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NORMS, FORMALITIES, AND THE STATUTE OF FRAUDS: A COMMENT

ERIC A. POSNER†

INTRODUCTION

Jason Johnston's Article makes three contributions to the economics and sociology of contract law.¹ First, it provides a methodological analysis of the use of case reports to discover business norms. Second, it makes a positive argument about the extent to which businesses use writings in contractual relations. Third, it sets the stage for, and hints at, a normative defense of the Uniform Commercial Code (UCC) section 2-201. Although the first contribution is probably the most interesting and useful, I focus on the second and third, and comment only in passing on the first. I conclude with some observations about the role of formalities in contract law.

I. JOHNSTON'S POSITIVE ANALYSIS

A. *The Hypothesis*

Johnston's hypothesis is that "strangers" use writings for the purpose of ensuring legal enforcement. "Repeat players" do not use writings for this purpose because they expect that nonlegal sanctions will deter breach. Because repeat players do not use writings, their legal disputes typically involve the issue of whether their nonwritten contracts satisfy an exception to UCC section 2-201. Because strangers do use writings, their legal disputes involve the issue of whether the writings they use satisfy the section 2-201 writing requirement. In addition, because repeat players use writings to record obligations in complex contracts, the "exception" issue will arise only for repeat players involved in simple contracts.

Despite the simplicity of the argument, there are a number of hidden complexities. In the following paragraphs I identify those

† Assistant Professor of Law, University of Pennsylvania. My thanks to Matthew Adler and Jason Johnston for comments.

¹ See Jason S. Johnston, *The Statute of Frauds and Business Norms: A Testable Game-Theoretic Model*, 144 U. PA. L. REV. 1859 (1996).

(1971)

that present the most serious barriers to confirmation of Johnston's hypothesis.

B. *"Strangers" and "Repeat Players"*

1. Legal Enforcement of Cooperation Between Repeat Players

An initial ambiguity arises over the meaning of "stranger" and "repeat player." According to Johnston, two parties are strangers if they have not had prior dealings; they are repeat players if they have.

The question is why parties that have had prior dealings with each other would necessarily rely on nonlegal sanctions. The game-theoretic analysis indicates that the threat of losing future business from the promisee deters breach only if the present value of future business with the promisee exceeds the benefit of breach to the promisor, and the likelihood that the promisee would, in fact, deny future business is significant.

But these conditions are not necessarily implied by prior dealings. For ease of exposition, imagine that the promisor is the buyer, that the promisee is the seller, that only the buyer has an opportunity to breach (that is, seller delivers, then buyer pays or breaches), and that the cost of breach to the buyer is less than the cost of compliance, excluding the costs imposed by any sanctions. Under these circumstances, the buyer would breach unless legal or nonlegal sanctions increase the cost of breach by a sufficient amount.

Suppose the buyer purchases goods from the seller at time 0. When the buyer and seller enter a second contract at time 1, they will be coded as repeat players. Yet the fact that the parties had a prior dealing does not mean that the threat of losing future business (at time 2 and beyond) from seller would deter a breach by the buyer at time 1. The buyer would not be deterred if he could simply obtain business from another seller. The game-theoretic analysis assumes that the buyer is locked in with the seller (for example, because of a relationship-specific investment). If market conditions do not lock the buyer and the seller into a relationship, we would expect these "repeat players" to use a writing in order to gain the protection of legal enforcement. Johnston should code for these conditions.

2. Nonlegal Enforcement of Cooperation Between Strangers

The converse point can also be made. Just as prior dealings between parties do not guarantee that they will rely on nonlegal sanctions to deter breach, the fact that parties are strangers does not preclude them from relying on nonlegal sanctions to deter breach. When two strangers enter an agreement that they expect to last for a long period of time—in which there are many opportunities for each player to penalize the other for breaching, and in which the rules and payoffs are clear—the game-theoretic analysis on which Johnston relies suggests that cooperation will occur. The absence of prior dealings is irrelevant, except to the extent that they would give each party useful information about the other. Therefore, if the agreement is simple enough, the parties, despite being coded as strangers, would not use a writing for the purpose of legal enforcement.

3. Groups and Reputation

A further difficulty with Johnston's analysis is that he does not adequately account for the effect of group membership. Two parties are coded as "strangers" if they have not had repeat dealings. Johnston's hypothesis would predict that these parties will rely on a writing to enforce their agreement. If the parties belong to a group in which reputation matters, however, then they will not rely on legal sanctions. As a result, they will not use a writing for simple contracts.

In response to this argument, Johnston points out that in a system of group enforcement, third parties must be able to verify that a breach has occurred. Verification can (or can most easily) occur only if parties put their contracts in writing. In contrast, in two-party situations only the injured party needs to observe the breach. Because the injured party can directly observe the breach, a writing is not necessary. The conclusion, however, does not follow from the premises. When information is cheap, both (i) parties to a contract and (ii) third parties in a group can observe or obtain information about the contract and the conduct that allegedly constitutes a breach. It is possible that the parties to a contract are less likely to need to refer to a writing in case of a dispute than are third-party members of a group. But Johnston provides no reason for believing that this possibility necessarily means that group members would need writings in order to evaluate claims in a

dispute. If reputation effects are sufficient and information is cheap, they would not. Indeed, Johnston's historical evidence regarding the failure to use contract formalities in general and writings in particular comes mostly from the practices of *groups*, not from the practices of two-person contractual relationships.

C. *Why Would Repeat Players Not Use a Writing?*

Johnston's assumption that repeat players would not use a writing is puzzling. He claims that they would not because they expect to depend on nonlegal sanctions. But surely—if they are sophisticated—they know that nonlegal sanctions will not deter breach at an endgame. Why, then, would they not supply a writing for this purpose?

Johnston's main argument is that the endgame is too remote to justify the cost of drafting a contract. This is possible. A writing sufficient to satisfy section 2-201, however, can be extremely brief and inexpensive. Because the people who act as repeat players in some contracts are strangers in others, they must—as occasional strangers—know about section 2-201. How costly could it be for such people to supply a writing?

Let me suggest two other reasons why repeat players might not put their contracts into writing. First, the parties might not put the contract into writing because they do not want judicial enforcement of the contract *even if* an endgame occurs. The parties know that each will have *ex post* incentives to litigate a dispute at endgame. They also know that because of information problems a court is unlikely to resolve the dispute in a way that maximizes the prospective value of the contract. *Ex ante*, they would prefer the arbitrary resolution of nonenforcement, if the alternative is an equally arbitrary resolution following costly litigation and judicial evaluation of the contract.²

Second, repeat players might not put their contracts into writing because of a norm against writings in their business community. The parties follow the norm blindly, in a way, without regard to

² Cf. Alan Schwartz, *Relational Contracts in the Courts: An Analysis of Incomplete Agreements and Judicial Strategies*, 21 J. LEGAL STUD. 271, 316-17 (1992) (noting how parties who contract through writing often leave out key terms). In the face of judicial arbitrariness, parties will create "structures" or "disagreement points" in their contracts, for the purpose of facilitating renegotiation when unforeseen contingencies arise. Such "structures" would be frustrated by attempts by courts to enforce the underlying agreement. *See id.*

whether writings are or are not cost-justified in their particular case. This possibility assumes plausibly that it is too costly for parties to evaluate in every case whether it makes sense to put their contract in writing, so they rationally defer to the norm. The normative implications of this explanation are quite different from those of the first explanation, but I defer comment on them to Part II.C.

D. *Judicial Enforcement of Section 2-201*

Johnston argues that the case reports reveal whether parties use writings for the purpose of obtaining legal enforcement. Johnston seems to say that if a case involves a “writing,” a simple contract, and parties who are strangers, then the parties must have used the writing in order to obtain legal enforcement.³ However, what Johnston means by “writing” is ambiguous. One possibility is that “writing” means a writing that meets the requirements of section 2-201. But if this is so, then all the cases involving insufficient writings have no relevance to his hypothesis. The other possibility is that “writing” means *any* writing, even unsigned records and other documents that do not meet the requirements of section 2-201. If this is so, then the hypothesis does not make any sense. Why would strangers try to obtain legal enforcement by using writings that do not meet the requirements of legal enforcement?

Johnston’s answer is that if the writing is insufficient, we know that the strangers never entered a contract. But this explanation is not satisfactory. Imagine a case that involves strangers, a simple contract, and *no* writing. The case invites two interpretations: (1) the strangers did not enter a contract; or (2) the strangers did enter a contract but relied on nonlegal sanctions. Johnston assumes that the first interpretation is proper,⁴ but he provides no basis for this assumption other than his readings of the cases.⁵ Now imagine a

³ Sometimes, Johnston uses the issues raised in the cases as proxies for whether a writing exists. If a “sufficiency” issue arises, a writing exists. If an “exception” issue arises, no writing exists. It is not clear why he uses these proxies rather than relying on the facts of the cases. In any event, this methodological choice does not affect the criticisms that follow.

⁴ See Johnston, *supra* note 1, at 1889-90 (discussing *Jones v. Wide World of Cars, Inc.*, 820 F. Supp. 132, 135 (S.D.N.Y. 1993) (holding that a contract did not exist between strangers where the parties negotiated but failed to produce a written deal)).

⁵ Here, he departs from the methodological rigor that characterizes the rest of the study. He might be right about *Jones*, where it does look as though the buyer never intended to commit himself; but it is possible that the buyer did intend to commit himself and intended to be bound by nonlegal sanctions.

case that involves strangers, a simple contract, and *insufficient* writings. Again, both interpretations are possible. Johnston would argue that the second interpretation is precluded by the existence of the writing: if the contract is simple, the parties would not include a writing for purposes of recording. The insufficient writings must reflect a preliminary effort, never completed, to lay the basis for legal enforcement. This argument is possible, but it makes too strong an assumption about the refusal of parties to simple contracts to use writings.

E. Summary

The importance of these criticisms depends on the robustness of Johnston's results. I do not take a position on whether the data confirm the hypothesis.⁶ If they do not, the criticisms present alternative explanations for the results. For example, if strangers do not use writings as frequently as one would expect, perhaps this is because people who appear to be strangers often belong to close-knit groups. If the data do confirm the hypothesis, the criticisms raise collateral questions that may have interesting answers. For example, if strangers always use writings, does this result mean that close-knit groups do not have effective nonlegal sanctions, or that they do but enforcement of these sanctions necessitates the use of writings, or just that members of close-knit groups have usually had dealings prior to contracts that resulted in litigated disputes? By raising these questions, Johnston's results provide a basis for further research into the connection between contract doctrines and business norms.

II. NORMATIVE IMPLICATIONS

A. *The Standard Defense of Section 2-201*

Imagine a world without the Statute of Frauds. A person I have never met could go to court and claim that last month I promised to sell him certain goods for \$1000 to be delivered on March 30. It is now March 30, the market value of the goods has risen to \$1500, and I refuse to go through with the alleged sale. He produces witnesses (in cahoots with him) who swear that I agreed to the deal.

⁶ The reason I take no position is that I do not have the space to address general questions about the reliability of coding and other aspects of Johnston's methodology. Johnston acknowledges these questions and addresses them in his Article.

In fact, I did not; but I cannot provide any sort of evidence to convince a jury that I did not enter this agreement and that the witnesses are lying. I cannot, for example, show that no such obligations exist in a written contract, because we have not, by hypothesis, entered a contract. The traditional rationale for the Statute of Frauds is to prevent this kind of dishonest conduct.⁷

The Statute of Frauds does not, to be sure, make such fraud impossible; it just makes it more difficult. In a world with the Statute of Frauds, the wrongdoer cannot convince the court through the testimony of his cronies. He must instead forge a document with my signature on it. He might be able to do this, but if he would prefer the oral method, it must be because forgery entails greater costs and risks. Perhaps it is harder to forge a document than to perjure oneself.

There are other possible normative justifications for section 2-201, including the justifications on which Johnston relies. I do not think they are persuasive, however, and defer discussion of them to Part III.

B. *The Critique of Section 2-201*

I have mentioned the benefits of UCC section 2-201; the critics emphasize its costs. Some parties do not know about section 2-201. Other parties know about section 2-201, but the costs of putting their contract into writing exceed the benefits from entering the contract. As a result, some contracts, otherwise valuable, are not entered. When parties enter a contract not knowing about section 2-201, or knowing about it but unwilling to incur the costs of supplying a writing, two undesirable results can occur. First, the courts may enforce section 2-201 and thus allow promisors to escape their contractual obligations. Second, the courts may strain to evade section 2-201, thus holding promisors to their bargain, but in the process creating complexity and uncertainty in the law. Neither result is desirable; therefore, section 2-201 should be abolished.

The critique is not decisive because it emphasizes the costs of section 2-201 without showing that the benefits are small. The

⁷ See E. ALLAN FARNSWORTH, *CONTRACTS* § 6.1, at 391-96 (2d ed. 1990) (discussing the origin of the Statute of Frauds); E. Rabel, *The Statute of Frauds and Comparative Legal History*, 63 *LAW Q. REV.* 174, 175-78 (1947) (providing a comparative historical analysis of the reasons motivating the adoption of the Statute of Frauds).

desirability of section 2-201 depends on whether its benefits (reducing fraud) exceed its costs (interfering with contracts).

This tradeoff is hard to resolve, but it is worth noting that it appears to be reflected straightforwardly in the language of section 2-201. First, the writing requirement does not apply to low-value contracts. It is unlikely that a person would risk a perjury conviction to convince a court that another person owes him a contractual obligation when the value of the asserted obligation is low. Where the benefits of a writing requirement are low, an exception to the rule makes sense.

Second, the writing requirement does not apply to customized goods. It would be difficult for a person claiming to be a buyer to make the fraudulent claim that a seller produced customized goods for his benefit when in fact the two parties never had a contract specifying the customization. If the parties never had an authentic deal, then the wrongdoer would not be able to point to goods in the seller's warehouse that are customized to the wrongdoer's tastes. In addition, enforcement of the writing requirement would put sellers who fail to obtain writings in a particularly vulnerable position because it is difficult to sell customized goods to a third party.

Third, the writing requirement does not apply when one party has partly performed. Part performance is straightforward evidence that the parties have a contractual relationship; therefore, it would be unlikely that a buyer's claim that the seller owes him an obligation is invented.

Fourth, the writing requirement does not apply when one party has admitted the obligation. If a party admits that an obligation exists, then it is impossible that the other party has invented it.⁸ Nevertheless, the question remains whether the rule and its exceptions are justified in light of the critique.

C. *Does Johnston's Study Undermine Any of the Premises of the Critique?*

Within its methodological constraints, Johnston's study weakens the critique by showing that some parties do, in fact, take account of UCC section 2-201 when they enter contracts. If strangers use

⁸ These and other exceptions reflect the problem of determining the proper degree of formality. As the number of exceptions rises, the formality interferes with fewer desirable contracts, but it also allows more fraud. See Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557, 618-19 (1992) (analyzing the benefits of rigid rules as compared to flexible standards to account for formalities).

writings for the purpose of ensuring legal enforcement, then they must know about section 2-201's writing requirement. It might be argued, however, that repeat players must not know about section 2-201 because they do not use writings. This argument is weak for two reasons. First, repeat players might not use writings just because they depend on nonlegal sanctions. Second, since the same actor sometimes plays the role of stranger and sometimes that of repeat player, the fact that he uses a writing for the purpose of legal enforcement when acting as a stranger means that he also knows about the writing requirement when acting as a repeat player.

But one should emphasize what Johnston's Article does *not* show. It does not show that courts evaluate the sufficiency issues and the exception issues in a predictable and correct way. Indeed, Johnston's study suggests that doctrinal straining does occur. Section 2-201 does not have an exception for repeat players. If courts find exceptions for repeat players, then they do so without statutory or explicit doctrinal authority.

Even if courts do evaluate the exception and sufficiency issues properly, Johnston's study does not show that the benefits of section 2-201 exceed its costs. We can see this by considering the case of strangers and the case of repeat players separately. For strangers, the benefit of section 2-201 is that it hinders fraudulent attempts to bind a party to an obligation to which he did not consent; the cost is that parties for whom it is too costly to supply a writing will not enter desirable contracts. Johnston's analysis does not tell us whether the benefits exceed the costs.

Now take the case of repeat players. As Johnston points out, the costs of section 2-201 are much lower. If courts do not strike down the unwritten contracts of repeat players on the basis of section 2-201 (instead finding an exception), then section 2-201 does not raise the cost of contracting and thus prevent repeat players from entering desirable contracts. But Johnston neglects to mention that the benefits of section 2-201 are also much lower. If courts do not require a writing, section 2-201 does not serve its purpose of preventing fraudulent attempts to bind a party to an obligation to which he did not consent. In particular, section 2-201 does not prevent a repeat player at endgame from fraudulently claiming that the other party owes him an additional obligation as part of their relationship. So if the costs of section 2-201 are lower for repeat players than for strangers, so are the benefits. But Johnston's analysis provides no reason for believing that the benefits are systematically higher than the costs or vice versa.

Nevertheless, Johnston seems to imply that section 2-201 should be enforced against strangers because in stranger cases the benefits exceed the costs, but should not be enforced against repeat players because in repeat player cases the costs exceed the benefits. Although a full discussion of this claim is beyond the scope of this Comment, a few remarks are in order.

Johnston's study may show that repeat players do not use writings; but it does not reveal whether they bypass the writing requirement in order to conform to norms or customs, or just because it is rational to do so whether such norms exist or not.

Suppose repeat players fail to use writings because they belong to communities with a norm against writings. The norm could be efficient or inefficient. If the norm is inefficient, there is no reason for courts to uphold it, and instead the courts should enforce section 2-201. If the norm is efficient, whether courts should find an exception to section 2-201 depends on whether courts can enforce the norm more effectively than the community can.⁹

Now suppose repeat players do not use writings simply because writings are not cost justified. Relevant norms are neutral with respect to the use of writings. If the use of writings is not cost justified because of the remoteness of an endgame, but the parties would want courts to enforce the contract at the endgame, then the courts should find an exception to section 2-201. If the use of writings is not cost justified simply because the parties do not want judicial enforcement at endgame, then courts should enforce section 2-201. In sum, the implications of Johnston's study for section 2-201 depend on the reasons why repeat players do not use writings; but his study does not reveal these reasons.

III. CONTRACT FORMALITIES

Johnston assumes that UCC section 2-201 is valuable to strangers because it provides them with a means for signaling their desire for legal enforcement. But Part II argued that the main purpose of section 2-201 is to prevent people from fraudulently convincing courts that nonexistent contracts exist. This Part explains why Johnston's assumption—which is common in the literature—is wrong.

⁹ For a discussion of this issue, see Eric A. Posner, *The Regulation of Groups: The Influence of Legal and Nonlegal Sanctions on Collective Action*, 63 U. CHI. L. REV. 133, 156 (1996) (arguing that courts "should defer to other dispute resolution mechanisms when those mechanisms provide better ex ante incentives to cooperate").

An interesting aspect of the Statute of Frauds and other contract formalities is that they do not fit easily into the default-immutable rule dichotomy frequently used by contract theorists. A default rule specifies the terms that will govern upon the happening of certain contingencies when the parties' obligations in the event of those contingencies are left unspecified by the contract. For example, the *Hadley* default rule states that only damages for foreseeable losses will be awarded in case of breach unless the contract states otherwise.¹⁰ A formality, such as the Statute of Frauds, also gives the parties the opportunity to avoid the default (here, nonenforcement), but the parties can seize that opportunity only by engaging in certain formal acts (supplying a writing). Similarly, the consideration doctrine establishes a default (nonenforcement) that can be overcome only by certain acts (a *quid pro quo*).

A "penalty default" is a rule that specifies, as the default, terms that the parties would *not* have wanted, in order to give them incentives to reveal information.¹¹ Although scholars have tended to treat the formality as a kind of penalty default,¹² the formality is different from the penalty default in a crucial way. To avoid the terms set by a penalty default, the parties must state the terms that they prefer. Thus, they can avoid the damages limitation set by *Hadley* by reciting that the promisor will be liable for consequential damages in case of breach. To avoid the terms set by a formality, however, the parties cannot simply state the terms that they prefer. Parties cannot avoid the nonenforcement outcome set by the Statute of Frauds or by the consideration doctrine just by reciting that they prefer enforcement. They must do more. To avoid the terms set

¹⁰ *Hadley v. Baxendale*, 9 Ex. 341, 354, 156 Eng. Rep. 145, 151 (1854).

¹¹ See Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 91 (1989) (defining "penalty defaults"). The literature on the use of default rules to give parties incentives to reveal information is vast; some recent contributions include Lucian A. Bebchuk & Steven Shavell, *Information and the Scope of Liability for Breach of Contract: The Rule of Hadley v. Baxendale*, 7 J.L. ECON. & ORGANIZATION 284, 287-92 (1991) (discussing the conditions under which the *Hadley* rule causes efficient revelation of information); Jason S. Johnston, *Strategic Bargaining and the Economic Theory of Contract Default Rules*, 100 YALE L.J. 615, 626-39 (1990) (arguing that expansive default rules, such as the limitation on consequential damages to those which are foreseeable, encourage bargaining around default rules); Robert E. Scott, *A Relational Theory of Default Rules for Commercial Contracts*, 19 J. LEGAL STUD. 597, 599 (1990) (explaining "the law's preference for generalized or 'off-the-rack' default rules in commercial contracts"); see also *Symposium on Default Rules and Contractual Consent*, 3 S. CAL. INTERDISCIPLINARY L.J. 1 (1994).

¹² See, e.g., Ayres & Gertner, *supra* note 11, at 123-25.

by a formality, the parties must perform certain formal acts—the drafting of a writing (in the case of the Statute of Frauds) or the execution of an exchange (in the case of the consideration doctrine).

By restricting freedom of action in this way, contract formalities are similar to immutable rules. But immutable rules prevent parties from obtaining outcomes that differ from the terms set by the rules. For example, no formalized act enables parties to escape the penalty doctrine's prohibition on unreasonable liquidated damages provisions. Immutable rules bar certain terms, regardless of the process through which they emerge; default rules allow people to choose terms different from the ones the default rules set; formalities allow parties to obtain the terms they desire only if they follow a specified process of bargaining.

The reason for these differences is that the function of formalities is different from the functions of default and immutable rules. Default rules either maximize the value of parties' contracts or give them incentives to disclose information to each other by contracting around the rules. Immutable rules protect third parties from externalities resulting from contractual behavior. Parties may not contract around them because the resulting contracts would reproduce the undesirable behavior. Contract formalities protect people (who are not necessarily parties to any contract) from the fraud of strangers (but not from an externality arising from another contract). Parties may not contract around them because this freedom would enable strangers to engage in the perjury the formalities are supposed to prohibit. The Statute of Frauds would not hinder fraud on the court if the wrongdoer could testify that both parties agreed that the Statute would not apply.

Like many legal rules, contract formalities discourage socially costly behavior at the price of suppressing socially valuable activity. Sometimes, the suppressed activity is behavior that grows increasingly valuable as economic conditions change. For example, the consideration doctrine became less attractive as firm offers and requirements contracts came into existence. This change does not mean that the consideration doctrine did not make sense earlier on; nor does it mean that the current version of the consideration doctrine—which generally bars gift promises only—does not make sense. It is possible that gift promises are of sufficiently little social value that they can be sensibly sacrificed to the goal of reducing fraud, whereas requirements contracts are so valuable that such a sacrifice is not desirable.

Because formalities restrict valuable behavior, parties have strong incentives to manipulate them. Examples have included the use of nominal consideration and the placement of the letters "L.S." next to a signature instead of a seal.¹³ In addition, because formalities interfere with the enforcement of valuable contracts, courts seeking to do substantive justice have a strong incentive to strain to avoid formalities. As a result, formalities may be intrinsically unstable.

In addition, sometimes a formality loses its ability over time to deter fraudulent behavior. Where, for example, the seal requirement could be satisfied with the "L.S." mark, it clearly could not deter fraud beyond the level already achieved by the Statute of Frauds. If the wrongdoer can forge a writing and a signature effectively, he can certainly add "L.S." to the document.

The optimal formality is a rule that prescribes an act that is cheap for a promisor to engage in but costly for a wrongdoer to mimic. In the past, the act was a seal; currently, perhaps it is the signed writing; maybe in the future it will be some kind of personal identification number verifiable through a recording system. Clearly, the desirability of a particular formal act will change with economic conditions and technological advances.

I have set out these arguments at some length because it seems to me that the purposes of contract formalities are often misunderstood. The mischief was done by Lon Fuller's influential article, *Consideration and Form*, which set out three justifications for contract formalities.¹⁴ I do not think that any of these justifications are plausible—at least, not as Fuller or anyone else has articulated them. Although Fuller's justifications may explain why parties would often want to use a writing or other precautions, they do not explain why

¹³ See FARNSWORTH, *supra* note 7, § 2.16, at 87 (discussing the replacement of seals on documents with the printed letters L.S., meaning "*locus sigilli*" or "the place of the seal").

¹⁴ See Lon L. Fuller, *Consideration and Form*, 41 COLUM. L. REV. 799, 800-03 (1941) (describing the evidentiary, cautionary, and channeling functions of legal formalities). The influence of this article can be found in cases, *see, e.g.*, *McIntosh v. Murphy*, 469 P.2d 177, 179 (Haw. 1970) (listing Fuller's justifications for legal formalities such as the Statute of Frauds), hornbooks, *see, e.g.*, FARNSWORTH, *supra* note 7, §§ 2.5, 6.1, at 50-51, 394 (discussing and applying Fuller's justifications for legal formalities), and articles, *see, e.g.*, Ayres & Gertner, *supra* note 11, at 123-25 (comparing Fuller's analysis to a theory of default rules). An exhaustive Fuller-influenced analysis of the Statute of Frauds can be found in Joseph M. Perillo, *The Statute of Frauds in the Light of the Functions and Dysfunctions of Form*, 43 FORDHAM L. REV. 39 (1974).

the Statute of Frauds and other formalities should have the immutable aspect mentioned earlier.¹⁵

First, according to Fuller, the purpose of contract formalities is to give the parties a way of signaling to the court their desire for legal enforcement (the "channeling" function).¹⁶ Under the Statute of Frauds, a writing signals that the parties desire legal enforcement; the lack of a writing does the opposite. The problem with this argument, however, is that the parties could send such a signal by simply stating orally whether they desire legal enforcement or not. If they want to increase the likelihood of the result they desire, they might write it down. But there is no reason that the use of a writing should *necessarily* count as a signal, that is, that the Statute of Frauds should be an immutable rule.¹⁷ Indeed, courts' disapproval of ritualized avoidances of formalities, such as recitals or nominal consideration, is evidence against the channeling view, since these ritualized activities provide clear signals that the parties desire legal enforcement. The channeling function justifies a writing requirement at most as a default rule, not as an immutable formality. It justifies a requirement that the parties articulate their desire for legal enforcement, not that they do so in writing.¹⁸

Second, one might argue that the Statute of Frauds serves the evidentiary purpose of providing a record for judicial evaluation.¹⁹

¹⁵ Rabel argues that some of these justifications may have influenced adoption of the original Statute of Frauds. See Rabel, *supra* note 7, at 178. However, the Statute itself mentions only the antiperjury function. See *id.* at 175.

¹⁶ This seems to be what Johnston means when he says that abolition of § 2-201 would "undermine the use of a detailed writing in relatively simple transactions, leading to greater cost and uncertainty in the resolution of disputes arising out of such transactions." Johnston, *supra* note 1, at 1907; see also *id.* at 1906.

¹⁷ Cf. Michael Braunstein, *Remedy, Reason, and the Statute of Frauds: A Critical Economic Analysis*, 1989 UTAH L. REV. 383, 423-26 (arguing that parties would often use writings to send signals even in the absence of the Statute of Frauds). Information-forcing arguments have been made for default rules, but they do not provide clear support for immutable rules, see Ayres & Gertner, *supra* note 11, at 123-25 (discussing some efficiency benefits of immutable rules), though there are some preliminary ideas in this area, see Ian Ayres & Robert Gertner, *Strategic Contractual Inefficiency and the Optimal Choice of Legal Rules*, 101 YALE L.J. 729, 743-46 (1992) (discussing the relative effectiveness of immutable rules at reducing inefficient contractual behavior when default rules are incapable of doing so).

¹⁸ The channeling function is also the dominant explanation for the role of formalities in the law of wills. See, e.g., Bruce H. Mann, *Formalities and Formalism in the Uniform Probate Code*, 142 U. PA. L. REV. 1033, 1036 (1994). It would be worth investigating whether this emphasis on channeling in the law of wills is improper, as I have argued that it is in the law of contracts, or whether it reflects some crucial distinction between the law of wills and the law of contract.

¹⁹ Fuller apparently absorbs the fraud-preventing purpose of the Statute of Frauds

The parties, however, bear almost all the costs of judicial error if the record is poor, so they have strong incentives to incur costs *ex ante* to create a record, and will produce one if it is cost justified. It might be argued that because the judicial system is subsidized, the parties have an incentive to impose the cost of evaluating the contract on the court system.²⁰ But there is little reason to believe that a poor record imposes significantly more costs on the courts than does a good record, and that the value of the subsidy is likely to be high enough to cause the parties to fail to use a writing when the parties otherwise care about the accuracy of judicial enforcement.

Relatedly, one might argue that the Statute of Frauds hinders a promisor from escaping a valid contract by claiming that he never agreed to it. The writing requirement makes it difficult for him to do this by providing a record of the promise. The problem with the argument, however, is that it does not explain why the law should *require* promisees to protect themselves in this way. If the promisee wants the additional protection of a writing, he can insist on it. But if drafting costs exceed the value of additional protection, he should not be required by an immutable rule to agree to a writing. Again, circumvention of the formality should provide evidence sufficient to satisfy the evidentiary function, but courts refuse to treat the Statute of Frauds and similar formalities as default rules.

Third, Fuller argued that formalities serve a “cautionary” purpose.²¹ This function has been interpreted: as a means for inducing deliberation; as a means for inducing parties to reveal information to each other; and as a means for preventing mistakes arising from the careless use of promissory language. In each case, formalities have no advantage over a penalty default. When parties go to the trouble of contracting around the rule (for example, transferring a dollar bill to satisfy the consideration doctrine or reciting that the Statute of Frauds does not apply), this behavior forces cautious deliberation, exposes information, and manifests linguistic care. Yet

into this evidentiary function. See Fuller, *supra* note 14, at 800 (“The most obvious function of a legal formality is . . . that of providing ‘evidence of the existence and purport of the contract, in case of controversy.’”). It is more helpful, however, to keep these functions distinct.

²⁰ See Ayres & Gertner, *supra* note 11, at 99 (noting that, since most contracts are unavoidably “obligationally incomplete,” the cost of filling obligational gaps is most efficiently placed on the courts).

²¹ See Fuller, *supra* note 14, at 800.

formalities, unlike penalty defaults, restrict such attempts at circumvention.

In sum, Fuller-influenced explanations of formalities fail because they do not explain why parties are forbidden to bargain around formalities. The purpose of contract formalities such as the Statute of Frauds is to prevent people from defrauding victims with whom they do not necessarily have a contractual relationship. It is against this standard that section 2-201 must be judged.

CONCLUSION

Within its methodological limitations, Johnston's study provides support for the intuition that strangers care more about legal rules than do repeat players. In particular, it suggests that strangers know about and try to conform their contracts to the writing requirements of UCC section 2-201. As Johnston acknowledges, however, the normative implications of the study are unclear. The study does not show that the writing requirement of section 2-201 is necessary or valuable for enabling parties to signal that they desire legal enforcement. Even if it did, the study does not show why a writing requirement should be a formality rather than a default rule. As Part III argued, section 2-201's value as a formality depends on whether its prevention of fraud justifies its costs in foregone contracting. But a study that shows behavior that does *not* occur as the result of a legal rule could not rely on surveys of practices or of cases. The necessary study would require a comparison of the amount of fraud that exists in jurisdictions with and without Statutes of Frauds. Designing such a study would be quite a challenge, but, if successful, it would finally resolve the centuries-old doubts about the social value of the Statute of Frauds.