unlike formalistic altering rules, however, interpretive altering rules can also function properly when the parties do not know the rule. More to the point, unlike formalistic altering rules, interpretive altering rules can be designed to succeed when parties are not thinking about the legal effects of their words and actions.

4.2.2 *Adjudication Costs and Predictability*

Like formalities, we can expect evidentiary formalism to provide cheaper adjudication and more predictable outcomes. Consider the costs of the ruling in *Pacific Gas & Electric v. G.W. Thomas Drayage & Rigging*,¹⁶⁸ the most famous antiformalist opinion in US law. At issue was the meaning of the words “Contractor shall indemnify Company . . . against all loss, damage, expense and liability resulting from . . . injury to property.”¹⁶⁹ The trial court was able to identify the sentence’s plain meaning based only on

¹⁶⁶ Model Written Obligations Act, *supra* note 77.

¹⁶⁷ U.C.C. § 2-313(1)(a) & (2).

¹⁶⁸ 69 Cal. 2d 33 (1968).

¹⁶⁹ 442 P.2d at 643.

its knowledge of the English language and perhaps a dictionary; the clause covered *all* property damage, and therefore covered damage to the property of the owner party.¹⁷⁰ This permitted the court to rule on the clause's legal effect at the beginning of the trial, narrowing the issues going forward. The California Supreme Court held that the trial court was wrong to exclude that extrinsic evidence that the parties understood the indemnification clause to cover only third-party property damage.

The test of admissibility of extrinsic evidence to explain the meaning of a written instrument is not whether it appears to the court to be plain and unambiguous on its face, but whether the offered evidence is relevant to prove a meaning to which the language of the instrument is reasonably susceptible.¹⁷¹

This is a much thicker use meaning rule. Its predictable effect: a protracted battle over how the parties, in the circumstances, understood the indemnification clause, with both sides possibly introducing party witnesses, expert testimony, facts from the course of negotiations, and other extrinsic evidence, all of which is expensive and time consuming.¹⁷² Thinner interpretive rules are relatively cheap to apply, thicker ones relatively expensive.

¹⁷⁰ In fact, the plain meaning of the clause was not quite so obvious as Traynor's opinion suggests. Traynor does not mention that the Court of Appeals focused on the meaning of "indemnifies" and gave significant weight to the California Civil Code's definition of "indemnity" as a "contract by which one engages to save another from a *legal* consequence of the conduct of one of the parties, or of some other person." Cal. Civ. Code § 2772 (emphasis added). Reasoning that the owner of the steam turbine "did not incur any legal liability for the damage done to its own property," the intermediate court concluded that the clause's plain meaning did not cover the damage at issue. *Pac. Gas & Elec. Co. v. G.W. Thomas Drayage & Rigging Co.*, 62 Cal. Rptr. 203, 204 (Ct. App. 1967), *vacated sub nom.* *Pac. Gas & Elec. Co. v. G. W. Thomas Drayage & Rigging Co.*, 69 Cal. 2d 33 (1968). The court went on to suggest that insofar as the clause was ambiguous, it should be construed against the owner-drafter to reach the same result. *Id.* at 204-05. In its brief to the California Supreme Court, the plaintiff pointed to other definitions of "indemnify" that encompassed non-legal losses. Resp. Pet. for Hearing By the Supreme Court, *Pac. Gas & Elec. Co. v. G. W. Thomas Drayage & Rigging Co.*, ___-___, 1 Civil No. 23738 (filed Oct. 30, 1967). There was therefore a good argument, unmentioned by Traynor, that the meaning of indemnification clause was at least ambiguous on its face.

¹⁷¹ 442 P.2d at 644.

¹⁷² Traynor's opinion mentions only the defendant's proffer of extrinsic evidence to prove that the parties intended the clause to cover only third-party losses. 442 P.2d at 643. The plaintiff was also prepared to introduce extensive evidence that the clause was meant to cover owner losses. See Resp. Pet. for Hearing By the Supreme Court, *Pac. Gas & Elec. Co. v. G. W. Thomas Drayage & Rigging Co.*, ___-___, 1 Civil No. 23738 (filed Oct. 30, 1967).

Evidentiary formalism can also render interpretive outcomes more predictable. By permitting testimony that the indemnification clause was in fact meant to cover only injuries to third parties, the California Supreme Court arguably created doubt where it did not exist before. Resolution of the case now required a judgment as to the weight of that extrinsic evidence as against the words' plain meaning. In Judge Kozinski's words:

Pacific Gas casts a long shadow of uncertainty over all transactions negotiated and executed under the law of California. . . . [E]ven when the transaction is very sizeable, even if it involves only sophisticated parties, even if it was negotiated with the aid of counsel, even if it results in contract language that is devoid of ambiguity, costly and protracted litigation cannot be avoided if one party has a strong enough motive for challenging the contract.¹⁷³

The more evidence one allows into interpretation, the less certain the outcome. The costs of such uncertainty in the contractual setting can be especially high. Parties who want to organize their behavior in light of the legal effects of their contractual agreement need to be able to predict how an adjudicator will later interpret that agreement. To the extent thicker interpretive rules reduce predictability, they impose an additional cost on the parties.

4.2.3 Compliance Costs and Relational Costs

Although plain meaning rules can reduce adjudication costs and increase predictability, they come with greater compliance and relational costs.

In the context of interpretive formalism, the most significant compliance cost is the cost of drafting. Because plain meaning rules tend to exclude evidence beyond the contractual writing, we can expect them to generate increased drafting costs. Responsive parties will expend more time and effort to produce a contractual writing whose plain meaning captures every aspect of their agreement. Rather than rely on their shared understanding of "indemnification," for example, the parties will define the term and many others. More to the point, they will pay lawyers to do so. Plain meaning rules therefore involve a commonly recognized tradeoff between drafting costs and litigation costs.¹⁷⁴

This marks an important difference between formalities and evidentiary formalism. Whereas formalities can be designed to reduce compliance costs, evidentiary formalism increases them.

¹⁷³ *Trident Ctr. v. Connecticut Gen. Life Ins. Co.*, 847 F.2d 564, 569 (9th Cir. 1988).

¹⁷⁴ See, e.g. Jody S. Kraus & Robert E. Scott, *Contract Design and the Structure of Contractual Intent*, 84 N.Y.U. L. Rev. 1023, ____-____ [Part III] (2009).

Plain meaning rules can also generate relational costs. I have observed that friendship, community, reputation, repeat play, a moral sense, and other nonlegal sources of trust often add value to a transaction. Richard Posner, invoking his years of experience on the bench, argues that even in arms-length transactions the drafting incentives plain meaning rules create threaten such extralegal trust.

There is frequent conflict between lawyer and client over how detailed a contract should be, the former pushing for the inclusion of endless protective clauses and the latter worrying that pressing for such clauses will not only protract negotiations and increase legal fees but also make him seem a sharpie and kill the deal. Better that the contract should be kept reasonably short, and that if an unforeseen contingency arises it be resolved in a commonsensical fashion. It is reassuring to think that if one's contract should come to grief the court will straighten matters out in a "reasonable" way rather than by recourse to legal technicalities. Businessmen want judges to resolve interpretive issues in the way that a reasonable businessman would.¹⁷⁵

Posner's point recalls Stuart Macaulay's observation that businesspeople often prefer to rely on a handshake. To the extent plain meaning rules push parties to spell out in advance every aspect of their transaction, they can also impede the development of extralegal forms of assurance.

That said, the effects of legal rules on nonlegal forms of trust are complex and likely to differ across transaction types. Lisa Bernstein suggests that in some contexts plain meaning rules in fact promote extralegal forms of trust.¹⁷⁶ Whereas Posner focuses on the time of formation, Bernstein looks to the effects of thick interpretive rules during performance. She argues that the UCC permissive rules for course of performance and course of dealings evidence deter parties during the life of a contract from making concessions that would promote extralegal forms of trust. When one party is out of compliance, the other might worry that a concession will later be used as evidence of the parties' agreement, thereby eroding their contractual rights. Thick interpretive rules might in this way discourage the flexible give-and-take that characterizes extralegal forms of trust.¹⁷⁷

¹⁷⁵ Richard A. Posner, *The Law and Economics of Contract Interpretation*, 83 *Tex. L. Rev.* 1581, 1607 (2005). Posner attributes what he sees as the excesses of New Formalism "in part to the fact that fewer and fewer legal academics have significant experience in the 'real world' of contract drafting or business litigation." *Id.* at 1592.

¹⁷⁶ Lisa Bernstein, *Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms*, 144 *U. PA. L. REV.* 1765, 1807-15 (1996).

¹⁷⁷ For more on the question, see Omri Ben-Shahar, *The Tentative Case Against Flexibility in Commercial Law*, 66 *U. CHI. L. REV.* 781 (1999) (providing a formal

We have again arrived a point where the right answer depends on empirical facts that are not only not available to armchair analysis but also difficult to investigate. And again the relevant costs are likely to turn on who the parties are, the type of transaction, market conditions, and the like. The best arguments for or against plain meaning rules are local and grounded in experience.

4.2.4 Accuracy

Drafting and relational costs magnify a deeper worry about plain meaning rules: their accuracy.¹⁷⁸

Consider yet again the facts in *Pacific Gas*. The indemnification clause at issue covered “all loss, damage, expense and liability resulting from . . . injury to property.” The sweeping language appeared on its face to cover losses to the plaintiff owner.¹⁷⁹ Yet the defendant was prepared to introduce evidence of the parties’ past conduct under similar contracts and even admissions by the plaintiff’s own agents that the parties understood the clause to cover only injury to third parties.¹⁸⁰ In such circumstances, application of a plain meaning rule risked doing violence to the parties’ shared intentions. Traynor again:

Some courts have expressed the opinion that contractual obligations are created by the mere use of certain words, whether or not there was any intention to incur such obligations. Under this view, contractual obligations flow not from the intention of the parties but from the fact that they used certain magic words. Evidence of the parties’ intention therefore becomes irrelevant.

In this state, however, the intention of the parties as expressed in the contract is the source of contractual rights and duties. A court must ascertain and give effect to this intention by determining what the parties meant by the words they used.¹⁸¹

The plain meaning of even sophisticated parties’ words in an integrated writing does not always reflect their actual agreement, intentions, or understandings.

argument that the use of past practices in interpretation both encourages and deters flexibility, and that in theory these effects cancel each other out).

¹⁷⁸ Many critics of plain meaning rules argue that there is no such thing as plain meaning. See Klass, *supra* note 14 at 32-33; Gregory Klass, *Arthur Linton Corbin (1874–1967)*, in *Scholars of Contract Law* 201, 225 (J. Goudkamp & D. Nolan eds., Hart 2022). The first section of this Part rejects that claim.

¹⁷⁹ But see my discussion of the intermediate appellate court’s decision, *supra* note 170.

¹⁸⁰ 442 P.2d at 643.

¹⁸¹ *Id.* at 644.

4.2.5 *When Plain Meaning Rules Work*

For all its rhetorical power, Traynor's *Pacific Gas* opinion elides important considerations. Few legal rules insist on accuracy at all costs. Traynor's opinion considers neither the increased costs of adjudication nor the reduction in predictability the *Pacific Gas* ruling was likely to generate.

That said, we should not expect a generic answer to the relative costs and benefits of evidentiary formalism. The costs of thick interpretation include increased adjudication costs and decreased predictability. The benefits include, one hopes, increased accuracy, reduced drafting costs, and reduced relational costs. All five variables are likely to receive different values depending on the type of transaction, the term at issue, the identity of the parties, who is doing the interpreting (judge or jury), and of course the type of evidence. Add to this Schwartz and Scott's observation that in certain contexts, parties might attach more value to predictability than to accuracy. Traynor's opinion emphasizes the value of accuracy, Kozinski's critique of it the costs in predictability. Neither does the full accounting.

The general intractability of the cost-benefit question suggests a different approach. Rather than attempting to predict the costs and benefits of evidentiary formalism writ large, we might look to two related questions: When do parties want evidentiary formalism? And when is the plain meaning of the parties' words likely to correspond to their intentions? Together they can suggest when a plain meaning rule is likely to succeed.

4.2.5.1 *Party Choice*

The easiest case is when the parties agree that the plain meaning of a writing shall govern. Jodi Kraus and Robert Scott, for example, find several contractual writings that include plain meaning clauses like the following:

The Parties' legal obligations under this . . . Agreement are to be determined from the precise and literal language of this . . . Agreement and not from the imposition of state laws attempting to impose additional duties of good faith, fair dealing or fiduciary obligations that were not the express basis of the bargain at the time this Agreement was made.¹⁸²

The parties' knowing agreement to a plain meaning clause suggests that they have done the cost-benefit analysis for themselves and concluded that evidentiary formalism best serves their interests. Where parties have expressed that preference, courts should defer to it. And in such

¹⁸² Kraus & Scott, *supra* note 174 at 1102 n. 274 (quoting E. I. du Pont de Nemours & Co. and EarthShell Corp., Alliance Agreement art. 12(h), at 7 (July 25, 2002), available at: <http://contracts.onecle.com/earthshell/dupont.collab.2002.07.25.shtml>).

circumstances, formalist interpretation will be highly accurate. The parties have effectively agreed to whatever the plain meaning of the contractual writing is, even that meaning it departs from their understanding of the agreement. In these circumstances, a plain meaning rule cannot help but be accurate.

4.2.5.2 *Responsive Parties and Integration*

The more interesting cases are those in which the parties do not expressly say one way or the other.

As noted above, US courts apply plain meaning interpretation primarily to integrated contractual writings. Unlike the above plain meaning clause, an integration clause does not typically stipulate how the writing shall be interpreted, only that it is a final statement of terms. Yet the legal effect of integration is not only to exclude evidence of different or additional terms; it also limits the interpretive evidence that will apply to it.

Why use integration as to trigger plain meaning? Williston explains as follows:

[I]n case of a writing wholly informal in character, but which nevertheless was adopted by the parties as a statement of their bargain, the same principle is applicable. The parties have assented to those words as binding upon them. In an ordinary oral contract or one made by correspondence, the minds of the parties are not primarily addressed to the symbols which they are using; they are considering the things for which the symbols stand. Where, however, they incorporate their agreement into a writing they have attempted more than to assent by means of symbols to certain things, they have assented to the writing as the adequate expression of the things to which they agree.¹⁸³

One might read Williston's explanation in either of two ways.

First, it might be a claim about how parties respond to plain meaning rules. In a jurisdiction where courts interpret integrated writings according to their plain meaning, responsive parties who agree to integrate will choose their words accordingly and will understand that they are also agreeing to be bound by the writing's plain meaning. That plain meaning will correspond to the parties' intentions because they have in fact agreed to be governed by it, if not in so many words. Moreover, at least in theory parties' have the power to change the interpretive rule. Their choice not to stipulate that the integrated writing shall be interpreted in light of all the evidence could be read to suggest their preference for plain meaning interpretation.

¹⁸³ Williston, *supra* note 7 vol. 2 § 606, 1165.

The explanation, of course, assumes responsive parties. Again, that is an empirical question. As far back as 1885, writing about the Statute of Frauds, Justice James Stephen and Fredrick Pollock argued:

One cardinal rule, which those who legislate on the common business of life ought always to bear in mind, is that the power of law to control conduct is small, and is constantly exaggerated. Laws ought to be adjusted to the habits of society, and not aim at remoulding them. The cases in which any law is actually enforced are infinitesimally small in number in comparison with those in which it has no effect whatsoever. Custom, and what is called common sense, regulate the great mass of human transactions.¹⁸⁴

Responsiveness is another area in which generalizations are difficult. We should expect the incentive effects of interpretive rules to depend in large part on who the parties are, the nature and stage of the transaction, and the type of communication at issue.

There is another limitation to this first reading of Williston. The responsiveness explanation presupposes the existence plain meaning rule that parties are responsive to. It seeks to explain only the accuracy of the rule, not its existence.

4.2.5.3 Audience Design

The linguistic theory of audience design suggests a second, noncircular reading of Williston's explanation. Almost forty years ago, Allan Bell suggested that speakers, and by extension writers, vary their style of speech based on the intended and expected audiences. Bell distinguishes four categories of potential audiences.¹⁸⁵

An addressee is a person to whom the familiar speech acts—assertions, promises, apologies, and so on—are directed. An auditor is like an addressee in that he is known to the speaker and has his participation approved (“ratified”), but he is not directly addressed. An overhearer is known but not ratified or addressed. An eavesdropper is not even known.¹⁸⁶

Bell observes that speakers adapt their styles primarily to accommodate the comprehension of addressees; that they do so to a lesser extent also for

¹⁸⁴ James F. Stephen & Frederick Pollock, *Section Seventeen of the Statute of Frauds*, 1 L. Q. REV. 1, 6 (1885). See also, famously, Macaulay, *supra* note 101 *passim*.

¹⁸⁵ Allan Bell, *Language Style as Audience Design*, 23 Lang. & Soc. 145 (1984).

¹⁸⁶ *Id.* at 1134.

auditors, and to a yet lesser extent for overhears; and that speakers do not shift styles for eavesdroppers, who are unknown to them.

No matter what the legal rule of interpretation, we might expect parties who are not thinking about legal liability to treat one another as addressees without considering possible future third-party adjudicators, who in Bell's categories would therefore be classified as eavesdroppers. Such parties are much more likely to communicate against the background of their privately shared understandings. A statement like, "Go ahead, you're all right; get your men out and don't let that worry you," is enough to signal agreement to renew a contract, even though that is not its plain meaning. Because their communications are designed only for one another, plain meaning is unlikely to capture such parties' intentions.

When parties are thinking about legal liability and the possibility of future litigation, they are more likely to treat third-party adjudicators as auditors or even addressees and to speak accordingly, no matter what the legal rule of interpretation and regardless of whether they are responsive to it. According to Bell's theory, such parties are more likely to craft their communications in ways a third-party adjudicator will be able to understand. They are therefore more likely to express themselves in terms that do not rely on context.

Audience design therefore provides a non-circular argument for applying plain meaning rules to integrated contractual writings. A writing is integrated when the parties have agreed that in any future litigation it shall serve as a final statement of some or all terms. Parties who produce integrated writings are therefore already thinking about the possibility of litigation before a third-party adjudicator. In Bell's way of speaking, they are treating possible third-party adjudicators as at least auditors and perhaps even addressees. We should therefore expect parties to an integrated agreement to express themselves in a way a third-party adjudicator can understand—that is, plainly.

This is not to say that the plain meaning of an integrated writing always corresponds to the parties' actual intentions. Drafting and relational costs can make it impracticable to expressly record every element of the parties' shared understanding in a contractual writing. Parties can also make mistakes about the plain meaning of their contractual writing. They might not accurately predict how a third-party adjudicator who does not know all they know is likely to understand it. Finally, and most significantly, one or both parties might agree to an integrated writing they have not drafted and have not fully read. In all these cases, the plain meaning of even an integrated writing might not correspond to the parties' actual understanding.

All that said, there is a reasonable argument that in many transactions the parties' agreement to an integrated contractual writing is a good reason to read that writing according to its plain meaning.

4.2.6 *Summary*

Interpretive formalism involves tradeoffs between interpretive accuracy, the costs of adjudication, the costs of drafting, predictability, and relational costs. The factors are not independent of one another. High drafting and relational costs, for example, are likely to cause a plain meaning rule to be less accurate. Though such generalizations are possible, they do not tell us how all the factors balance out, generally or in specific transaction types. The relative costs and benefits of interpretive formalism is empirical question, and the data is limited.

There are, however, indicators of when plain meaning rules are likely to succeed. The first is party choice. Where parties knowingly agree that a contractual writing shall be interpreted according to its plain meaning, they have presumably done the cost-benefit analysis themselves and courts can defer to their choice. In such transactions, the writing's plain meaning is perforce the parties' intended meaning. Second, plain meaning rules are also likely to gain in accuracy from party responsiveness. Parties who know that their integrated writing will be interpreted according to its plain meaning are likely to invest extra effort to express themselves plainly. Third, the integration of a contractual writing suggests that parties intend it to speak not only to one another, but also to possible future third-party adjudicators. No matter what the interpretive rule and no matter how responsive parties are to it, the theory of audience design suggests that in such circumstances they are likely to express themselves plainly.

All of this explains why evidentiary formalism generally is and should be limited to integrated writings. Contract law attaches legal consequences to an enormously wide variety of nonjuristic altering acts—making an agreement, saying something about the quality of goods, manifesting an intention to perform despite the nonoccurrence of a condition, expressing doubts that one will perform, and so forth. Sometimes when parties satisfy these nonjuristic altering rules they are not thinking about the legal consequences of their words or actions. When this is the case, parties are more likely to speak elliptically, relying on their shared background and understanding of the transaction. In such circumstances, the plain meaning of the parties' words, even if those words appear in a writing, is much less likely to correspond to the speaker's actual intentions or to the hearer's reasonable understanding.

5 **Application: Integration Rules**

The above analysis of formalism in contract law is abstract. The goal has been to provide an understanding of what is at stake in different forms of formalism, not to argue for or against contract formalism writ large or even small. Although I am convinced of the theory's soundness, its ultimate test lies in its ability to untangle real-world knots.

This Part applies the analysis in Parts Three and Four to critically examine an understudied component of parol evidence rules: the rules for deciding whether a contractual writing is integrated, which I will call *parol evidence altering rules* or simply *integration rules*. These rules have a double interest in this context. First, because the most common way for parties to opt for a plain meaning rule by way of integration, integration rules are special interest in study of contract formalism. Second, the above analysis reveals significant defects in existing integration rules and suggests possible improvements.

5.1 How Courts Tell When a Writing is Integrated

Notwithstanding James Bradley Thayer's famous observation, "[f]ew things are darker than . . . , or fuller of subtle difficulties," than the parol evidence rule,¹⁸⁷ the basic idea behind parol evidence ruled is simple: sometimes a writing should be given more weight than other evidence of the parties' intentions. If the adjudicator finds a writing to be fully integrated, the parties may not introduce evidence of terms that do not appear in it. If the adjudicator finds that the writing is partially integrated, parties may not attempt to prove terms contrary to those in the writing. In either case, integration commonly also triggers a plain meaning rule, limiting the extrinsic evidence that can go into interpretation of the writing.

These are the legal effects of integration. Of more interest here are the rule for deciding whether a writing is integrated. Scholars have largely neglected these integration rules. For example, although Jody Kraus and Robert Scott argue at length that most sophisticated commercial parties want courts to apply formalist rules of interpretation to their integrated agreements, they say nothing about how courts should tell when a writing is integrated. They write only that courts "have devised various neutral tests for determining whether parties intended to integrate part or all of their agreement into a final, legally enforceable writing."¹⁸⁸ In fact, these rules are hardly neutral, and they vary across jurisdictions. A theory of contract exposition should have something to say about the altering rules that trigger plain meaning rules.

The modern view of integration, which dates to Wigmore,¹⁸⁹ holds that absent a seal integration depends on the parties' intentions. A writing is integrated when and only when the parties have agreed that it shall be a final statement of some or all terms of their contract. As Williston explained: "The parol evidence rule does not apply to every contract of which there is written evidence, but only applies where the parties to an

¹⁸⁷ James Bradley Thayer, *A Preliminary Treatise on Evidence at the Common Law*, 390 (1898).

¹⁸⁸ Kraus & Scott, *supra* note 174 at 1047.

¹⁸⁹ See, e.g., Wigmore, *supra* note 35 §§ 2401, at 240.

agreement reduce it to writing, *and agree or intend that that writing shall be their agreement.*¹⁹⁰

It its 1986 report on the parol evidence rule, the English Law Commission took this agreement-based understanding to entail a radical conclusion: that there is no parol evidence rule.

[A]lthough a proposition of law can be stated which can be described as the “parol evidence rule” it is not a rule of law which, correctly applied, could lead to evidence being unjustly excluded. Rather, it is a proposition of law which is no more than a circular statement: *when it is proved or admitted that the parties to a contract intended that all the express terms of their agreement should be a recorded in a particular document or documents, evidence will be inadmissible (because irrelevant) if it is tendered only for the purpose of adding to, varying, subtracting from or contradicting the express terms of a contract.* We have considerable doubts whether such a proposition should properly be characterized as a “rule” at all.¹⁹¹

If integration is merely one contract term among others, what has traditionally been called the “parol evidence rule” is no more than enforcement of the parties’ agreement—hence no special rule. It is not the existence or form of the writing that matters, but the fact that the parties have agreed that it shall serve as a final statement of some or all of the terms of their agreement.¹⁹²

Despite its rhetorical power, the Law Commission erred in concluding that an agreement-based parol evidence rule is not in fact a rule. First, if parties have the power to attach special significance to a writing, it is only because contract law gives them that power. It is only because there is a rule of construction that gives legal effect to agreements to integrate. Second, at least in the United States the parties’ agreement to a writing as a final statement of some or all terms does more than exclude extrinsic evidence of contrary or additional terms. It also triggers plain meaning interpretation, regardless of whether the parties have agreed to that interpretive rule.¹⁹³ This rule of construction extends beyond interpretation of the parties’ agreement. Third, even if integration is a matter of agreement, we require a rule that says how such agreement must be

¹⁹⁰ Williston, *supra* note 7 vol. 2 § 633, 1225 (emphasis added).

¹⁹¹ Law Commission, *Law of Contract: The Parol Evidence Rule*, § 2.7, at 8 (Law Com. No. 154, 1986) Cmnd 9700 (hereinafter “Law Commission Report”).

¹⁹² For example, on the agreement-based view, parties could just as well integrate an oral exchange—by agreeing that the exchange is a final statement of some or all of their agreement. *Id.* § 2.20, at 14-15 (citing commentators who hold this view).

¹⁹³ The Law Commission expressly rejected applying different rules of interpretation to integrated writings under English law. *Id.* §§ 1.2 & 2.7 at 2 & 8.

expressed or evidenced if it is to be legally effective. We require a parol evidence altering rule.¹⁹⁴

US courts today recognize two ways parties can effectively express or evince their shared intent to integrate.¹⁹⁵ First, they can include in the writing a merger clause. A merger clause expressly says that the parties intend the writing as the final statement of some or all terms. For example:

This instrument embodies the whole agreement of the parties. There are no promises, terms, conditions, or obligations other than those contained in this contract, and this contract shall supersede all previous communications, representations, or agreements, either verbal or written, between the parties.¹⁹⁶

I will call this the *express prong* of the parol evidence altering rule: an express statement of the parties' intent to integrate suffices to render a writing integrated. Second, if the writing contains no merger clause, courts ask whether the writing appears to be intended as final statement of some or all terms. The Second Restatement, for example, provides that "[w]here the parties reduce an agreement to a writing which in view of its completeness and specificity reasonably appears to be a complete agreement, it is taken to be an integrated agreement."¹⁹⁷ I will call this the *implied prong*.

There is an important difference between the two prongs. When the parties agree to a merger clause, they say how they intend the writing to be used. The express prong asks courts to interpret the communicative meaning of the parties' words. The implied prong, in distinction, asks courts to interpret the parties' likely intention with respect to integration based on the document's appearance—"its completeness and specificity." The implied prong is comparable to the rule for implied-in-fact contracts. The question not one of communicative content, but the reasonable interpretation of the parties' propositional attitudes.

¹⁹⁴ Putting the question in these terms clarifies that there is a default as well. In US law, the default is that a writing is not integrated.

¹⁹⁵ Here a caveat is in order: The law governing the parol evidence rule is less clear than one might wish. As Farnsworth observes with respect to the Williston-Corbin divide, discussed below: "Surprisingly little light is shed on the problem by the hundreds of decisions resolving the issue of whether an agreement is completely integrated. Opinions often fail to set out the text of the writing in full, and each case turns on its own peculiar facts." E. Allan Farnsworth, *Contracts* § 7.3, ___ (4th ed. 2004). The below paragraphs are my best attempt at a rational reconstruction of the rules courts have articulated and apply.

¹⁹⁶ 1A Williston on Contracts 4th Forms § 33F:2 (2016).

¹⁹⁷ Restatement (Second) of Contracts § 209(3) (1981).

US authorities differ on what interpretive evidence an adjudicator may consider to determine whether a writing is integrated.¹⁹⁸ Most courts adopt the same rule for both the implied and express prongs. Jurisdictions with so-called *hard parol evidence rules*, commonly associated with Williston, employ a thin test for integration. “[T]he contract must appear on its face to be incomplete in order to permit parol evidence of additional terms.”¹⁹⁹ Jurisdictions with so-called *soft parol evidence rules*, associated with Corbin, employ a thicker test. The decision maker should always consider all available evidence of the parties’ intent, even if the writing includes a merger clause. “If the offered evidence is relevant and credible on the issue of either interpretation or integration, it should never be excluded, for the reason that, whatever are the written words, those issues are always debatable.”²⁰⁰

The most recent edition of Williston acknowledges that the Second Restatement adopts a thick test for integration, but reports that the thin test remains the majority rule.²⁰¹ The most recent edition of Farnsworth’s treatise, on the contrary, suggests that “the prevailing view [is] that other evidence, including evidence of prior negotiations, is still admissible to show that a writing was not intended as a final expression of the terms it contains.”²⁰² Under either rule extrinsic evidence may be introduced to show an invalidating cause such as misrepresentation, duress or mistake.

5.2 Analysis and Possible Reforms

What should one make of this collection of parol evidence altering rules? The above analysis suggests several critical observations and possible reforms.

First, the law would do well to provide a formality with which parties could signal their intent to integrate. The parol evidence rule is a power-conferring rule: it allows parties to determine by agreement the legal effects of a writing. The associated altering rule is therefore a juristic one: parties can integrate a writing simply by expressing their intent to do so. Moreover, the legal effects of integration are simple and standardized: evidence of contrary or additional terms is excluded, and the writing is interpreted in accordance with its plain meaning.

¹⁹⁸ For a discussion of the differences between hard and soft parol evidence rules, see Posner, *supra* note 46, *passim*.

¹⁹⁹ Williston, *supra* note 7 vol. 2 § 633, 1226.

²⁰⁰ Arthur L. Corbin, *The Interpretation of Words and the Parol Evidence Rule*, 50 *Cornell L.Q.* 161, 173 (1965). See also Arthur L. Corbin, *The Parol Evidence Rule*, 53 *Yale L.J.* 603, 642 (1944) (“Just as no written document can prove its own execution, so none can prove that it was ever assented to as either a partial or a complete integration, supplanting and discharging what preceded it.”).

²⁰¹ 11 Williston on Contracts § 33:17, “Evidence on the issue of whether an integration exists; traditional and modern views,” at ____ (4th ed. 2016).

²⁰² Farnsworth, *supra* note 195 at § 7.3, ____ (2004).

Given all this, a short, canonical form with which to express intent to integrate would be highly desirable. Although form books are full of possible merger clauses, there exists in US law no short, effective, standard formula, comparable to “F.O.B.” or “as is,” parties can use to integrate a writing. The seal once served that purpose. But it was a blunt instrument, as putting a writing under seal had many other legal effects. What we want is an ordinary language formality designed to inform parties of its effects. A rule that printing the words “Final Statement of All Terms” or “Final Statement of Terms Included” at the top of a document suffices to integrate it would provide parties who want to integrate a writing a useful tool for doing so. That we have no such formality is a historical accident that might be easily remedied by statute.

Second, it is more than a little curious that courts are willing to find writings integrated absent merger clauses. Why permit courts to look for parties’ actual but unexpressed intent to integrate? Why not require those parties sophisticated enough to agree to integrate a writing to express their agreement in words?

Although I have compared the implied prong of the parole evidence altering rule to the rule for implied-in-fact contracts, there is an important difference. The rule for implied-in-fact contracts is a nonjuristic altering rule. What matters is whether the parties were in agreement regarding an exchange, not whether they intended to acquire legal obligations to perform. Integration, in distinction, can be understood to be juristic act. The parties express their intent that should they end up in litigation, the writing shall be given special evidentiary weight.²⁰³ But then why not require them to express that intent? If the parties are attuned to the rules of interpretation courts will apply to of their agreement, they are likely to be responsive to a rule that requires them to express their intent to alter the default.

Moreover, there are significant costs to the state of agreement rule. First, it is not obvious that, absent a merger clause, ex post adjudicators are very good at identifying the parties’ objective intent with respect to integration, no matter what evidence they are allowed to consider. The implied prong might generate more judicial Type I and II—false positives and false negative—than it avoids in Type II errors by the parties. Second, the implied prong increases both adjudication costs and reduce predictability. Third, requiring parties who wish to integrate a writing to say so could put nonsophisticated parties on notice of the legal effects of the writings they sign, further reducing party Type I errors.

A third even more puzzling feature is hard parole evidence rules’ application of evidentiary formalism to the implied prong of the integration rule. A rule that limits evidence of integration to the writing itself might

²⁰³ This is not the only way to think about integration. Corbin characterized it as simply an agreement to discharge all prior agreements. Corbin on Contracts, *supra* note 8 § 574. I discuss Corbin’s characterization of integration in *Arthur Linton Corbin (1874-1967)*, *supra* note 178 at 226.

make sense if the writing states that it is the final statement of terms, especially in a negotiated agreement between parties represented by counsel. Parties who knowingly agree to an integration clause are likely to take extra care to ensure that their words match their intentions—including the words of the integration clause. Absent an integration clause, however, it is not obvious why courts should not consider extrinsic evidence of the parties' actual intentions with respect to integration. As Wigmore argues more generally,

The document alone will not suffice. What it was intended to cover cannot be known till we know what there was to cover. The question being whether certain subjects of negotiation were intended to be covered, we must compare the writing and the negotiations before we can determine whether they were in fact covered.²⁰⁴

Without a clear statement one way or another, the interpretation of the parties' intentions with respects the legal effect of a writing is necessarily uncertain. Relevant extrinsic evidence should always be of value in ascertaining the parties' intent to integrate.

So why does contemporary contract law not require parties who intend a writing as a final statement of terms to add a few words to that effect? And why do jurisdictions with hard parol evidence rules not at least look to extrinsic evidence of the parties' intent to integrate when the parties have not said one way or another?

Although post hoc justifications are always possible,²⁰⁵ the explanation of these aspects of contemporary integration rules probably lies in their history. Whereas today agreement-based accounts of the parol

²⁰⁴ Wigmore, *supra* note 35 § 2430.

²⁰⁵ Scott and Schwartz, for example, argue that parties should be able to decide how their rules are construed, but rather than focusing on the altering rule, they emphasize finding the right default.

A commitment to party sovereignty regarding the contract's substantive terms implies a further commitment to party sovereignty regarding the interpretive style an adjudicator should use to find the substantive terms. Party preferences regarding judicial interpretive styles can differ. Therefore, interpretive styles should be defaults. The relevant question, then, is what should be the majoritarian default. Put another way, the issue is not what interpretive style is best calculated to yield the correct answer. Rather, the issue is what interpretive style would typical parties want courts to use when attempting to find the correct answer.

Schwartz & Scott, *supra* note 135 at 569. If one believes that most parties prefer plain meaning rules, one way to satisfy their preference is a rule that favors a finding of integration, as the implied prong of the integration rule does. (Schwartz and Scott say nothing about what the rule should be for altering their preferred plain meaning default.)

evidence rule are the norm, the rules' origins can be traced to two other features of early English law: the best evidence rule and a desire to control the jury. The best evidence rule established an evidentiary hierarchy: written evidence, which was commonly under seal, could not be contradicted by oral evidence. "An inferior matter [was] admissible neither in opposition to nor in substitution for superior."²⁰⁶ This was a rule of evidence, not contract; the writing's weight came not from the parties' intentions, but from its form. At the same time, as Wigmore observes, there was a judicial desire "to keep from the jury all alleged oral transactions which might be misused by them to overturn the words of a writing."²⁰⁷ "If the parties were allowed to put in averments extraneous to the writing, it must go to the jury, and there was no telling what the jury might do; but if the judges took exclusive charge, they could better control the situation."²⁰⁸ Mistrust of the jury required a rule that did not merely give the written word greater weight but rendered it dispositive.

These historical roots suggest the contemporary parol evidence altering rule is not only about enforcing the parties' agreement with respect to integration but serves other social goals as well. Allowing courts to find integration in the absence of a merger clause based only on a writing's apparent completeness effectively puts a thumb on the scale in favor of integration, and thereby also plain meaning interpretation.²⁰⁹ If a writing looks to the judge like a final document, the judge has the power to decide that it is legally controlling, to interpret it according to its plain meaning, and to avoid sending its interpretation to the jury. The altering rule is structured not only to effectuate the parties' intentions, but also to favor judicial plain meaning interpretation of contractual writings. Whether this is a good thing or not leave for the reader to decide.

Finally, it is worth thinking a bit more about party responsiveness, and especially contracts of adhesion between sophisticated and nonsophisticated parties. The recently adopted Restatement of the Law, Consumer Contracts effectively does away with the integration of consumer contracts of adhesion. Section 9 provides:

A standard contract term that contradicts, unreasonably limits, or fails to give the effect reasonably expected by the consumer to a prior affirmation of fact or promise by the business does not

²⁰⁶ Salmond, *The Superiority of Written Evidence*, 6 L. Q. Rev. 75, 76 (1890). See also Wigmore, *supra* note 35 § 2426, 299-300.

²⁰⁷ Wigmore, *supra* note 35 § 2426, 298.

²⁰⁸ *Id.*

²⁰⁹ This explanation is comparable to Stephen Hedley's explanation of the English rule for intent to contract, which also permits courts to make a finding regarding the parties' intent absent their expression of it. Stephen Hedley, *Keeping Contract in Its Place—Balfour v. Balfour and the Enforceability of Informal Agreements*, 5 Oxford J. Legal Stud. 391, 393 (1985)

constitute a final expression of the agreement regarding the subject matter of that term and does not have the effect under the parol evidence rule of discharging obligations that would otherwise arise as a result of the prior affirmation of fact or promise.²¹⁰

Although the Reporter's Note states that the "Parol Evidence Rule . . . applies to consumer contracts," in fact section 9 provides nearly the opposite: a consumer can always introduce evidence of additional or contrary terms even if the contractual writing includes an integration clause.

It is unclear whether the case law fully supports this proposed rule.²¹¹ It is, however, supported by the broader theory of the new Restatement and by the design considerations identified above. The comments to section 9 emphasize that consumers do not read the contracts of adhesion they agree to.

Because consumers are not likely to notice, read, or understand the effect of such merger clauses, they do not ordinarily control the conclusion of whether the standard contract terms constitute a partially or completely integrated agreement, and thus do not preclude a finding that the standard contract terms do not constitute the parties' final expression of a particular matter.²¹²

In the language of the above analysis, consumers are rarely responsive to the terms in the contractual writings to which they agree, much less to the legal rules that govern them. It does not follow that such terms should never control. But it does suggest at a minimum that they should not control in the face of evidence of salient communications suggesting additional or different terms. Drafters of consumer contracts of adhesion should not have the power to integrate those contractual writings against evidence of additional or contrary terms.

As I have emphasized, however, integration commonly has a second legal effect as well: the words in the writing will be interpreted according to their plain meaning. Neither section 9, the comments, nor the Reporter's Note address this aspect of the parol evidence rule. The comments do, however, state that the section "is not a complete statement of the parol evidence rule and does not supplant or derogate from other

²¹⁰ Restatement of the Law, Consumer Contracts § 9 (Revised Tentative Draft No. 2, June 2022) (approved at the 2022 Annual Meeting of the ALI).

²¹¹ Although the Reporters' Notes to section 9 discuss judicial holdings, many of the cases cited either do not concern consumer contracts or the reasoning does not turn on the fact that it was a consumer contract. And many of the statements are in dicta. That said, the section 9 rule is consistent with Restatement (Second) of Contracts § 211(3) (1981).

²¹² Restatement of the Law, Consumer Contracts § 9 cmt. 3 (2022).

limitations on the parol evidence rule that might apply.”²¹³ Reading between the lines, this suggests that in integrated consumer contract of adhesion should be interpreted according to its plain meaning.

The Restatement neither articulates nor attempts to justify such a rule. But it probably makes sense. If the law gives legal effect to standard terms in consumer contracts, it is not because they accurately reflect the parties’ shared intentions. One party has almost certainly agreed to the terms without reading them. If accuracy is not a concern, perhaps adjudication costs and predictability should control. Moreover, as I observed in the discussion of boilerplate formalities, there are good reasons to construct consumer contracts of adhesion uniformly, as section 211(2) of the Second Restatement recommends. Doing so enables consumer class action plaintiffs to satisfy the commonality and predominance prongs of Rule 23 of the Federal Rules of Civil Procedure. Interpreting the writings according to their plain meaning advances that end.

Conclusion

A large portion of contract law consists of altering rules that determine when a default legal state of affairs does not pertain. Salient design questions include: Should the altering rule employ a legal formality, either as a sufficient to effect a legal change or as both necessary and sufficient to do so? If lawmakers adopt a formalistic altering rule, what should the formality be? Should a formality’s legal effects be defeasible or nondefeasible? If lawmakers opt for an interpretive altering rule, should interpretation seek out the parties’ beliefs and intentions or the communicative meaning of their words and actions, and if the latter, should interpretation aim at semantic meaning or pragmatic meaning, the common meaning of words or their local meaning, objective meaning or subjective meaning? As or more importantly, how much evidence of meaning should interpreters be permitted to consider. Finally, what circumstances should suffice to trigger more or less formalist interpretive rules?

This Article has not sought to answer all these questions for every type of term or transaction. Their correct answers turn on multiple variables that are unlikely to have the same values across all types of transactions, legal questions, and altering acts. Instead this Article provided a framework for understanding and answering them in specific instances.

In the course of the analysis, however, one broad conclusion has emerged. Formalist rules of contract exposition make sense when two conditions are satisfied: the law seeks to give parties the power to purposively alter the legal state of affairs, and parties understand themselves to be exercising that power. Just when the first condition is met is a deeper question than this article can answer. The many rules of contract law that

²¹³ *Id.* § 9 cmt. 1.

Contract Formalism

empower parties to effect a legal change by expressing their intent to do so reflect the fact that contract law is designed to give individuals the power to change their legal situation when they wish. Formalities and evidentiary formalism serve that purpose. At the same time, the many contract rules that give legal effect to nonjuristic acts suggest that contract law often seeks to do more than give individuals that power. When the reason for altering the legal situation between the parties does not turn on their legal intent, neither a formality nor a plain meaning rules is likely to fully serve the law's ends.