The Common Sense of Contract Formation
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Abstract:
Unlike torts or civil procedure or any area of public law, the rules of promissory exchange apply exclusively to parties who have manifested their assent to be bound. What parties know, and what parties think they know, about contract law affects their contract behavior and in some cases the legal status of their agreements. Drawing on a series of new experimental questionnaire studies, this paper does two things. First, it lays out what information and beliefs ordinary individuals have about how to form contracts with one another. These studies suggest that the colloquial understanding of contract law is almost entirely focused on formalization rather than actual assent, though the modern doctrine of contract formation takes the opposite stance. The second part of the paper tries to get at whether this misunderstanding matters. Whether and when do beliefs and misunderstandings about the nature of legal rules affect parties’ interactions with each other and with the legal system? We find that indeed information that a contract has been legally formed has behavioral effects, enhancing parties’ commitments to a deal even when there are no associated formal sanctions. However, we also document a series of situations in which misunderstandings have limited practical repercussions, because even parties who believe that legal obligation is about formalities take seriously the moral obligations associated with informal expectations, promises and exchanges. We conclude with brief speculations about the implications of these results for consumer contracts.

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THE COMMON SENSE OF CONTRACT FORMATION

Unlike torts or civil procedure or any area of public law, the laws of promissory exchange only apply to parties who have manifested their assent to be bound. Even so, the moral norms of exchange and promise are quite firmly entrenched and more broadly applicable than legally enforceable contracts. Norms of promise-keeping and reciprocity, interpersonal courtesy, community reputation—these kinds of intangible goods have real effects on contracting behavior. And, although it is perhaps a less exciting claim, it is also the case that the law itself (as it exists or as understood) affects transactional decision-making and parties’ commitments to their interpersonal obligations.

This paper presents four new questionnaire studies of commonsense approaches to contract formation in the hopes of making two primary contributions. The first is to survey intuitions about what the law of formation is. In a world in which the vast majority of contracts are signed without the advice of counsel, most people have to make inferences of formation based on their background knowledge and beliefs. We find that the colloquial understanding of contract law is about formalization of an agreement rather than the agreement itself.

Our second goal is to tease out the intuitive relationship between formation and obligation—to ask whether and when it matters if individuals believe a contract exists. The law of contracts is very clear that parties’ obligations to one another turn entirely on whether or not they have mutually manifested assent to be bound. And, in fact, we find that behavioral results suggest that legal (or legalistic) formation does enhance commitment to a deal irrespective of its power to impose sanctions; it seems that the law has freestanding normative force at least in this context. However, we also find that the there are cases in which knowing or not knowing the legal rule is essentially irrelevant. In many scenarios, our results suggest that parties’ likelihood to perform or breach is largely determined by their moral and social preferences—reciprocity, altruism, and promise-keeping—rather than the law of contract formation.

Contracts scholars have long debated the doctrinal and economic importance of formation, particularly when parties often invest significant resources into negotiating (e.g. Craswell 1996; Craswell 1995). From a policy perspective, the subjective experience of formation is often
significant because contracts act as reference points (Hart & Moore 2006; Hoffman & Wilkinson-Ryan 2013). Parties treat each other, and their obligations, differently pre- and post-contract. Once a contract is formed, they take fewer precautions, seeking less information about the market and about one another (Craswell 1988). As we have previously argued, if ordinary individuals think they are in a contract, but the law treats them as strangers, they can be exploited by their counter-parties. Indeed, the converse vulnerability also exists, for parties who think they are still negotiating but are in fact already legally committed.

To date, there has been almost no investigation of when individuals act like contracting parties. This Article undertakes to fill that gap in the literature by relating a series of experiments and studies regarding lay attitudes and behaviors surrounding contract formation.

We proceed as follows. Parts 1 and 2 provide context for the empirical project, with a literature review of what we know about lay attitudes about formation, including the law’s inconsistent perspective on whether such attitudes matter. Part 3 reports the methods and results of four original surveys and experiments. Part 4 proposes a framework for thinking about these results and their relevance to doctrinal and policy debates in contract.

1. THE LAW OF SUBJECTIVE ASSENT

Like many scholars writing in law and psychology, we take a broad view of what it means for particular beliefs and judgments to have “legal implications.” There are various ways that a legal system might take notice of parties’ intuitions and beliefs about contracts even when they have no obvious doctrinal role (Solan 2007; Joo 2000; Ricks 2004). However, contract formation is a somewhat unusual area in which there are also legal mechanisms for taking into account parties’ subjective beliefs about the legal status of manifestations of assent. In this section, we take up the doctrinal mechanisms for taking subjective assent seriously, before turning in the next section to the behavioral ramifications of subjective assent or lack thereof.

1.1 Subjective Interpretations of Objective Manifestations of Assent

Courts and contracts professors doggedly intone that contract parties’ secret views on the enforceability of their agreements are irrelevant to actual legal enforceability. The 1907 case of Embry v. Hargadine, McKittrick Dry Goods Co. provides a vivid example. In Embry, the plaintiff, a term employee, approached his boss, McKittrick, in December to inquire about the subsequent year’s employment.¹ McKittrick responded

¹ Embry v. Hargadine, McKittrick Dry Goods Co., 105 S.W. 777, 777 (Mo. Ct. App.)
“Go ahead, you’re all right. Get your men out, and don’t let that worry you.” Embry thought they had a deal; McKittrick denied intending to enter into a legally binding relationship. The court, of course, found a contract, and indeed Embry is typical. In *Lucy v. Zehmer*, defendant Zehmer asserted that he never intended to enter into a contract to sell his land to his neighbor, and was drunk and/or joking the whole time. Calling the defense “unusual, if not bizarre,” the Court enforced Lucy’s demand for specific performance, ruling that only the party’s objective manifestations of assent, not their secret reservations, mattered.

Cases like *Embry* and *Lucy* present specific examples of a general puzzle: does contract law care if its subjects are aware of its premises? In some areas, the answer is definitely “no.” A murderer-for-hire may not recover against his employer by arguing that he was unaware of the proposition that illegal contracts are unenforceable. Nor may a party depending on oral promises argue that a court should enforce them notwithstanding conflicting provisions of a written agreement because she did not know about the parol evidence rule or the statute of frauds. And, indeed, Zehmer’s belief that manifesting assent in inebriated jest prevented a meeting of the minds was wrong and irrelevant.

But in the law of mutual assent, parties’ beliefs about contract formation sometimes actually influence case outcomes. In *Embry*, for example, McKittrick’s lack of specific intent to form a contract was not relevant, but Embry’s *was*: the promisee must actually believe in the existence of the contract he is suing under. Cases like *Embry* and *Lucy* express a principle of “formation estoppel”: Professor Larry Solan identifies a number of cases “when both parties agree that a commitment has been made, the promisor is bound, and when neither believes that a promise has been made, the promisor is not bound. Objective considerations are irrelevant.” (Id. at 356).

That said, examples of such shared agreement cases addressing formation rather than interpretation are few and far between. Most of the examples that Professor Solan identifies are ones where interpretation has bled into formation, or are implied based on dicta. For perhaps obvious reasons, there are relatively few cases where both parties intend to enter into a legally binding relationship but a reasonable person would not, and even fewer where they mutually understand themselves to be unbound but a reasonable person would find them to be.

1.2 Promissory Estoppel

According to the Restatement (2nd) of Contracts, the triggering condition for
esstopel is a promise that the “promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce such action or forbearance.” Of course, which promises we should reasonably expect others to rely on may come down to whether or not it is reasonable for a counterparty to rely on a non-contractual promise. Indeed, one could read this doctrine to imply that legally unenforceable promises are not ones that the promisor should expect the promisee to rely upon. But the doctrinal evolution suggests otherwise. The understandable ignorance about the requirement of consideration, for example, permits courts to uphold gift promises, especially when those promises look otherwise highly formal (e.g., *Ricketts v. Scothorn* and *Feinberg v. Pfeiffer*). It may be that courts sympathize with plaintiffs who have relied on promises that have the trappings of legal enforceability but are not—that courts are sympathetic to promisees who misunderstand contract law. Indeed, the estoppel doctrine that enforces promises when parties have relied on verbal contracts for exchanges within the Statute of Frauds suggests that the doctrine is in part about enforcing promises that are easily mistaken for legally binding contracts.

1.3 Intent to Be Legally Bound

Finally, a related set of questions comes up when courts are considering questions of definiteness and finality of negotiated deals. For example, consider agreements with crucial open terms. Traditionally such contracts faced judicial hostility. But under the Uniform Commercial Code (particularly § 2-305), courts are to ask if the parties intended to conclude a contract—that is, did they intend to be legally bound? If so, courts will fill in the open terms with UCC gap fillers (Choi 2003).

Intent to be bound also plays a crucial role when the parties disagree about whether they were still negotiating or the contract had begun. Here too courts often rely on a reconstruction of the parties’ intent. The more indefinite the exchanged writings, for example, the less likely a court will be to conclude that the parties intended to be bound. Clauses which specifically disclaim an intent to be bound are typically enforced. But the

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3 Such as, for example, when a contract comes into existence during the course of negotiations. *See, e.g.*, A/S Apothekernes Laboratorium v. I.M.C. Chem. Group, 873 F.2d 155, 157 (7th Cir. 1989).
Inquiry’s focus—what was the relationship between the parties’ behavior and their understanding of their legal relationship—highlights a limited but real role for subjective understandings of formation in contract doctrine.

In sum, a small number of doctrines directly assess a particular party’s subjective understanding of assent to contract. The goal of this paper is to see if we can say something more general or more systematic about how people think about contract formation. For that we turn to the psychological literature and then to our own empirical project.

2. The Psychology of Contract Formation

Our focus in this paper is on the point when a negotiation becomes an agreement, whether that agreement is legally binding or just reflected in the behaviors and preferences of the parties. Although there is relatively little existing research on the psychology of mutual assent to contract, some of our hypotheses are inspired or at least supported by findings from other areas within the broader category of contract formation, including negotiation and drafting.

2.1 Negotiation

In the present paper we are particularly interested in cases in which parties fail to break a deal when doing so appears to be in their financial self-interest (Wilkinson-Ryan 2011; Wilkinson-Ryan & Hoffman 2010). This is the converse of a more thoroughly-documented puzzle, which is when parties who appear to have compatible preferences (e.g., cases in which there should be gains from trade) fail to arrive at a deal. Psychology has been quite influential in the study of negotiation and drafting, and the kinds of anomalous behaviors observed in bargaining and drafting are rooted in the same psychological phenomena we see in the formation context.

The mechanisms that explain bargaining impasse tend to boil down to one underlying psychological phenomenon, namely that people tend to exaggerate the advantages, material or moral, of their own positions and

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4 Indeed, this plays out not just with material entitlements but also with viewpoints in general. Most people overestimate the fairness of their own position. The idea is that parties not only have a sense of what they want out of a bargain, but also a sense of the range of bargains that are objectively “fair.” Even when an agreement appears materially beneficial to both sides (e.g., superior to available outside options including not dealing at all), it may be rejected if one or both parties believes that it is objectively unfair. Linda Babcock and George Loewenstein have explained failure to arrive at a mutually beneficial agreement has also been explained in terms of self-serving biases. Their research
fail to see the merit in whatever a counterparty is offering. There is a “stickiness” to initial views and entitlements (Ben-Shahar & Pottow 2006; Korobkin 1998; Jones & Brosnan 2008), an observation that has been exhaustively borne out in the heuristics and biases literature on the endowment effect (Huck, Kirchsteiger & Oechssler 2005; Ortona & Scaccaiai 1992). In a variety of experimental and real-world contexts, the initial allocation of goods and entitlements has real effects on parties’ willingness to trade (Kahneman, Knetsch & Thaler 2004). In the famous Cornell mug experiment, subjects were randomly assigned to receive a mug or to receive nothing. When the experimenters offered to effect any mutually beneficial trades, to allow any mugless mug-lovers to purchase from mug-indifferent mug owners, they found almost none to be made. The mug owners on average demanded over twice the price to give away a mug than the average would-be buyer was willing to pay. Though there are various explanations for this phenomenon (and some challenges to its generalizability), it seems safe to say that people often overestimate the value of the status quo; overvaluation of the status quo raises the seller’s reserve price and decreases the probability of an efficient transaction.

This kind of status quo bias has also been invoked to explain the failure to negotiate terms. Much as the initial entitlements affect the parties’ respective reserve prices, initial terms—e.g., default terms or forms—largely determine which terms end up in the contract at all. As Russell Korobkin has argued, there is a preference both for terms that are legal defaults, and also for any contract term that the parties perceive as the default position. He posits an “inertia theory” of contract drafting, in which parties prefer any terms that they can choose without having to do anything—even when there are different, Pareto-superior terms available (Korobkin 2003). In this Article, we are looking in part at how this kind of inertia or status quo bias is instantiated at the moment of contract formation, an investigation that asks about the perception of that crucial turning point as well as the effects of inertia in the contracting context.

Indeed, we would be remiss if we did not point out that there is one highly salient fact of inertia in contract formation that we know for sure—not only are people not negotiating form contracts, they are not even reading them. Non-readership has been meticulously documented by Florencia Murotta-Wurgler and her co-authors (Bakos, Murotta-Wurgler & Trossen 2013), and demonstrates the bargaining impasse that results from the tendency to “conflate what is fair with what benefits oneself.”

4 To some extent, what we want to know is whether or not there is a flip side to this—do parties who have crossed the rubicon from adversaries to partners then overestimate a partner’s fairness?
Intuitive Contract Formation

has been recently taken up by Omri Ben-Shahar and Carl Schneider in their discussion of failed disclosure regimes (2011). Non-readership has been explained as a function of over-optimism (nobody thinks they will need to know all the contingencies) (Prentice 2011), limited attentional resources (we can’t even stand to read and process all the terms in a given deal, much less take them into account in a multi-factorial decision process) (Hillman & Rachlinski 2002), and even over-trust (we think the contract has been vetted, either by the market or the government or possibly the other party) (Plaut & Bartlett 2012). In many ways, this non-readership is in sync with the predictions we test here about the focus on the formalities of contracting rather than substantive assent to terms.

2.2 Contract Performance as a Function of Formation

One of the central hypotheses of the research we present below is that perceptions of contract formation affect the quality and likelihood of performance. Although they are not typically grouped in this fashion, there are existing studies from diverse methodologies that can be understood as explorations of the effects of contract formation on the performance of promissory obligations.

First, there is evidence that the perceived fairness of the formation process affects performance. Procedural justice research suggests that the process of reaching a legal decision affects the efficacy of the decision—e.g., how likely parties are to approve of the decision, or appeal it; follow its dictates, or avoid them (Feldman & Teichman 2011). In recent work, Zev Eigen has shown that this precept has bite in contract. Using a real online contracting context, he had participants who participated (minimally) in a negotiation of the terms, and others who had no role in drafting. Subjects who participated, even in an essentially meaningless way, were more likely to perform and more likely to report that the contract was fair (Eigen 2008).

Second, we have some evidence that parties will sometimes perform, at a cost to themselves, not because they are formally bound but because they feel morally bound. In the experimental economics literature, contract formation is often represented by a Trust game (Berg, Dickhaut & McCabe 1996). In a classic Trust game, of course, the parties do not actually manifest assent. Instead, the second-mover (the “Trustee”) performs out of a sense of fairness—if the first-mover (the “Investor”) has been generous, the Trustee performs on her obligation. In these cases, the sense in which a contract is formed is that the trustee feels morally obligated to adhere to the terms of what is essentially an implicit contract. In the behavioral contracts literature, there is evidence that reciprocity norms are implicated in mortgage contracts, in assigned contracts, and even in divorce settlements (Wilkinson-Ryan 2013; Wilkinson-Ryan 2011; Wilkinson-Ryan & Baron
There are two implications of these literatures for our purposes. The first is that it seems that reciprocity plays a role in whether people understand themselves to be in a morally binding (or at least morally persuasive) agreement. Thus, in the Trust game, it is not that Trustees believe that they must pass money to a generous Investor; it is that they believe that they ought to do so, and so they behave as if the exchange is contractual. The second implication is that reciprocity norms affect how parties behave even when there is also a formal contract in place. We test the effects of reciprocity in the specific context of formation in the studies we report below.

2.3 Formation

Finally, there is some preliminary evidence that the formal fact of contract formation—even when it has no legal consequences—changes how parties behave toward one another. We explored this in the context of contracts precautions in our recent paper on contracts as a reference point (Hoffman & Wilkinson-Ryan 2013). The reference point hypothesis, first articulated by Hart and Moore, essentially posits that evaluations of various costs and benefits depend on comparisons to the reference point—and the reference point is the moment of contract formation. In experimental studies, we found that when parties believe that they are in an ongoing contract relationship, they appear to be less willing to engage in a variety of self-protective behaviors, including adding terms, purchasing insurance, and continuing to search for a better deal. What is striking about these findings is that this behavioral shift at the moment of formation was observed in contexts in which it was clear that the costs and benefits of the behavior were identical pre- and post-formation. Participants in these studies seemed to really care whether the contract period had started, even when it had no practical effect on the exchange. The natural follow-up question is when people think a contract has been formed, in the event that it is not laid out explicitly.

3. EXPERIMENTAL METHOD AND RESULTS

In the four studies reported below, we are trying to fill a gap in the existing literature by exploring how ordinary consumers understand contract formation and how, in turn, their intuitions about contract formation affect their contractual choices.

3.1 Study 1: Believing a Contract Exists Matters

Our first study asks whether the fact of legal contract formation affects behavior, even when it has no bearing on any practical outcomes for the
parties. Does it matter when parties think a formal contract exists? This study is a replication, and to some extent a reminder, of a result we reported in a previous paper (Hoffman & Wilkinson-Ryan 2013).

We surveyed 296 respondents on Amazon Turk who were paid $1 to complete a short questionnaire. 62.1\% of respondents were female. Ages ranged from 19 to 85 with a median age of 29.\(^5\)

Subjects in this study were randomly assigned to one of two conditions, the Contract condition or the No Contract condition. They read the following short scenario in one or the other of the conditions before answering questions about their judgment of the contract:

Please imagine that you are in the market for car insurance. There are a number of reputable small insurance agencies in your town, and you prefer to deal with a local firm. You find an insurance agent, Tom Anderson. He is backed by a good national insurance company, and he gives you a very reasonable quote of $77 per month to insure your 2011 Toyota Camry.

**Contract:**

You go to Tom Anderson’s office and sign the standard one-year insurance contract, which includes a three-day cancellation clause—if you decide within three days of signing that you do not want to use Anderson’s agency, you can call and cancel the coverage, no questions asked, for no fee. In other words, you have an insurance contract, and insurance coverage as soon as you sign, but you have three days to cancel with no legal or financial consequences. You sign and drive home.

Remember: You are under contract with Tom Anderson’s insurance agency, but you can walk away without consequences.

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\(^5\) For an explanation of Amazon Mechanical Turk, *see* Cherry (2010) (“Named after an 18th-century mechanical device that could beat humans at the game of chess . . . the Amazon Mechanical Turk is one of the most prominent crowdsourcing websites. Individuals or companies formulate and post tasks for the vast crowd of Turkers/Workers on the Mechanical Turk website. These tasks may include image tagging, comparing two products, or determining if a website is suitable for a general audience. The Turkers are able to browse among the listed tasks, complete them, and receive payment in the form of credits from the Amazon.com website . . . . While no statistics are available on the class background of workers on the Mechanical Turk, at least some are middle class, live in the First World, and casually perform clickwork for fun when they have a few spare minutes.” (internal quotation marks and citations omitted)). For a scholarly take on using Amazon Mechanical Turk for survey research, *see generally* Mason & Suri (2012); Paolacci, Chandler & Ipeirotis (2010).
No Contract condition:

You go to Tom Anderson's office and he gives you the standard one-year insurance contract. He tells you that his agency uses a three day waiting period with all new contracts. If you decide within three days of meeting that you do not want to use Anderson's agency, you can call and cancel the coverage, no questions asked, for no fee. In other words, you have insurance coverage as soon as you sign, but your one-year contract does not go into effect for three days, during which you can call and terminate coverage with no legal or financial consequences. You agree and drive home.

Remember: You are not under contract.

Questions:

1. One day after you meet with Tom Anderson, you see an ad in the paper from Showalter Insurance, offering discounts for the 2014 year. What is the likelihood you would call Showalter Insurance to get a quote? (1-7 where 1 is very unlikely, 4 is undecided, and 7 is very likely)

2. Now please imagine that the newspaper ad lists some sample rates, including the kind of basic coverage you are looking for, and they are charging $70/month. What is the likelihood that you would decide to terminate your coverage with Anderson and go with Showalter Insurance instead? (1-7 where 1 is very unlikely, 4 is undecided, and 7 is very likely)

3. What is the highest monthly payment that Showalter could charge at which you would decide to terminate coverage with Anderson and go with Showalter Insurance instead?

Table 1. Summary of Results, Study 1, Effect of Contract on Willingness to Cancel Deal

<table>
<thead>
<tr>
<th></th>
<th>Contract</th>
<th>No Contract</th>
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<tbody>
<tr>
<td>Call to inquire</td>
<td>4.2</td>
<td>5.1</td>
</tr>
<tr>
<td>Cancel for $7 savings</td>
<td>3.9</td>
<td>4.5</td>
</tr>
<tr>
<td>Low price to switch agents</td>
<td>$64.16</td>
<td>$66.92</td>
</tr>
</tbody>
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Overall, subjects were more willing to shop around for a new deal in the No Contract condition. They were more likely to call to inquire about the new
car, more likely to be willing to cancel for a $7 savings, and willing to switch agents for a lower overall savings. The Call variable differs significantly by condition ($t=4.15$, $df=289.57$, $p < .001$), as does the Cancel variable ($t=2.79$, $df=293.77$, $p=.006$). The effect of contract on the Price variable is less clear, but our main analysis suggests that among subjects who understood the question, those in the Contract condition required a significantly lower price in order to switch agents ($t=2.40$, $df=231.29$, $p=.017$).

As in our 2013 paper, we see here, using a different context (car insurance rather than a car lease), that a fairly technical or semantic fact about contract formation—whether the contract is in place but can be cancelled as opposed to a contract period that has not started—has real effects on how individuals make judgments and decisions about their participation in the market.

The remainder of this paper jumps off from this point, and asks how individuals behave when they are reliant on their own assumptions and intuitions in order to understand their contractual obligations.

3.2 Study 2: What Do People Know About Contract Formation?

Our second study surveys the basic landscape of lay intuitions about formation. The study includes four scenarios that will be familiar to anyone who has taken a contracts course and reasonably easy to follow for a general adult subject pool. Study 2 is not experimental; it is a survey. In each scenario, we describe a series of events that happen around the formation of a contract. Subjects read the entire scenario, and are then asked to pinpoint which of the actions described constitutes the formation of a binding contract.

Subjects in this study were 100 subjects from Amazon Turk. 60 subjects were male. Ages ranged from 19 to 69 with a median age of 32. In this study, subjects were paid one dollar for completing the 5-minute task and offered an additional $0.25 for every question they answered correctly.

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6 The results of Studies 2, 3, 4, and 5 are reported as mean differences. The statistical significance of the mean differences was analyzed with t-tests. We report the t-value ($t$), the degrees of freedom ($df$), and the p-value ($p$)—the probability of finding such a result randomly if no actual difference exists—for each significance test.

7 This variable produced a fair amount of noise or confusion. 10.5% of subjects gave a number higher than 77—which is to say, they indicated that they would switch to the other insurance agency even if that insurance agency were charging higher premiums. There are no significant differences between conditions on this items if we use the raw data. The numbers in this table include only subjects who gave a number of 77 or below. We get similar results if we code all of the high responses as 77 (Mean without Contract: $67.88$ vs. Mean with Contract $65.62$; $t=2.04$, $df=264.30$, $p=.04$). Given this level of confusion, however, this result is less robust than the result for the Likert items.
meaning a possible bonus of an additional dollar. They were instructed to answer based on their own knowledge and not to do research online or otherwise. No subject took longer than 7 minutes to complete the survey, suggesting that they complied with this admonition.

We present these items roughly in order of complexity. The first scenario involves an advertisement followed by an offer and acceptance. The second introduces the complexity of a private, formal manifestation of assent that precedes an informally communicated acceptance. The third follows a typical mailbox-rule fact pattern, and the fourth introduces terms that follow the initial manifestations of assent. In each of these cases, subjects were asked, “What is the first point in this timeline when the American legal system would find an enforceable contract between the parties?”

The goal of these surveys is two-fold. First, we hope to get a preliminary sense of the match or mismatch between intuitions about contract formation and the existing contract doctrine. Second, we are trying to infer what kinds of intuitions are driving subjects’ responses, to generate hypotheses that we can test experimentally.

**Offer and Acceptance**

We asked subjects when the parties entered a “binding contract” in the following circumstance.

Pam is buying a new car and wants to sell her old one. She decides that the first thing she’ll do is see if anyone she knows wants to buy it. She posts on her Facebook page, “I’ve got a 1999 Toyota Camry that I’m looking to sell. I’m hoping for $2,000 but it’s negotiable. If you or anyone you know is interested, send me an email.” Her friend Doug sends her an email. It reads, “I’ll buy it! Can I drop the check off tomorrow and pick up the car? $2,000 is fine by me.” Pam replies, “Yes! I’ll see you tomorrow.” Doug brings Pam the check the following day and picks up the car. (Please assume that in this state, contracts can be formed via email.)
This scenario was in some ways the most straightforward procession of a contract: an advertisement from the seller, followed by an offer from the buyer and then an acceptance from the seller, and then, with the contract formed, performance by each party in turn. Indeed, if we wanted to identify the doctrinal ambiguity, it would be whether the advertisement could constitute an offer that in turn rendered the buyer’s reply an acceptance. Surprisingly, that is not what we see here, even though subjects were explicitly informed that a contract could be formed via email. The majority of subjects did not think that a contract had been made until payment, meaning that the clear mutual manifestations of assent were not deemed adequate to bind the parties under the law. We further discuss and explore the reluctance to credit informal communications with legal import in the remaining studies.

Formality

In this item, we included both verbal communication of assent as well as private written assent.

Please imagine that you are meeting with general contractors because you are planning to build a small addition to your house. The contractor you like the best, Tim Burnell, goes through the details of your planned renovation point by point and writes them out along with his price of $11,000. You tell him that he’s your top pick, but you need a night to think it through before you can...
commit. He points to the paperwork and says, “This is my offer. Call me at my office to accept, and we’ll get this show on the road. I hope we get to work together.”

That night, you invite a friend over who works in the construction industry. The two of you discuss your project and Tim’s proposal. At the end of the discussion, you say, “All in all, this is a great deal. I’ve made up my mind. I’m going with Tim.”

After your friend has left, you sign the paperwork that Tim left with you and go to bed.

The next morning, you call Tim and tell him, “It’s a deal. I’m in.”

Figure 2. Percentage of subjects identifying each moment as the first moment of contract formation.

This scenario included three key moments in formation. The first is the decision to enter a contract; the second is the signing of a contract; and the third is communication of acceptance to the offeror. We disaggregated these actions in order to force subjects to choose the definitive factor. From a doctrinal perspective, the contract is formed upon communication of acceptance. In this case as in the previous item, we included information intended to push subjects toward the correct response by telling them that the offeror explicitly identified his preferred mode of acceptance (calling him at his office). And, indeed, one-third of subjects identified that as the moment of formation. A plurality of subjects, however, thought that the
contract was formed by the signature, even though the contract is signed privately. Because so few subjects identified the first announcement of the decision (telling your friend you’re “going with Tim”) as dispositive, we can infer that it is the signature itself, not the fact of the decision or the first objective indication of assent.

**Mailbox Rule**

Although the Mailbox Rule is arguably becoming obsolete in the world of fax and email, it provides an interesting case study precisely because none of the possible moments of formation are squarely in line with a prototypical assent.

Subjects read the following scenario and indicated the moment of binding contract:

Janine is looking to hire a general contractor to rehab her house. She interviews Jayson, who makes a good impression. He gives her a standard form contract, which he has signed, that lays out the terms and conditions of the job. She decides to take it home to think over the deal. At home, she signs the form. The next day, she puts it in the mail. Two days later, he receives it.
This scenario further disaggregates the assent process by introducing a lag between the sending and receiving of the signal of assent. This contract is legally binding when the offeree puts the contract in the mail; this is a classic Mailbox Rule problem. The results suggest that the Mailbox Rule is deeply unintuitive; that moment is hardly a more popular choice than the offeree taking the contract home to think about it. As between sending and receipt, subjects clearly prefer receipt. However, what is perhaps more surprising is how many subjects again identify the signing of the contract—the private signing—as the moment of formation.

Terms that Follow

The final scenario is the only scenario subject to real doctrinal debate. Like the Mailbox Rule example, this scenario includes a lag that essentially bifurcates the manifestation of assent. Here, however, what is bifurcated is communication of the terms. The primary terms of exchange are communicated before acceptance and payment, and other terms are communicated after acceptance and payment. Law students will be familiar with this fact pattern from the Gateway cases.

Peter is ordering new custom speakers from Audionuts, a mail-order sound system retailer. Peter calls the company and speaks at length to a customer service representative, hashing out the details of his

Figure 3: Percentage of subjects identifying each moment as the first moment of contract formation.
order, which include speakers for his main media unit (TV and stereo system) as well as his portable devices (phone and iPad). Peter and the customer service representative arrive at a final product specification, including a price and delivery date. Peter gives the rep his credit card number, and the charge is immediately posted to his account. Eight days later, Peter receives his speakers in the mail. Inside the box is a piece of paper headed “Terms and Conditions.” The Terms and Conditions sheet includes information about the duration of the warranty (90 days), the dispute resolution process (mandatory arbitration) and the return policy (return within 14 days for full refund for any reason). The Terms and Conditions sheet states at the bottom, “If you do not agree to these terms and conditions, please return the product within 14 days for a full refund.” Peter uses the speakers with no problems for two months.

**Figure 4: Percentage of subjects identifying each moment as the first moment of contract formation.**

<table>
<thead>
<tr>
<th>Event</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>When Peter calls Audionuts</td>
<td>2%</td>
</tr>
<tr>
<td>When they agree on the product specifications</td>
<td>10%</td>
</tr>
<tr>
<td>When Peter pays for the speakers</td>
<td>55%</td>
</tr>
<tr>
<td>When Peter receives the box</td>
<td>12%</td>
</tr>
<tr>
<td>When Peter reads the terms and conditions</td>
<td>10%</td>
</tr>
<tr>
<td>When Peter does not return the speakers</td>
<td>11%</td>
</tr>
</tbody>
</table>

The salient moment of formation here is clearly payment. Much like academic commentators in the area, lay subjects appear to be confused about how to handle terms that follow.\(^8\)

When assent is not clearly associated with signing documents, subjects

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\(^8\) Indeed, for this item, we paid the $.25 bonus to every subject, reasoning that this is a sufficiently unclear case to justify multiple possible responses, which in turn renders it confusing enough to justify compensating subjects for any response at all.
appear to choose the formalization of the deal over the substantive assent. We might think of as a formation heuristic—a moment that fit neatly into a typical contract schema. Signing a document, for example, is a key part of a contract schema. In the next two studies we consider whether or not the contract schema itself is the dispositive factor in motivating performance behavior.

3.3 Study 3: Do Parties Need to Know the Law to Make Binding Contracts?

Study 1 and Study 2 are explicitly about the moment of legal formation; Study 3 takes up cases in which beliefs and knowledge about legal contract formation are less important than parties’ own preferences and beliefs around promissory exchange. This study has something of the same set-up as Study 2, but uses the dependent variable of the first study. That is, rather than asking whether or not there is a contract at each point, we are instead asking subjects to report on the extent to which they feel bound at each point. We do this by asking whether or not they would be willing to cancel their contract.

Study 3 compares how subjects think about backing out of a potential deal across various points on the continuum of contract formation. This study uses a between-subjects experimental design, meaning that each subject is asked to consider only a single point on the continuum. With this design, we can apprehend subjects’ intuitions about each contractual situation without explicitly invoking their intuitions about the comparative “bindingness” of each point.

Furthermore, this dependent variable in this particular context requires a study design feature that may seem odd for a study about when a contract is binding: namely, each of these scenarios, in each condition, stipulates that the contract is not binding on the consumer until some kind of cancellation or waiting period has passed. The reason for this is to test subjects’ behavioral and/or moral intuitions without implicating their (mis)understandings of actual contract penalties and remedies, or their concerns about the transactions costs entailed by breach of contract. It also permits us to compare how subjects feel about their commitments to contract before and after legal formation in a world in which the actual consequences of backing out are the same in either case.

This study was conducted with the same subject pool as Study 1, using Amazon Turk participants. Each subject read the following scenario. Subjects were randomly assigned to see the scenario in one of four conditions, noted below:

Please imagine that you are interested in buying a used car. You are looking for a recent-model Mazda sedan, and you have been
browsing the listings on an online auto retailer. You see a Mazda sedan being sold in your area. It is listed as having been driven only by the employees of the dealership. It has 25,000 miles on it. The asking price is $15,500. This appears to be about $300 under Kelley Blue Book value. It has a five-year warranty.

The dealership has a Free Trial Period policy with their used cars. The buyer can return the car for a full refund anytime within the first three days after signing the sales agreement.

Possible Offer:
You leave a message on the voicemail of the local dealer saying you saw a car online that interested you, and could he please call you back to discuss.

Offer:
You email the dealership that owns the vehicle and offer $15,000 for it.

Acceptance:
You email the dealership that owns the vehicle and offer $15,000 for it. The dealer responds by phone and agrees to the sale.

Performance:
You email the dealership that owns the vehicle and offer $15,000 for it. The dealer responds by phone and agrees to the sale. You go to the dealership that afternoon, sign the sales contract, pay, and agree to pick up the car the next day so that the dealer can have it cleaned and vacuumed for you.

After [this interaction with the dealership] you get an email alert that the site sends automatically when it finds something within your parameters. A competing dealership is selling the same car (same make, model, and year), with 26,500 miles on it, also with a five-year warranty.

1. Assume the competing dealership is selling the car for $14,750 (firm). Would you buy the car from the competing dealership for $14,750?
2. To what extent do you think it would be morally wrong to not buy the car from the original dealership?
We analyzed these results in two ways. First we tested the overall effect of Formation Level (the four “levels” of increasing transactional commitment in the left-hand column) on willingness to cancel. Second, we tested for differences of each level against the adjacent levels.

Overall, Formation Level has a highly significant effect on Willingness to Cancel (F[1, 292]=47.8, p<.0001). Willingness to cancel is not significantly different as between the Possibility and Offer levels (t=1.26, df=139.07, p=.21). Subjects are significantly less willing to cancel when there is both an offer and acceptance as opposed to an offer alone (t=2.72, df=139.51, p=.007), and, in turn, less willing to cancel when there is some performance as compared to offer and acceptance without performance (t=2.18, df=141.31, p=.03).

The analysis of the immorality variable is similar. Formation Level overall has a highly significant effect on Immorality (F[1, 293]=34.0, p<.0001). We see significant differences between Possibility and Offer (t=2.47, df=136.81, p=.015) and again between Acceptance and Performance (t=2.75, df=135.88, p=.007), but not between Offer and Acceptance (t=.70, df=141.19, p=.48). Oddly, the biggest jump in willingness to cancel, between offer and acceptance, is not reflected in the immorality variable.

These results suggest two things. First, many people are unwilling to break a deal even if the deal can be cancelled without penalty, and in some cases, even if the deal is not yet even made. Indeed, only about half of subjects were sure that they would break the deal to save $250 in the Hope and Offer

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9 Subjects could choose Yes, No, or Not Sure. We report our results with Yes and Not Sure responses as a single category. The trends and the significance tests do not change if we analyze the results by dropping the “Not Sure” responses.
conditions.

Second, each step that brings the parties closer together matters, not just the moment of legal formation. One interpretation of this sort of spectrum of formation is that the parties’ commitment to the deal increases incrementally in a way that is not entirely or even primarily driven by an understanding of what it means to be legally bound. Whether parties are getting the law right or not may be irrelevant where they prefer to make choices that align with their underlying moral preferences, reflecting courtesy, altruism, and reciprocity. The final study reported below tests this hypothesis with a more targeted manipulation, asking how the norm of reciprocity affects decision-making in contract.

3.4 Study 4: Bargaining in the Shadow of Reciprocity Norms

One of the central, if diffuse, hypotheses of this research is that contractual interactions involve multiple, distinct moral and social norms, some of which are doctrinally irrelevant. In contracts as in other contexts, people have many other-regarding preferences. All else being equal, I might prefer not to disappoint another person, to reciprocate generous behavior, to keep my promises, and to obey the law. Each of these preferences is implicated in contractual exchange in ways not captured by the law. In this final experiment, we consider a particular case in which we conjecture that knowing the legal rule has limited effects on behavior when individuals have strong personal commitments to particular values or goals.

In order to test our supposition that reciprocity norms play a distinct role in the moral psychology of contract, we used a scenario involving pre-contractual reliance. This is a case in which there is an expectation of contract but no promise. Our hypothesis was that even before contract, one party’s investment in the deal will create moral incentives for the other party to proceed with the agreement.

Of course, in the normal course of commerce, there are good reasons to choose a counterparty who invests more in the deal. It sends signals about that party’s commitment and trustworthiness; provides more information about the value of the deal; and may even add value to the contract. In the scenarios below, we are trying to minimize some of these rational justifications by comparing a party who relies in response to a particular hope of offer of purchase to a party who makes the same investments in the deal but not in response to one potential buyer in particular.
101 subjects participated via Amazon Mechanical Turk. Subjects were paid $1.00 to complete a 5-minute questionnaire. 61.8% of the subjects were female. Ages ranged from 18 to 70, with a median age of 28. Participants who had also completed previous studies in this series were removed from the sample prior to data analysis. Subjects were randomly assigned to read the following scenario in either the Reliance or the No Reliance condition:

**Reliance Condition:**

Please imagine that you are looking to buy a used car, preferably something inexpensive but moderately reliable. You find a listing for a 1998 Toyota Camry in the local newspaper's Sunday classified section. The seller is asking $2,300 or best offer. You call the seller to say that you would pay $2,300 for the car as long as it’s clean and drives reasonably well. He keeps it parked at the end of his driveway, near the road, with a For Sale sign in the window. He only drives it around the block once a week to check that everything is working.

The seller lives about an hour away from you, in the opposite direction of your commute to work, so you agree that you’ll come check out the car the following weekend.

In the meantime, the seller takes the For Sale sign out of the window of the car and gets it detailed.

**No Reliance Condition:**

Please imagine that you are looking to buy a used car, preferably something inexpensive but moderately reliable. You find a listing for a 1998 Toyota Camry in the local newspaper’s Sunday classified section, published once a week. The seller is asking $2,300 or best offer. You call the seller to say that you would pay $2,300 for the car as long as it’s clean and drives reasonably well. The seller says that he had it detailed before posting the advertisement, so it is quite clean. He has it parked in his garage and only drives it around the block once a week to check that everything is working.

The seller lives about an hour away from you, in the opposite direction of your commute to work, so you agree that you’ll come check out the car the following weekend.

Subjects answered two questions.

1. Before you go for the test drive, you pass a used car lot on your way home from work. The lot has clearly gotten a big
delivery of used Camrys recently. Assume you see a similar car—identical for practical purposes—on the lot to the one you agreed to buy from the seller from the classified listing. The car on the lot is being offered for $2,000. Would you cancel your deal with the original seller and buy the car from the lot?

2. What is the highest amount that the lot could be asking for the Camry such that you would cancel your deal with the original seller and buy the car from the lot?

**Table 4. Effect of Counterparty’s Reliance on Willingness to Cancel**

<table>
<thead>
<tr>
<th>Cancel for $300 savings</th>
<th>No Reliance</th>
<th>Reliance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>84.3%</td>
<td>70.0%</td>
</tr>
<tr>
<td>Median savings to cancel</td>
<td>$100</td>
<td>$200</td>
</tr>
<tr>
<td>Mean WTA</td>
<td>$2140.16</td>
<td>$2063.25</td>
</tr>
</tbody>
</table>

In the No Reliance condition, 84.3% of subjects said they would cancel for a $300 savings. In the Reliance condition, 70% of subjects responded that they would take the $2,000 car. This difference is marginally significant in a two-tailed test (t=1.719, df=93.32, p=.089). The free-response result is less equivocal; those in the Reliance condition gave a significantly lower WTA value than those in the No Reliance condition. The mean value cited to induce cancellation was $2140.16 in the No Reliance version and $2063.25 in the Reliance condition (one “0” response was omitted as an outlier). A comparison of medians is also helpful, with No Reliance subjects requiring a $100 savings to cancel (WTA of $2200) and Reliance subjects requiring a median of $200 savings to cancel (WTA of $2100) (W=1576.5, p=.023).

A counterparty’s investment in or reliance on the deal affected whether the second-moving party was willing to perform. This is true even though we were comparing two relatively similar acts—one seller who improves the good in anticipation of a sale, and another who improves the good in anticipation of this sale. The norm of reciprocating one trusting and generous act with trustworthiness and generosity makes the latter a particularly important element in the timeline of contract.
4. Discussion

In the last two decades, scholars have begun to systematically excavate individuals’ intuitions about what the law is (e.g., Kelman 2013; Robinson & Darley 2007; Baron & Ritov 1993). In some cases, evidence of intuitions that diverge from doctrine is framed as a challenge to existing doctrine, on grounds that it may delegitimize law, or at least reduce compliance (Slobogin & Brinkley-Rubinstein 2013). In this paper we have also set out to document lay intuitions about the content of law, but our project remains largely descriptive.

As with any descriptive empirical project, our analysis is limited by our methodological choices. The results we have presented here are based exclusively on scenario studies. As such, there are serious impediments to generalizability and limits to our confidence in their external validity. In these studies, subjects in three of the four studies lack extrinsic incentives to respond truthfully, and may feel motivated to make themselves look more moral or savvy than their real-world choices would reflect, or they simply not be able to imagine how they would really feel if they were actually party to one of the contracts described here. Furthermore, our sample is by definition limited to individuals willing to fill out internet surveys for small amounts of money. We take this paper to be a first step, partly creating hypotheses for future research. With that said, insofar as what we are interested in is in large part beliefs and intuitions, asking people about contract law directly (as in Study 2) or indirectly, manipulating the details of the contract in question (Studies 1, 3 and 4), is a method reasonably well-calibrated to our particular research agenda. In the remainder of this section, we lay out a summary of the results and some possible implications of those results to help frame future research.

4.1 Overview of Results

Taken together, responses to these questionnaires begin to map a psychology of contract formation. In particular, we note the following results:

- The most common understanding of contract formation involves signing a written document.
- In at least some cases, what parties know and think they know about the legal rule has limited practical repercussions, because even parties who believe that legal obligation is about formalities take seriously the moral obligations associated with making promises and participating in reciprocal exchange relationships.
The primary goal of this paper is simply to lay out the ways in which ordinary understandings of contract formation converge and diverge with the legal rules, we hope in ways that will inform other contracts scholarship. But we also want to offer a framework in which to think of these results, because they present a potentially puzzling juxtaposition.

On the one hand, we see in the first two studies a startling level of interest in contract formalities, including, in Study 2, an almost rigid refusal to acknowledge verbal agreements. On the other hand, in the last two studies, we see a real sensitivity to informal norms that clearly do not implicate legal formation. For example, in both Studies 3 and 4, subjects are indicating that they would feel more committed to a contract when the counterparty has already started to perform. Why do subjects sometimes behave like 19th century legal formalists, and other times like realists from the Wisconsin School of relational contract theory?

Our tentative conclusion is that subjects themselves draw a distinction between legal and moral obligations. They view their legal obligations as heavily dependent on formal manifestation of assent via signature. But their moral obligations are attendant to both legal formalism (as in Studies 1 and 2) and also to more fine-grained moral norms. This is an interesting case in which we see some evidence of a legal context—contract—in which moral norms are not entirely determined by legal norms.

4.2 Formalism

A consistent theme in the experiments is that individuals privilege particular behavioral moments—signature, payment, and possession—above the verbal communication of assent. This is a particularly interesting finding, and one that we can only speculate about at this point. We surmise that the prototypical contract implicates the vernacular of “doing the paperwork,” “getting it in writing,” and “signing on the dotted line.”

The normative implications of this kind of formal bias are potentially complex. The general rule is that an offer to conclude a bilateral contract is accepted when the acceptance is communicated. The mailbox rule, a minor and increasingly irrelevant exception, holds acceptance good after it is out of the offeree’s possession and on the way to the offeror in some reasonable medium. For both the rule and the exception, our results in Study 1 are provoking. They suggest that individuals do not believe that communicating acceptance makes a contract. Rather, signatures before communication and payment after communication are the modal psychological moments of
formation. Lay views about acceptance appear to diverge from the legal rule. Of course, simply because individuals reach conclusions in conflict with the legal approach does not mean that the legal rule is clearly problematic. Contract law implicates a number of moral norms that people are quite accustomed to navigating in both a non-legal social space (social promises, for example) as well as a legal space (actual contracts). This is an area in which we would need further research to discover exactly where and to what extent the divergences between contract and morality are truly dissonant to individuals. In many cases, we may find that people find the legal rule surprising but reasonable.

4.3 A Spectrum of Obligation

The second thematic strand of this research concerns the general approach that individuals have to obligation, as opposed to legal formation. In the common law tradition, formation is generally an event. We find that intuitive obligation is an iterative process, heavily influenced by a growing sense of reciprocal ties. Even at the beginning of the relationship, when all that is on the table is an offer, individuals begin to constrain themselves. Over time, as the relationship deepens, they act more like contracting parties and less like strangers.

That individuals experience contracting as a process and not a moment provides support for reform proposals which would permit liability for pre-contract reliance under certain circumstances (Ben-Shahar 2004). The proposition has been explored in the context of failed negotiations, in which an award of reliance damages may have not only economic benefits (Craswell 1996) but also intuitive appeal. It also tends to make more easily defensible promissory estoppel recovery even under circumstances where the promisor has made statements which a reasonable individual would not have relied upon.

5. Implications for Consumer Contracts: Does Knowing You’re In a Contract Make You Less Likely To Know What’s In the Contract?

Although, as we have said, this is really a descriptive project, we think it worthwhile to speculate briefly about one possibly troubling implication of our findings for consumer contracting. As Study 1 suggests, when individuals are induced to believe that they are in a contract, they are less likely to take steps to protect their own self-interest. One such defense, as we have discussed in previous work, is information (Hoffman & Wilkinson-Ryan 2013). The terms-that-follow study in particular illustrates that
individuals often believe that their rolling contracts are complete on payment, even though in many courts they would not be until the terms had been received. Believing themselves not to be in deals, consumers may be even less likely to read (and protect themselves) than they would otherwise be.

Craswell (1988) argued that selecting the right counterparty is one way that parties take precautions in contract. Craswell’s analysis identifies search—“this gathering of information about potential contracting partners” as a key problem for scholars worried about inefficient investments and precautions in contract, particularly when the parties’ have incomplete or uneven information. The studies here reconceptualize search as something that happens both before and after the deal is signed. Many contractual relationships are characterized by surprisingly weak constraints on exit, whether because they include cancellation clauses, or because they are essentially at-will arrangements—everything from employment agreements to Netflix subscriptions to credit cards. This essentially prolongs the period of investigation, or renders the idea of “precontractuality” meaningless in any sense that has serious bite. Our suggestion, though, is that many consumers continue to behave as though once the deal is formally signed, they no longer need to worry about the state of the competition or their information about the deal’s profitability. To the extent that the timing of formalities is in the control of one of the parties, usually the drafter, it is conceivably susceptible to manipulation to the unwitting disadvantage of the non-drafting party.

CONCLUSION

This research presents evidence of a nuanced set of intuitions about contract formation, with an uneasy and incomplete overlap between legal and moral obligations. Individuals themselves seem to draw lines between their own social or ethical preferences and what the law of contracts requires. Legally binding agreements have real behavioral consequences for the parties, but they are situated in a rich context of interpersonal obligations and personal commitments. Our approach here is, clearly, largely descriptive. With these findings, our goal for this and future research is to draw analytic attention to the distinct contents and consequences of, respectively, the formal and informal rules of promissory exchange.
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