**Deal Momentum**

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*When does a deal begin? Does it begin when parties sign a non-binding term sheet? Or only when parties sign a formal contract? This Article uses mergers and acquisitions (M&A) deals to examine why and how parties use non-binding preliminary agreements. It provides the first modern, comprehensive account of how parties use these common, but rarely publicly disclosed, bargaining tools to build deal momentum and carry a deal forward.*

*In M&A deals, sophisticated parties enter into non-binding preliminary agreements, such as term sheets and letters of intent. Once parties sign non-binding agreements, however, parties behave as though bound—almost always following up with a formal contract that closely tracks the early non-binding terms. Scholars and courts have long treated preliminary agreements as contract-like tools that need to be enforced. This Article develops an alternative theory of “deal momentum” to explain why parties use non-binding agreements. Non-binding agreements are not minor contracts—rather, they are signposts for when enough momentum has accumulated that a deal has become “sticky” and is likely to go forward. Although non-binding agreements are not contracts, they play an important role in facilitating complex contracting through their signaling, organizational, and formal functions.*

*This Article makes two contributions to the literature. First, using original interviews with deal lawyers, this Article provides a rich and layered account of how sophisticated parties use non-binding agreements in modern dealmaking. Parties almost never disclose non-binding agreements publicly, so interviews offer a rare glimpse into this common, but little-understood, deal practice. Second, it differentiates, for the first time, between the formal and substantive functions of agreement-making. By focusing exclusively on non-binding agreements’ contract-like qualities (their substantive functions), scholars have overlooked their formal functions. Non-binding preliminary agreements can nudge parties toward collaboration and signal seriousness, for example. Reframing preliminary agreements as signposts for deal momentum, rather than as minor contracts, has significant implications for contract theory, contract enforcement, and deal design. It suggests that the theoretical boundaries of the deal do not begin with preliminary agreements, that courts ought not to enforce those agreements, and that parties ought to use them—but as organizational tools, not as contracts.*

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# 

# Introduction

In 2015, the Delaware Supreme Court awarded $116 million in expectation damages when a sophisticated deal party did not honor the terms of an unsigned, two-page term sheet marked “non-binding.”[[2]](#footnote-2) Over a ten-year battle, the Delaware courts’ four decisions in *SIGA Technologies Inc. v. PharmAthene Inc.* stirred up a storm of interest from deal lawyers.[[3]](#footnote-3) They also breathed new life into central questions of contract law: Should courts enforce preliminary agreements like the non-binding term sheet in *SIGA*? And, if so, what measure of punishment should be meted for parties who breach them?

Much of contracts scholarship has focused on questions of ex post enforcement after a contract has been breached. Formal enforcement for breach is understood as a way to motivate party behavior ex ante. In the absence of formal enforcement, informal enforcement—such as damage to one’s reputation—can also motivate deal parties to play by the rules.[[4]](#footnote-4) In the *SIGA* cases, too, the role of enforcement is hotly debated. Scholars and practitioners alike have debated whether entering into a term sheet (even if unsigned and marked non-binding) created a legal obligation to perform—and, if it did create an obligation to perform, whether breaches are best punished with awards of reliance or expectation damages.[[5]](#footnote-5)

But to understand whether and how to enforce agreements like the one in *SIGA*, we must first address fundamental questions: Why do sophisticated parties use non-binding agreements at all? And, if these agreements are not binding, why do deal parties abide so strictly by their terms?

This Article’s approach—which begins the inquiry from the perspective of contract design,[[6]](#footnote-6) rather than from contract enforcement—fills a void in debates amongst both scholars and practitioners. It reveals that scholars have largely misunderstood the role of non-binding preliminary agreements in dealmaking, and that a clear understanding of that role offers fresh insight for contract theory, contract enforcement, and deal design.

Private mergers and acquisitions (M&A) deals are an excellent lens through which to understand non-binding agreements. In the early stages of a private M&A deal, parties often outline the material terms of their deal in a non-binding preliminary agreement—such as a term sheet or letter of intent.[[7]](#footnote-7) These short agreements often list only a few material business terms—such as price, what is being sold, and a few other terms—and can be signed or unsigned. In some ways, they can be understood as written versions of handshake agreements, and resemble non-binding agreements in a variety of contexts, such as engagements in family law or informal agreements in international lawmaking.

Non-binding agreements are agreements, rather than formal contracts—they create no binding obligation under the law.[[8]](#footnote-8) In fact, like the term sheet in *SIGA*, M&A preliminary agreements are often explicitly marked “non-binding.” They are also not meant to be enforced when breached.[[9]](#footnote-9) Uniquely, M&A parties have both the means and the sophistication to create binding contracts. In fact, in the course of an M&A deal, parties create a complex web of contracts to govern issues both large and small.[[10]](#footnote-10) Thus, these sophisticated business parties’ use of non-binding preliminary agreement is presumably intentional and considered, rather than the result of constraints imposed by lack of resources or skills.

Other scholars have explored the role of preliminary agreements in dealmaking more generally—but always with the assumption that preliminary agreements are minor contracts, and that enforcement is an important part of the story.

In their series of articles on preliminary-agreement enforcement, Bob Scott and Alan Schwartz examined a set of over 100 cases involving preliminary agreements to determine how preliminary agreements ought to be enforced by courts.[[11]](#footnote-11) They argued that parties use preliminary agreements when substantial deal uncertainty makes it impossible for parties to agree to all of the terms of a deal. For instance, parties may know, in a general sense, that they would like to do a deal together. They may then agree that they need to invest time and money to investigate further whether the deal is worth doing, and how. So, while parties investigate deal specifics, they enter a non-binding preliminary agreement—one that will either turn into a formal contract and a completed transaction, or be abandoned if the deal proves unprofitable.[[12]](#footnote-12) Schwartz and Scott argue that, to preserve preliminary agreements’ important role in efficient dealmaking, and to encourage parties to make relationship-specific investments in a deal prior to the complete resolution of uncertainty, courts ought to award reliance damages when one party breaches a preliminary agreement.[[13]](#footnote-13)

Albert Choi and George Triantis offer another explanation for why parties use preliminary agreements: to cope with deal complexity. They argue that complex deals are entered in stages—first a preliminary agreement, then a definitive contract—because some deals are “simply too complex or too time-consuming to be completed in a single stage.”[[14]](#footnote-14) Parties use preliminary agreements so that they can use the time between the preliminary and definitive agreements to engage experts, such as lawyers, to offer their expertise in fine-tuning the deal terms and documentation.[[15]](#footnote-15) Like Schwartz and Scott, Choi and Triantis note that by formally enforcing preliminary agreements, courts may improve efficiency.[[16]](#footnote-16)

While both of these explanations are compelling, they are incomplete, for two major reasons. First, neither explanation differentiates between binding and non-binding preliminary agreements. In M&A deals, parties often choose *non-binding* preliminary agreements. This is puzzling, given that the marginal cost of making a non-binding agreement into a binding one is low. Moreover, parties do not simply forget to make agreements binding—rather, they go out of their ways to indicate, sometimes on every page, that the agreement is non-binding. If judicial enforcement of preliminary agreement plays an important role in encouraging parties to act efficiently, why do parties go out of their way to indicate that they do not want judicial enforcement to play a role?

Second, neither of the existing explanations addresses why parties behave as though non-binding agreements are binding. Specifically, once parties sign a non-binding preliminary agreement, they almost always sign a definitive deal contract that hews closely to the preliminary agreement’s initial terms. A central observation of contract law is that enforcement for breach plays an important role in motivating parties not to breach. In the case of M&A preliminary agreements, there is a disconnect between the role of enforcement and the behavior of the parties—preliminary agreements are not binding, which should give parties plenty of opportunity to breach them. But in reality, preliminary agreements are both not binding and not breached. Why?

This Article introduces a theory of deal momentum to explain the role of non-binding agreements in modern dealmaking. It shows that these agreements are signposts—they mark a moment in the deal’s lifecycle when enough uncertainty and complexity has been resolved that the deal is likely to go forward, and serve signaling, formality, and organizational purposes. Reframing preliminary agreements as markers for the accumulation of deal momentum explains why, once parties sign a preliminary agreement, they are likely to do a deal, and at close to the preliminary agreement’s terms. This explanation cuts against the conventional wisdom that preliminary agreements are minor contracts that need to be enforced to promote efficient dealmaking. Rather, preliminary agreements can promote efficient dealmaking even though they are not contracts, and even in the face of minimal enforcement.[[17]](#footnote-17)

The remainder of this Article proceeds in three Parts. Part I draws on interviews with deal lawyers to show how parties and lawyers use non-binding preliminary agreements in modern dealmaking.[[18]](#footnote-18) It shows that, once parties enter a preliminary agreement, they usually follow up with a definitive contract that closely mirrors the preliminary agreement’s non-binding terms. This is in spite of the fact that enforcement—whether formal or informal—is very weak. Preliminary agreements are almost never publicly disclosed, so original interviews with deal lawyers offer a rare glimpse into a common, but little-understood, deal practice. Part II introduces the theory of deal momentum. It begins by showing that scholars have misplaced when, in the deal timeline, parties enter into preliminary agreements. Preliminary agreements are not first steps to a potential deal—rather, parties enter a preliminary agreement when the deal already has enough momentum to move forward. Accurately pinpointing *when* parties use preliminary agreements also helps explain why and how parties use preliminary agreements. Specifically, this Part draws an analogy to Lon Fuller’s distinction between the formal and substantive functions of consideration. It differentiates, for the first time, between non-binding agreements’ formal and substantive functions. In doing so, it shows that non-binding preliminary agreements are not effective tools because they substantively resemble contracts. Rather, they serve a formal function, injecting form and formality into an otherwise nebulous negotiation process. Part III considers implications for contract theory, contract enforcement, and deal design. Specifically, it suggests that courts should not enforce preliminary agreements, but that parties should embrace them as organizational and signaling tools.

The principles developed in this Article can be applied broadly. Within corporate law, this Article helps to sharpen the theoretical boundaries of the deal. Beyond corporate law, this Article helps to inform why parties in a variety of contexts choose to use non-binding agreements, rather than formal contracts backed by the threat of enforcement. It also illuminates a context where private ordering flourishes even when formal enforcement is available.

# Non-binding Agreements in Modern Dealmaking

A central tenet of contract law—and, indeed, the law in general—is that enforcement (or the threat thereof) motivates good behavior and deters bad behavior. Scholars who have studied preliminary agreements argue the same—that the threat of enforcement for breach motivates parties to abide by the agreements’ non-binding terms. But this link between enforcement and adherence to terms does not appear to hold true in modern dealmaking. Later Parts tackle the normative question: When should courts enforce preliminary agreements? But the normative question cannot be answered without first answering a positive one: Why do parties use non-binding preliminary agreements? This Part approaches that positive question anew, drawing on previously unstudied sources—in particular, qualitative evidence from interviews with practicing deal lawyers—to provide fresh insight that contravenes the conventional wisdom.

It begins, in Section A, by establishing the current scholarly understanding of why sophisticated parties use preliminary agreements. Section B presents the findings from original interviews with deal lawyers, and from surveys of practitioners’ literature and of recent preliminary agreement cases in prominent commercial jurisdictions. These findings offer three new observations about how deal parties use preliminary agreements. First, most preliminary agreements in M&A deals are signed, but specifically designated non-binding. Second, once parties sign a non-binding preliminary agreement, their deal is very likely to be consummated, and on terms that the parties agreed to in the initial preliminary agreement. This Article calls the combination of these two attributes “deal stickiness.” Third, deals are sticky even though enforcement for breach is weak. This third observation is particularly puzzling. It cuts squarely against a central understanding of contracts (and, indeed, legal) scholarship—that consequences, such as enforcement, have an effect on behavior. The puzzling observations in this Part set the stage for Part II, which offers and alternate explanation for why parties use non-binding preliminary agreements.

## Dealmaking in Theory

There are two leading theories on why parties use preliminary agreements: to resolve deal uncertainty, or to resolve deal complexity. Both of these theories suggest that preliminary agreements make deals more efficient, and that, like contracts, enforcing them helps motivate parties to use these efficient tools. This Section begins with a short primer on the timing of deals, and then outlines those leading theories. This Section sets the stage for Part B, *infra*, which presents an alternative theory for how parties use preliminary agreements.

### The Timing of the Deal

Parties enter M&A deals in several stages.[[19]](#footnote-19) The stages are punctuated by two major events: “signing” and “closing,” which refer to the signing and execution, respectively, of a definitive acquisition agreement.[[20]](#footnote-20)

The bulk of deal negotiation occurs before signing.[[21]](#footnote-21) In private M&A deals,[[22]](#footnote-22) parties also often enter into a preliminary agreement in the pre-signing period. The preliminary agreement “describes the basic terms of the proposed transaction.”[[23]](#footnote-23) It may include, for example, an agreed-upon price, a description of what is being sold (such as assets or stock), and a description of deal structure (such as whether the assets will be purchased debt-free, whether the buyer will need to secure financing, and whether the deal is a merger or acquisition).

The preliminary agreement also “usually states that the document is nonbinding.”[[24]](#footnote-24) In particular, the agreement makes clear that the business terms of the proposed transaction—such as price—are nonbinding. Provisions governing the negotiation process, however, may be binding.[[25]](#footnote-25) For instance, the parties may agree that they are bound to exchange information confidentially, or that they agree to negotiate exclusively with each other for a period of time.[[26]](#footnote-26)

After the initial negotiation period, parties sign the definitive acquisition agreement. This “signing” event creates contractual liability.[[27]](#footnote-27) Parties are, at that point, legally obligated to perform the transaction.[[28]](#footnote-28) After signing, there is often a gap in time of several weeks or months before closing. The time gap between signing and closing exists so that parties can complete a number of “closing conditions,” such as obtaining regulatory approval or deal financing, reorganizing their corporate structures to maximize the deal’s tax benefits, or completing due diligence of the target company.[[29]](#footnote-29)

After parties meet the closing conditions, they “close” the deal—that is, they perform the deal they agreed to at signing.[[30]](#footnote-30) They may, for instance, exchange consideration for stock or assets.

It is worth highlighting two common misunderstandings about preliminary agreements. First, scholars generally do not distinguish between binding and non-binding preliminary agreements—and, in fact, seem to assume that parties intend for preliminary agreement to be binding. The opposite is true: the vast majority of preliminary agreements are specifically *non-*binding. Parties specifically elect not to avail themselves of judicial enforcement for breach, even though making the election would require low marginal cost.

Second, scholars have routinely misplaced when, in the deal’s lifecycle, parties enter preliminary agreements. Scholars assume that preliminary agreements are first steps[[31]](#footnote-31)—parties before investigation, and before making relationship-specific investments. In reality, parties sign preliminary agreements slightly later in the deal process, after most initial investigation is done. This subtle distinction in the deal timeline is of central importance for practical and theoretical reasons. Practically, it sheds light on how serious parties are at the time they sign a preliminary agreement, which informs whether courts should punish parties for breach. Theoretically, a clear understanding of timing may also help to define the boundaries of deals. Previous work noted that a deal’s theoretical boundaries extend beyond the central, definitive acquisition agreement, and should encompass a number of contemporaneous ancillary agreements. Mapping the nuanced contours of the early deal timeline helps contracts and corporate law scholars understand whether deal boundaries also ought to encompass preliminary agreements.[[32]](#footnote-32)

### Preliminary Agreements and Deal Uncertainty

In their series of influential papers on assigning liability for preliminary-agreement breaches, Alan Schwartz and Bob Scott argue that parties use preliminary agreements to resolve deal uncertainty, and that enforcing breaches motivates parties to use preliminary agreements efficiently.

At the core of Schwartz and Scott’s idea is the observation that in complex deals, parties may not be able to resolve enough uncertainty before entering into a full, detailed, definitive acquisition agreement. In order to resolve uncertainty and determine whether the deal is feasible and worthwhile, parties need to make relationship-specific investments[[33]](#footnote-33)—and those investments cannot be recouped if the deal does not materialize. Parties may also not trust the other party not to behave opportunistically—for example, Party A might walk away from a deal after Party B has sunk significant costs into investigation. Preliminary agreements—backed with a bit of enforcement bite, in the form of reliance damages—are an efficient way to motivate parties to make relationship-specific investments to resolve uncertainty, and also to assuage fears of opportunism.[[34]](#footnote-34)

M&A deals provide a paradigmatic example for how parties use preliminary agreements to resolve uncertainty. Suppose that the buyer and seller can agree on some basic terms—for instance, that the buyer will acquire all of the seller for $50-70 per share of stock. However, before the parties can agree to the exact price term within that range, the buyer must do some further investigation into the seller. Thus, the parties enter into a preliminary agreement that notes the price range. The buyer then does due diligence on the seller, to understand better the seller’s financial position and overall company health. The buyer’s due diligence is a “relationship-specific” investment—it is specific to the seller, and information gained in that process cannot easily be transferred to another deal if the current one falls through.

Schwartz and Scott argue that, in order to motivate the buyer to undertake the expensive due diligence process, the seller must face the threat of enforcement for breaching the preliminary agreement.[[35]](#footnote-35) Without the threat of enforcement, the seller might walk away from the deal at any time, even though the buyer has made relationship-specific investments into the deal. In a world without enforcement, buyers would generally be hesitant to make relationship-specific investments, which would mean that many efficient deals simply would not take place. In other words, Schwartz and Scott contend that preliminary agreements are efficient, and courts ought to enforce them in order to motivate parties to use and abide by them.

### Preliminary Agreements and Deal Complexity

Another line of scholarship suggests that deal parties use preliminary agreements because the sheer complexity of a deal might make it impossible to complete in one stage. Parties may thus use a preliminary agreement for one of two reasons: to deal with the cognitive load of negotiating so many issues at once,[[36]](#footnote-36) or to buy some time to engage experts to weigh in on the most complex parts of deals.[[37]](#footnote-37)

For example, business parties may work amongst themselves to agree to essential business terms during the preliminary agreement stage, and, in later stages, engage lawyers, accountants, and others to work through the details.[[38]](#footnote-38) In this case, then, deal parties are using preliminary agreements to modularize complex deals—to break complex deals into smaller pieces, for the purpose of making them easier to handle.[[39]](#footnote-39) Breaking complex deals into smaller, expert-specific pieces also allows experts to work on those pieces more efficiently—a deal management strategy that parties also use after the preliminary stage, while they are drafting the definitive set of documents.[[40]](#footnote-40)

This scholarship suggests that some deals are too complex to complete in one step, but are nonetheless efficient and worth doing. Preliminary agreements are tools that allow parties to break their deals into multiple steps. But those agreements are only useful if parties feel motivated to adhere to them. Thus, like Schwartz and Scott, Choi and Triantis also argue that courts ought to enforce preliminary agreements—at least a little bit. Specifically, they note that “the court can [] restrict bargaining flexibility through the imposition of the duty to negotiate in good faith, especially on the party with the superior bargaining position.”[[41]](#footnote-41) In other words, if a preliminary agreement is the result of parties breaking a complex deal into smaller, time-staggered parts, then a preliminary agreement is, in fact, part of the M&A bargain. And if it is part of the M&A bargain, it ought to have some enforcement bite. Moreover, enforcing a preliminary agreement means that parties can rely on their preliminary bargains as they engage in the costly process of solving for deal complexity. In fact, if preliminary agreements are not enforced, parties may back out of deals while counterparties have already invested in solving for deal complexity—an inefficient result.

### Enforcement as a Motivator, and the Overlooked Cost of Performance

Both existing explanations for why parties use preliminary agreements—deal uncertainty and deal complexity—rely on *formal* enforcement for breach as an important part of the story. Preliminary agreements are thought to be efficient—without them, it is harder to execute complex or uncertain deals. Some amount of enforcement for breaches gives preliminary agreements enough bite to incentivize parties to abide by their terms, which is important to ensure that parties continue to use them to facilitate complex and uncertain deals.

But formal enforcement is not the only way to motivate behavior—there is also informal enforcement. This sub-Section addresses each in turn.

#### Formal Enforcement

It should not be a surprise that these scholars have relied on formal enforcement as a way to motivate behavior. After all, much of law is based on this same premise. Enforcing a consequence for crime, for instance, is thought to deter citizens from committing crimes.[[42]](#footnote-42) Similarly, consequences for infringing intellectual property are meant to deter ordinary people from downloading music illegally.[[43]](#footnote-43) In contract law, the same conventional wisdom holds: consequences for breaching a contract—usually the award of expectation damages—should deter parties from breaching, and motivate parties to adhere to contract terms.

In the business law context, the idea of enforcement as motivation is also closely related to the idea that business contracts (and contracts in other contexts) can be understood as having two distinct stages. In the first stage, the ex ante “contract design” stage, parties negotiate and agree to contracts.[[44]](#footnote-44) In the second stage, the ex post “enforcement” stage, parties who breach contracts have to pay for and deal with the aftermath in litigation.[[45]](#footnote-45) There is a connection between the ex ante design stage, and the ex post enforcement stage.

Sophisticated parties make a thoughtful trade-off between incurring cost in the design phase and incurring cost in the enforcement phase.[[46]](#footnote-46) If parties invest more time and money in the design stage, their contracts presumably become more precise and more clear.[[47]](#footnote-47) This means that they are likely to be litigated—or, if litigated, the parties will expend fewer resources in that litigation, which will presumably take less time. However, parties may also choose to spend less time drafting an agreement in the design phase—which results in a vague, boilerplate, or not-as-thoughtfully constructed agreement—on the theory that an enforcement action is unlikely.[[48]](#footnote-48) Other scholars have described incidences where expending less time in design makes sense. For example, material adverse change clauses in acquisition agreements are vague—but they are also rarely enforced, which makes it sensible for parties not to expend too much time and effort making the clauses specific in the design phase.[[49]](#footnote-49) Sometimes, however, deal parties have also learned the hard way that lack of attention in the design phase can lead to unexpected, highly negative outcomes in the enforcement phase. In the recent *Martin Marietta* case, for example, M&A deal parties entered into a fairly standard confidentiality agreement without much negotiation.[[50]](#footnote-50) In the subsequent enforcement phase, the agreement cost the buyer the opportunity to close a $5.5 billion hostile takeover (which was enjoined), and cost both parties significant legal fees.[[51]](#footnote-51)

When parties draft a contract, they are not trying to avoid litigation—they are not trying to maximize precision and clarity. Rather, parties are trying to minimize overall costs associated with the contract—which means that they must also take into account the cost of later litigation. As other scholars have noted, this means that the cost of a contract is not just the cost of drafting, ex ante, the contract provisions. Rather, the cost of a contract is the sum of the ex ante stage and the enforcement phase.[[52]](#footnote-52)

#### Informal Enforcement

While much of the law is concerned with how formal enforcement can affect party behavior, informal enforcement can serve the same purpose when formal enforcement is unavailable or not preferred. For instance, other scholars have done much work to show that some closed communities, like those of whalers, diamond merchants and cotton merchants, have opted out of formal enforcement in public courts for contract breaches.[[53]](#footnote-53) Instead, when a breach occurs, parties substitute for formal enforcement with, for example, private trade-association sanctions—a form of informal enforcement. Even amongst those who are not repeat players, contract parties can opt out of court enforcement and into private arbitration.

As with formal enforcement, however informal enforcement relies on the threat of punishment for breach to curb parties’ behavior. Without enforcement, either formal or informal, there seems to be little incentive for parties to play by the rules. In other words, scholarship on preliminary agreements aligns with contract theory in general: the literature suggests that preliminary agreements are useful and efficient, and further suggests that enforcement—through reliance damages—plays an important role in motivating parties to keep using them.

## Dealmaking in Practice

The conventional wisdom is that parties rely on preliminary agreements to resolve complexity and uncertainty—and that the threat of enforcing those agreements is what makes parties abide by their terms. In particular, when one party breaches a preliminary agreement, the other party can sue for an award of reliance damages.[[54]](#footnote-54)

But these explanations for preliminary agreements—and how they should be enforced—are incomplete. This Section presents an alternative view. First, it shows that preliminary agreements are very “sticky”—that is, they appear to have strong influence on parties’ behavior. Once parties sign a preliminary agreement, they are very likely to sign definitive contracts, and on similar terms to the non-binding ones set forth in the preliminary agreement. Second, preliminary agreements are sticky even though enforcement for breach is weak. There is both very little litigation (formal enforcement) and very little reputational damage (informal enforcement).

This presents a puzzle that seems to contradict what scholars have observed about not just preliminary agreements, but contracts and legal frameworks generally: that is, parties appear to adhere to contract terms even in the absence of enforcement. If this holds true across other areas of the law, it would suggest that law has little role to play in motivating behavior—which would be very odd, indeed. This puzzle sets the stage for Part II, *infra*, which introduces the concept of deal momentum to explain why unenforced, non-binding preliminary agreements have such a hold on parties’ behavior.

Previous work in this area has focused on surveys of enforcement outcomes. This Article relies, instead, on original interviews with practicing deal lawyers and previously unsurveyed practitioners’ literature to bring fresh insight from the front lines of deal design. It also supplements these with a traditional survey of court cases in common business jurisdictions.

This Section is organized as follows. First, it shows that preliminary agreements are sticky. Then, it shows that stickiness persists *despite* weak enforcement for breach. While existing scholarship examines sanctions through the lens of formal enforcement, this Article also presents findings about informal enforcement, gleaned from interviews.

### Stickiness

Once signed, preliminary agreements appear to have exceptional binding power, in two ways. First, once parties sign an agreement, they tend to follow up by entering into a definitive acquisition agreement. Deals in which parties use preliminary agreements also appear to have high completion rates. Second, parties tend not to stray too far from the business terms agreed to initially in the preliminary agreement, even though those terms are specifically deemed non-binding.[[55]](#footnote-55) This Article describes these two characteristics, together, as preliminary agreements’ “stickiness.”

Stickiness is surprising in two ways. First, it is a surprise that preliminary agreements so often lead to parties signing a definitive contract. Scholars describe preliminary agreements as a tool that parties use specifically when they do not have enough information to sign a definitive contract. After signing a preliminary agreement, parties theoretically engage in due diligence that should, sometimes, reveal information that makes the deal not worthwhile, or that makes a deal counterparty unfeasible. The fact that preliminary agreements almost always lead to deals suggests that parties almost never find information in due diligence that changes parties’ decisions about whether to do a deal. This would be a surprise. It would suggest that due diligence is expensive and time-consuming, but largely useless—and yet, it is a common practice in which sophisticated parties continue to engage. In other words, if parties use preliminary agreements when deals are uncertain, it seems odd that uncertain deals tend to lead to definitive contracts and deal completion.

Second, it is a surprise that parties tend to hew closely to the business terms initially agreed to in the non-binding preliminary agreement. Legally, parties are only required to negotiate in good faith toward a definitive deal. However, parties appear to go beyond that duty, and to abide closely by the specific business terms outlined in the preliminary agreement. That is, while a duty to negotiate in good faith does not require parties to adhere to the specific business terms outlined in a preliminary agreement, parties appear to feel bound by those terms anyway. If parties do need to renegotiate business terms, they tend not to do so without at least offering a reason for the deviation.

This is particularly puzzling in light of the lengths to which parties go to ensure that, as a legal matter, preliminary agreements are neither binding nor enforceable. For example, parties routinely include the words “non-binding” on every agreement page and add provisions that allow parties to walk away from the agreement without consequences.[[56]](#footnote-56) To avoid even the *inference* that a preliminary agreement is binding, deal lawyers often advise their clients not to sign the agreements.[[57]](#footnote-57) Nonetheless, business terms appear sticky.

### Weak Enforcement

#### Formal enforcement

While preliminary agreements tend to be sticky, enforcement for preliminary agreement *breaches* appears to be limited and weak. A comprehensive survey of preliminary agreement litigation between business parties revealed that very few preliminary agreement cases were litigated to opinion in those jurisdictions.

One important exception is the *SIGA* case, which wound its way through the Delaware Chancery and Supreme Courts twice in a decade-long litigation over a letter of intent.[[58]](#footnote-58) Each time the courts decided a significant chapter of the *SIGA* litigation, law firms issued client alerts and memoranda—which this Article calls “practitioner literature”—that dissected the meaning of the decision for preliminary agreement-making in M&A deals. A thorough survey of practitioner literature also shows that practitioners were surprised by the Delaware courts’ various decisions to enforce a preliminary agreement that had been marked “non-binding.”[[59]](#footnote-59) This reaction is not a surprise: preliminary agreements are rarely litigated—in other words, enforcement for breaches is weak—so when they are, practitioners find the result unusual.

Interviews with deal lawyers also revealed that deal lawyers believe that enforcement for preliminary agreement breaches is rare. This is in spite of the fact that deal lawyers, in general, showed a sophisticated understanding of enforcement options available to them—most of the deal lawyers interviewed understood that preliminary agreements obligated parties to negotiate in good faith toward a definitive agreement, and that breaching that duty could result in an award of reliance damages.[[60]](#footnote-60)

Despite understanding the law, however, deal lawyers nonetheless presented a very different account—in several ways—of how enforcement of preliminary agreements plays out on a practical level.

First, deal lawyers describe actively trying to contract out of the legal default to negotiate in good faith toward a definitive deal. Most lawyers said that they regularly drafted provisions stating that parties could walk away from a preliminary agreement at any time, for any reason.[[61]](#footnote-61) Some lawyers took this further, and described provisions in which the parties agreed that they have no obligation to negotiate in good faith.[[62]](#footnote-62) They also described using exceptional care to make sure that their preliminary agreements are “non-binding” and “non-enforceable.” Lawyers use a variety of techniques to achieve these goals: they include document footers that read “non-binding,” they advise their clients not to sign the agreements (so that the agreements do not look like contracts), and they include provisions specifying which agreement provisions are enforceable (usually confidentiality, exclusivity, and one or two others) and which are not enforceable (the business terms).[[63]](#footnote-63) For example, one lawyer said of letters of intent that they are, “as a general proposition, non-binding,” and another described them as presumptively non-binding, but with some binding provisions, like those governing exclusivity or confidentiality.[[64]](#footnote-64) One lawyer noted that “pretty much on every page, we have something that says that this is a non-binding agreement,” while another noted that he went through “great pains to put in the agreement in ten different ways” that it was non-binding.[[65]](#footnote-65) One lawyer had entered into a binding term sheet—one that would be binding even if the parties did not eventually sign more detailed definitive documents—but also mentioned that in drafting that particular term sheet, he could find almost no precedent for such a transaction within his firm (which employs several hundred deal lawyers, and which is a leading deal firm).[[66]](#footnote-66)

Second, deal lawyers also expressed that even if preliminary agreements *could be* enforced, as a legal matter, they are so rarely enforced that enforcement is not considered a real possibility. Lawyers expressed several reasons for not considering enforcement a real possibility. First, they believe that the duty to negotiate in good faith is an extremely easy duty to meet, and that proving a breach of that duty in a litigation would be extremely hard.[[67]](#footnote-67) One lawyer, for instance, noted that “sometimes people do disavow what’s in the term sheet because of a change in circumstances . . . . I wouldn’t necessarily consider that bad faith.”[[68]](#footnote-68) When asked about the duty to negotiate in good faith the same lawyer replied: “[The duty] may be binding, but good luck proving failure to negotiate in good faith.”[[69]](#footnote-69) Another lawyer notes that he has “seen plenty of deals where buyers walk—they find something better, the numbers don’t play out, they haven’t had much faith the management team. Deals fall apart all the time before an agreement. But as far as bad faith, I’ve not been involved in any situation where the seller thinks the buyer is trying to steal [confidential information].”[[70]](#footnote-70)

Third, when asked about their experience with preliminary agreement enforcement, only two of the twelve lawyers interviewed had even heard of a threatened litigation over a preliminary agreement.[[71]](#footnote-71) One Silicon Valley lawyer noted that she has never been in a situation where there have been ramifications for walking away from a term sheet.[[72]](#footnote-72) None had worked personally with a client who had been involved in a preliminary agreement litigation, none had threatened enforcement, and none had been on the receiving end of such a threat.

The lack of appetite for formal enforcement makes economic sense. Commercial litigation between sophisticated parties is exceptionally expensive.[[73]](#footnote-73) Compared to the cost of litigating a dispute to opinion, at the preliminary agreement phase, parties have often invested relatively little in the transaction. The cost of litigating quickly eclipses the investment.

One lawyer described the loss of having a party walk away from a preliminary agreement as a “sunk cost”:

Generally, there’s nothing you can do [if the parties walk away from a preliminary agreement]. [The preliminary agreement] will usually say this expressly that either party will walk away for any reason or no reason. Unless you can show fraud or some other behavior that is otherwise actionable on a standalone basis, you view it as a sunk cost in your business.[[74]](#footnote-74)

The fact that lawyers account for that early cost—the cost of drafting a preliminary agreement, and the costs associated with performing the preliminary agreement—as a sunk cost may also help to explain low rates of enforcement. Litigating a preliminary agreement has many opportunity costs—litigation distracts management, and may prevent the company from pursuing other promising transactions. Rationally speaking, parties ought to write off the sunk cost of the preliminary investment and make a decision based solely on the (high) opportunity cost of pursuing litigation. This is especially true because the expected recovery of winning a preliminary agreement contest is low: in most cases, at best, the winning party can hope to recover reliance damages. In other words, the expected value of litigating a preliminary agreement breach is very low.

#### Informal enforcement

In some circumstances, informal enforcement can complement or substitute for weak formal enforcement. In the New York diamond industry, for instance, a system of internal processes substitutes for formal enforcement, even though formal enforcement is available.[[75]](#footnote-75) Amongst cattle ranchers in rural Shasta County, California, reputational sanctions between neighbors also substitutes for formal enforcement.[[76]](#footnote-76)

In those situations, “performance is encouraged and breach penalized by the cancellation of expected future dealings with the counterparty, by the loss of reputation (with the resulting reduction in future business with the potential counterparties in the relevant economic and social communities), or by an individual disposition toward reciprocity (and thus a willingness to reward cooperation and punish defection).”[[77]](#footnote-77) In other words, those who do not play by the rules are punished—they earn a reputation for being outside of the norm, and their future dealings are suspect. It is expected that, even when parties are not repeat players with each other, they may be deterred from bad behavior if they do not want to suffer reputational consequences within their *community* that may later translate to a loss.[[78]](#footnote-78)

The community of M&A parties, however, is not like that of diamond merchants or rural cattle ranchers. For one thing, the community of M&A parties does not appear tight-knit. While certain subsets of M&A parties are repeat players—for example, serial acquirers or private equity firms—many M&A parties enter the market rarely. As a result, parties are not repeat players within the community, and their reputations, good or bad, are less well-formed (and are less important, as they will not be using them in a future transaction).

Moreover, when interviewed, deal lawyers report, at most, mixed consequences for parties who back out of preliminary agreements. One Silicon Valley lawyer, for instance, noted that companies that serially breach preliminary agreements *do* gain a bad reputation. “In the tech world, [if] some serial buyer approaches the sellers, . . . one phone call and [the sellers] know the buyer and kind of know what to expect. If one buyer has a bad reputation, like a reputation for reneging the purchase price at the eleventh hour before signing the [definitive acquisition] agreement, that will be taken into account.”[[79]](#footnote-79)

Most other lawyers, however, note that parties with reputations for backing out of preliminary agreements are only minimally punished on the market, if at all. For instance, a New York lawyer began by noting that “if there was someone who routinely didn’t get deals done, that would become market knowledge, and be taken into account when thinking about whether the deal will go through.”[[80]](#footnote-80) He immediately qualified the statement, however, by noting the deals are very fact-specific, and that “the color of their [the serial breacher’s] money is the same as everyone else’s.”[[81]](#footnote-81) Another Silicon Valley lawyer made a similar statement: “There are buyers that have a reputation for being willing to renegotiate some of the terms. But it’s often based on stuff that they find in due diligence. Everyone knows going into the term sheet [that] it’s all subject to the buyer’s due diligence.”[[82]](#footnote-82) In other words, even when a party breaches a preliminary agreement, it is often thought to be the result of issues found in due diligence—a legitimate, good-faith change in facts and circumstances—rather than a result of the breaching party’s bad faith. The same Silicon Valley lawyer also notes the extremely marginal effect a bad reputation has on future deals: “It’s certainly possible in circumstances where a company is selling itself and there are multiple different people are interested in it, that if they get two bidders who were very close in price, there may be . . . [an] inclination to go for the other one [the bidder who does not have a reputation for breach.” She notes, however, that management must still look out for investors’ interests, and investors are interested in getting as high a price as possible.

\* \* \*

Existing explanations suggest that parties use preliminary agreements to solve for deal complexity and deal uncertainty. Because both of those lead to the efficient completion of deals, it is important to motivate parties to enter into and be held accountable to preliminary agreements. Thus, preliminary agreements ought to be backed by the threat of reliance damages for breach. In other words, as in other contracts and contracting literature, the existing literature about M&A preliminary agreements suggests that enforcement of agreements is important to motivate performance.

These explanations for preliminary agreements, however, appear to be incomplete. This section shows that, in M&A preliminary agreements, there is only rare, weak enforcement—both formal informal—for breach. At the same time, preliminary agreements are “sticky”—once signed, parties are likely to go through with the negotiation of a definitive acquisition agreement, and are likely to hew closely to the non-binding business terms agreed to in the preliminary agreement. This seems to sever the connection between enforcement and stickiness, which is relied on heavily in existing theories. This is puzzling. What is it about M&A agreements that makes them sticky, without the usual threat of enforcement? Part II presents a theory of deal momentum to explain this phenomenon.

### A Note on Methods

Existing scholarship on preliminary agreements has focused on the results of enforcement—i.e., reported opinions from cases that are litigated to a decision. But these enforcement surveys are necessarily incomplete, because most commercial litigations settle out of court[[83]](#footnote-83)—and settled suits are not accompanied by reasoned judicial opinions that shed light on the circumstances of dealmaking.

This Article brings previously un-surveyed qualitative data to the debate in order to close this gap in the literature. This Article relied on three types of inquiry, which are described in more depth below. First, it conducted a series of interviews with practicing deal lawyers. Then, it conducted a survey of practitioners’ literature. Finally, it conducted a traditional survey of preliminary agreement cases in jurisdictions with high volumes of complex business litigation. Each is described in more depth below.

* + - 1. Interviews

At the heart of this Article are the original interviews. Preliminary agreements are used in private M&A deals, where the terms of the deals—and the terms of the preliminary agreements—are not disclosed to the public. Moreover, preliminary agreements are rarely litigated, so information about preliminary agreements cannot be found in opinions or filings. Original interviews—until now, overlooked in the literature—are the best source for understanding this common deal practice.

Interviews were conducted with twelve deal lawyers who have substantial M&A practices. Most of the deal lawyers interviewed were trained in and practiced in New York or California, although a few interviewees were trained in or practiced in Virginia, Texas, or Illinois. Seven of the interviewed deal lawyers had more than 20 years of experience advising M&A clients. The interviewee with the fewest years of experience—seven—primarily advises on private M&A deals, which is the most relevant type of M&A deals for a study of preliminary agreements.[[84]](#footnote-84)

* + - 1. Practitioners’ literature survey

Law firms with corporate practices often publish client alerts and memoranda. In the ten years that it took *SIGA* to wind its way through the Delaware courts, for instance, many practitioners issued alerts and memoranda to update their clients on the results of the case. Because practitioners publish this literature in order to generate business, these alerts do not stop at analysis of the case: they also include high-level opinions and advice about how a case will shape the legal landscape, or how a case should inform practices and norms going forward.

This “practitioners’ literature” is often overlooked as a research source, but is, in fact, a rich source of information. In the case of preliminary agreements, practitioners’ literature provides a reasonable proxy for large-scale survey or interview data. To survey the practitioners’ literature on preliminary agreements, this Article relied primarily on the digital archives of the Bloomberg database, which attempts a comprehensive collection of practitioners’ literature. In addition, a general search of practitioners’ literature was conducted. This yielded results from, for instance, the Harvard Corporate Governance Law Forum and the law firm Fried Frank’s analysis archives, both of which are oft-cited and respected sources for practitioners and academics alike.

* + - 1. Litigation survey

A comprehensive survey was conducted of litigation in all state and federal courts in New York and Delaware relating to preliminary agreement dispute in business transactions. This Article focused on New York and Delaware because of the relatively high number of business disputes between sophisticated parties that are litigated in those forums. The survey of these cases found that there were only 21 opinions published between the ten-year period from June of 1996 to June of 2006. This is a very small number compared to the overall volume of private M&A deals. While the exact number of private M&A deals is hard to count—precisely because they are private, and therefore not always disclosed—overall deal volume provides a rough benchmark. In 2014—one of the years surveyed—companies announced 9,802 deals.[[85]](#footnote-85) Another survey suggests that in the last month of 2016—just outside of the surveyed timeframe—106 private equity deals were announced.[[86]](#footnote-86) The very small number of opinions during the surveyed period supports interviewees’ accounts that very few preliminary agreements are disputed, and those that are disputed are very rarely litigated to opinion.

# Deal Momentum

The conventional wisdom is that contract enforcement and contract adherence go hand-in-hand. Specifically, enforcing a contract—whether formally or informally—motivates parties to abide by the contract’s terms, even when the terms are inconvenient. M&A parties, however, appear to break that rule: after they enter a non-binding preliminary agreement, M&A parties appear to adhere to the terms, even though enforcement is extremely weak.

This Part explains why M&A parties behave as they do. Specifically, it introduces a theory of deal momentum: the idea that, at some point in a deal’s lifecycle, parties have invested in and investigated the deal to such an extent that enough momentum accrues to push the deal forward, even in the absence of a preliminary agreement. In other words, preliminary agreements are better understood as signposts for the accrual of deal momentum, rather than as contract-like devices.

The remainder of this Part proceeds as follows. Part A suggests that existing scholarship misunderstands when parties enter into preliminary agreements. Existing scholarship suggests that preliminary agreements are first steps, and that, when parties enter into them, there is still much uncertainty to be resolved. This Part shows that parties enter preliminary agreements later than other scholars have described. Specifically, parties enter into preliminary agreements after they have already resolved material uncertainty through initial due diligence. There is very little uncertainty left to resolve by the time the parties enter a preliminary agreement—which, in turn, suggests that the uncertainty rationale for preliminary agreements is perhaps not as robust as it appears. Part B, then, proposes an alternative explanation for why parties enter into preliminary agreements. Specifically, it posits that preliminary agreements have both formal and substantive aspects. While the literature has focused exclusively on the substantive aspects—preliminary agreements’ resemblance to contracts, and the need to enforce them as such—preliminary agreements are, in reality, largely valuable because they contribute form and formality to an otherwise unstructured dealmaking phase. In other words, preliminary agreements are not very useful as contracts, but quite useful in that they can help parties signal, organize, attach moral suasion, and increase verification of deal counterparties. Finally, Part C considers some alternative theories to explain M&A parties’ adherence to non-binding, unenforced agreements.

## Not-So-Preliminary Agreements

Perhaps the first place where the literature on preliminary agreements deviates from modern practice is in its description of *when* parties enter into a preliminary agreement. For the most part, the literature describes the preliminary agreement as the first step in dealmaking. Imagine, for instance, two CEOs meeting for coffee, thinking that they wish to do a deal, and scrawling some basic ideas on the back of an envelope. Having formed this extremely basic plan for doing a deal, the parties then separate, resolve uncertainty about the deal—perhaps by investigating each other as potential business partners, or by investigating whether their collaboration would be profitable. After some time, the CEOs then regroup to hash out the details of their deal.[[87]](#footnote-87)

When asked, even deal lawyers offer answers that, at least facially, support the literature’s description. At many stages in a deal’s lifecycle, bankers and lawyers engage in the process of “due diligence”—they investigate the other potential deal partner to see if that party is a good fit for a merger or acquisition.[[88]](#footnote-88) For instance, a buyer can find out, through a review of the target’s organizational documents and contracts, whether the target is duly organized, financially sound, and able to sell the assets that it claims to sell.[[89]](#footnote-89) Due diligence for a large M&A deal can be an expensive, and labor-intensive, undertaking: it “is not simply first-year lawyers looking through boxes of documents. The process also includes experts in various areas, . . . [and] covers any issue that a buyer or investor would possibly care about.”[[90]](#footnote-90) Deal lawyers, in describing the deal process, tend to describe the bulk of due diligence as being done before the preliminary agreement is signed, and before the definitive documentation is signed.[[91]](#footnote-91) In other words, in a deal timeline, the preliminary agreement is signed, *then* uncertainty is resolved through due diligence, *then* business terms are decided.

Both the literature and deal lawyers, however, overlook an important distinction between the *quantity* of due diligence and the *materiality* of due diligence. Indeed, between the preliminary agreement and definitive documentation, parties engage in a high-quantity due diligence process—both the literature and deal lawyers agree on that point.[[92]](#footnote-92) This quantity, however, does not necessarily represent the process’s importance in determining the deal’s business terms. For instance, many lawyers note that, despite the quantity of the diligence done between the preliminary and definitive agreements, the information discovered in that diligence only “sometimes” causes the parties to renegotiate business terms.[[93]](#footnote-93)

Rather, the majority of the material diligence—information that would have an effect on purchase price, for instance—is obtained prior to the parties signing the preliminary agreement. Consider, for instance, a company that is auctioning itself. In preparation for accepting bids, that company will put much of its relevant financial information in a physical or virtual data room on which potential bidders conduct “preliminary” due diligence.[[94]](#footnote-94) That preliminary due diligence, however, is perhaps the most important—it is the information on which the potential buyer determines the most important business terms.[[95]](#footnote-95) In fact, at least one publication by non-lawyer deal advisors describes the due diligence process as largely being completed in the pre-preliminary agreement phase. The diligence that is conducted after the preliminary agreement is described as “final diligence” that “generally serves to confirm the consistency and material accuracy of representations made by the target company.”[[96]](#footnote-96) While the buyer will “often . . . uncover information that will warrant [it] to revise its valuation . . . ,” the message is clear: from the perspective of bankers, who set the deal price and negotiate the preliminary agreement’s material business terms, the bulk of diligence is done before parties sign the preliminary agreement. The voluminous diligence that lawyers do between the preliminary and definitive agreements is high in quantity, but confirmatory, rather than material, in nature.

Distinguishing the quantity of due diligence from the materiality of due diligence suggests an amendment to the conventional understanding of when parties enter into a preliminary agreement. The conventional understanding suggests that parties enter into preliminary agreements at the very beginning of the deal: relatively little diligence has been done, so much uncertainty is yet to be resolved. By distinguishing between bulk and materiality, however, it becomes apparent that parties into preliminary agreements after the bulk of the *material* due diligence is complete. As a result, preliminary agreements can be understood as not very preliminary—they are entered into when enough material has been examined to determine, with some certainty, important business terms like price.[[97]](#footnote-97)

Another way to think about bulk and materiality of diligence is to reframe the deal timeline from the perspective of bankers and businesspeople. As Choi and Triantis note, the time period between the preliminary agreement’s signing and the definitive agreement’s signing is characterized by the addition of experts—such as lawyers—to resolve the deal’s uncertainty.[[98]](#footnote-98) This suggests that, often, lawyers become heavily engaged in the deal only after the parties have signed the preliminary agreement. From a deal lawyer’s perspective, then, the real work of the deal begins after the preliminary agreement. From the perspective of the bankers and businesspeople, however, the deal is, in broad strokes, finalized at the preliminary agreement stage. This framing also helps to explain why preliminary agreement terms remain largely unchanged after the agreement’s signing—they are business terms that are negotiated by bankers and businesspeople, who have already completed the bulk of their relevant diligence prior to the agreement’s signing.

## Preliminary Agreements as Signposts for Deal Momentum

Pinpointing when parties enter preliminary agreements presents an interesting puzzle: if preliminary agreements are not meant to be early contractual tools that help parties resolve uncertainty,[[99]](#footnote-99) then why do they exist? And if deals are close to being finalized by the time parties sign the preliminary agreement, why do parties divert from the process of negotiating the definitive agreement and expend time and resources drafting a non-binding, unenforced preliminary agreement?

This Section offers an alternative explanation for why and how parties use preliminary agreements. It begins by distinguishing between an agreement’s formal and substantive functions. Then, it suggests that preliminary agreements are not primarily powerful because of their resemblance to contracts. Rather, preliminary agreements are powerful because they lend form and formality to an otherwise unstructured phase of the negotiation process, and are thus better understood as signposts for when sufficient deal momentum has accrued than as contracts. In other words, there comes a time in a deal’s lifecycle when the parties have resolved enough uncertainty that they are likely to do the deal. The preliminary agreement marks that moment—when, with or without a preliminary agreement, a deal is likely to go forward.

### Form and Substance in Preliminary Agreements

In his seminal article *Consideration and Form*, Lon Fuller argued that there are both formal and substantive reasons to attach consideration to contracts. By way of example, Fuller notes that “it has been said that enforcement of gratuitous promises”—that is, promises without consideration—“is not an object of sufficient importance . . . to justify the expense of time and energy necessary to accomplish it.”[[100]](#footnote-100) This, Fuller notes, is a substantive objection, because it relates to the significance of the promise made—promises without consideration are not substantively important. In contrast, most arguments about the need for consideration relate to the importance of form. Fuller identifies three broad categories that characterize the functions performed by legal formalities—the evidentiary function (creating evidence of a contract), the cautionary function (forcing parties to consider the contract more carefully), and the channeling function (signaling to the outside world that the contract is enforceable).[[101]](#footnote-101)

Preliminary agreements, too, have both formal and substantive functions. The literature has focused only on the substantive aspects of preliminary agreements. Specifically, the literature attributes a preliminary agreement’s usefulness to the threat of potential remedies for breach (i.e., the award of reliance damages). Like in contracts, the threat of enforcement of a preliminary agreement is meant to incentivize adherence. But there is significant evidence to suggest that the primary contribution of a preliminary agreement is not its substance, but its form, and the formality it lends to the negotiating process. Specifically, preliminary agreements are vehicles through which parties can accomplish several goals. Through the formality of a preliminary agreement, they can signal to each other and attach moral suasion to their non-binding agreement. Through the form of a preliminary agreement, parties can organize their early collaboration, and introduce a set of reputational gatekeepers—lawyers—that will help them further solidify their certainty in the deal.

### Signaling

In the early stages of deal negotiation, parties make very few promises to each other, formal or otherwise.[[102]](#footnote-102) They do, however, begin sinking costs into investigating each other as potential deal parties, and begin considering the value of the potential deal.[[103]](#footnote-103) At some point, material due diligence is largely complete, and parties are positioned to begin the expensive process of negotiating a detailed definitive agreement. But before then, parties enter into a non-binding preliminary agreement

An important reason that parties incur the expense of entering into non-binding, unenforced preliminary agreements is to signal to one’s deal counterparty that one is a good deal partner. One of the most puzzling interview results is that the deal lawyers interviewed reported seemingly contradictory information about the consequences for a preliminary-agreement breach. On one hand, they almost uniformly reported that breaching a preliminary agreement had “no effect” on a non-repeat-player deal party’s reputation—or that the reputational damage was relatively mild.[[104]](#footnote-104) At the same time, deal lawyers also reported that parties, even (or especially) those that were not repeat players in the M&A market, cared about “their word,” or having a reputation as an “integrity player.”[[105]](#footnote-105) These observations seem almost diametrically opposed: why do non-repeat players care about their reputations, if breaching a preliminary agreement appears to have little effect on their reputations?

One explanation is that even non-repeat players, who do not care about their reputation on the broader M&A market, care about their reputation within the context of that particular transaction. M&A dealmaking is a multi-stage process: after the preliminary agreement, there is more exchange of information, a more thorough round of deal negotiations, and potentially weeks or months of daily or near-daily interaction with one’s deal partner.[[106]](#footnote-106) In each stage, there is even more granular opportunity for negotiation and interaction. And, if the deal completes—which is everyone’s goal—many of those who interacted during the M&A process may continue to work together indefinitely. For instance, the target’s key employees, who were involved in the deal process, may agree to work for the buyer for a period of time, or indefinitely. Thus, even non-repeat players take on the roles of repeat players within a particular deal. Framed this way, it becomes clear why lawyers describe deal parties as caring about their reputations. A preliminary agreement is one of the deal parties’ first opportunities to interact with each other, and to prove that they are trustworthy deal parties. Adhering by deal terms—especially non-binding terms—helps to build one’s reputation within the context of that deal, which presumably smooths the transaction process going forward.

Preliminary agreements may also serve another signaling function. Because they are signed when there is enough deal momentum for a deal to go forward, parties may also wish to enter a preliminary agreement to signal that they have reached that tipping point. One lawyer, for instance, drew an analogy between preliminary agreements and giving gifts when dating: “You go on dates, . . . but that doesn’t mean you’re getting married. But you give gifts sometimes. It means some level of commitment.”[[107]](#footnote-107) In other words, preliminary agreements signal to deal parties that one is interested enough and serious enough to undertake the expense of negotiating and signing a preliminary agreement.

Thus, even though nothing legally prevents a party from deviating from the preliminary agreement’s terms, adhering to the terms may serve important signaling functions to one’s deal partner, making the preliminary agreement an attractive step to take.

### Organization

The formal process of entering into a preliminary agreement also serves organizational purposes. One deal lawyer, for instance, described having a central document to focus on as the primary reason for having a term sheet:

It helps me and the deal team focus on whether there’s a deal to be had. Too many times the business people come and they think they have a great idea. Like, I’m going to put my chocolate in your peanut butter. You have to sit back and be like, that’s great, but who’s going to pay for the packaging? The marketing? How about employees? [A term sheet] helps both sides knock out the material terms and figure out if there’s a skeleton to get the deal done.[[108]](#footnote-108)

Other deal lawyers described a similar purpose for using preliminary agreements: to “mak[e] sure there’s a meeting of the minds on fundamental deal provisions,”[[109]](#footnote-109) to “make sure the parties are in the same ballpark,”[[110]](#footnote-110) and “even though it’s non-binding, it helps to solidify whether there’s a meeting of the minds on the material agreements.”[[111]](#footnote-111)

Relatedly, preliminary agreements can be a tool for getting the attention of upper management and to create a central document on which the board of directors can vote. And, lawyers note that having a tangible document—even one that is unsigned or specifically marked non-binding—helps management feel “comfortable that this is a real offer” and that there is basic agreement that justifies “getting the bankers spinned up and the attorneys spinned up and getting the internal people and the accounting [and] finance people involved.”[[112]](#footnote-112) In other words, even though the preliminary agreement is non-binding, preliminary agreements can be a useful tool around which upper management can have discussions and focus their efforts.

In addition to using preliminary agreements to aid in internal organization, parties might also agree to enter into a preliminary agreement to organize necessarily external affairs. For instance, lawyers report using preliminary agreements to begin the antitrust review process, or to solidify financing for a leveraged deal.[[113]](#footnote-113)

### Attaching Moral Suasion

Deal parties and deal lawyers also use preliminary agreements to attach a sense of moral obligation to a preliminary bargain.

Many lawyers report that even non-repeat players care about such squishy factors as morality and integrity. One deal lawyer notes that “even if [M&A parties] aren’t repeat players in the market, most players want to be seen as integrity players. At the time they enter into the [letter of intent], they have a good faith intention to do the deal.”[[114]](#footnote-114) Multiple deal lawyers reported that preliminary agreements created some kind of integrity bond. They noted, for example, that a deal party might not ask for a change in a term sheet’s business terms because “they cannot go back on their word” and because an M&A deal party’s business people, who negotiated the preliminary agreement’s terms, “want not to go back on their word.”[[115]](#footnote-115) Another lawyer described having a senior colleague explain to him that a term sheet is a “gentleman’s agreement” and if someone backed out, the senior colleague “would say, ‘You gave me your word, and now you’re trying to back away from your word?’”[[116]](#footnote-116) Repeatedly, lawyers called preliminary agreements “gentlemen’s agreements” or “handshake agreements”[[117]](#footnote-117)—terminology that suggests that, while these agreements are non-binding, parties believe that they attach a level of moral suasion.[[118]](#footnote-118) While the amount of legal obligation that parties take on when they enter a preliminary agreement is very small, the attachment of moral obligation actually causes parties to act with more adherence to the bargain than could be motivated by legal obligation alone.

Moral suasion is the process through which actors are encouraged to act a certain way not because of material incentives, but because of normative, or moral, appeals. Regulators, for example, sometimes appeal to private actors’ sense of morality or altruism in order to ensure compliance, rather than ensure the same through formal sanctions. Moral suasion can also compel parties to take on activities that are not economically in their best interest.

In preliminary agreements between M&A parties, moral suasion is particularly important for two reasons. First, deal parties do not think of their agreements as formally enforceable, as a legal matter. Moral suasion allows parties to add seriousness and heft to agreements that otherwise have none. Second, moral suasion in this context differs slightly from other forms of informal enforcement. Most informal enforcement is forward-looking: when a non-breaching party informally enforces a breached agreement, their recourse against the breaching party is, for example, to deprive the breaching party of future interactions. Because many M&A deal parties are not repeat players—they may enter the M&A market very infrequently—it is easy to think of them as being judgment-proof from informal sanctions. But attaching moral suasion—a non-forward-looking riff on informal sanctions—allows M&A deal parties to use a form of informal sanction, even though they may not interact with that deal counterparty again in the future.

### Verification

Although deal lawyers generally report that serial preliminary-agreement breachers suffer from few, if any, reputational consequences, the same may not be true of deal advisors. Where deal parties themselves are immune to informal enforcement, the reputation of related repeat players—such as investment bankers and lawyers that advise on the deal—may play a role.

Deal advisors can be thought of as gatekeepers—independent entities that serve as an outside monitor, “who screens out flaws or defects or who verifies compliance with standards and procedures.”[[119]](#footnote-119) The role of gatekeepers in curbing bad behavior is well developed in the corporate governance literature. Gatekeepers have two different roles. They can be in a position “to prevent wrongdoing by withholding necessary cooperation or consent,” or they can be “reputational intermediaries to assure investors as to the quality of the ‘signal’” sent by another entity. In the literature, auditors are “the paradigmatic examples of ‘gatekeepers’—independent professionals who are interposed between investors and managers in order to play a watchdog role that reduces the agency costs of corporate governance.”[[120]](#footnote-120)

In the case of M&A deals, deal advisors can play the role of reputational intermediaries. For example, a handful of elite law firms advise most M&A deal parties, and even when their clients are not repeat players, the law firms are.[[121]](#footnote-121) Thus, even when deal parties are not concerned with reputational losses from breaching preliminary agreements, their lawyers will be concerned, and may advise their clients to think carefully both during the entry of the preliminary agreement and before walking away.

\* \* \*

In each of these cases, preliminary agreements are not useful because they are quasi-contractual. Rather, they are useful because they are a central document that parties can use as a reference, or to organize their affairs, either internally or externally.

Preliminary agreements are not quasi-contractual tools at all. They do not set up frameworks in which parties can resolve deal uncertainty. Enforcing them is not necessary to encourage efficient dealmaking. Rather, preliminary agreements merely mark a moment in time when parties have resolved enough uncertainty that a deal is likely to occur, whether or not they actually set forth their dealmaking intent on paper in a preliminary agreement. In other words, preliminary agreements are not necessary to get a deal done—they are a step that parties take when a deal is all but inevitable.

One easy way to see the lack of necessity for preliminary agreements is to examine when preliminary agreements are most prevalent. Specifically, preliminary agreements are very common in private M&A deals—deals in which parties do not need to disclose the deal to securities regulators—and quite uncommon in public deals.[[122]](#footnote-122) The broad strokes of the deal contracting process remain the same, whether parties engage in a private or public deal. Parties do diligence, sign a contract, and then close the deal.[[123]](#footnote-123) In public deals, however, preliminary agreements are rare because parties do not wish to trigger the need to make a securities filing. Nonetheless, public deals are completed—suggesting that preliminary agreements are not a necessary step in dealmaking.[[124]](#footnote-124)

## Alternative Explanations

This Part has argued that preliminary agreements play a signposting function: they mark the moment in which a deal is likely to go forward. Even so, however, there must be a reason that parties go through the effort of putting up the signpost. This Part suggests that the main reasons are formal in nature: that using the preliminary agreement as a signpost helps to signal seriousness and trustworthiness, and helps parties to organize deal-related activities both internally and externally. This Section addresses, in brief, some potential alternative explanations for preliminary agreements. It begins with the observations of Part I: that preliminary agreements are sticky, even though enforcement is weak. Why?

First, it is possible that contract law scholarship is wrong: enforcement is unnecessary to motivate party behavior. In other words, while most contract scholarship has moved forward on the presumption that enforcement affects party behavior and contract design—that consequences curb bad behavior—this presumption is wrong. This suggestion, however, seems implausible. One convenient thing about contracts is that humans enter contracts constantly, both big and small. This means that one need only think back to the last contract one entered into—perhaps a disadvantageous cellular phone contract, or an overpriced residential real estate lease—and imagine whether the consequences for breach affected one’s behavior. In short, the consequences for breach do affect behavior: larger consequences appear to deter breach.

In the alternative, M&A parties’ behavior could suggest that M&A parties, and their lawyers, lack an understanding of how their preliminary agreements work. Perhaps they believe that these agreements are binding and that breach comes with serious consequences. This explanation also seems implausible. When interviewed, deal lawyers interviewed showed that they intended to make preliminary agreements non-binding. They also demonstrated a remarkably crisp understanding of the extent to which their agreements could be enforced—that is, to the tune of reliance damages.

Finally, it is possible that M&A preliminary agreements are simply not very much like contracts at all. This is the most plausible explanation, and the one advanced in this Part, *supra*. Rather than shaking up the whole of contract law scholarship, or attributing the surprising behaviors surrounding M&A dealmaking to sophisticated parties’ lack of understanding of their contracts, this Part makes the modest suggestion that M&A preliminary agreements are not, primarily, contractual tools. That is, parties do not enter into preliminary agreements intending for them be enforced like contracts. Rather, when a deal goes south after a preliminary agreement is signed, parties rarely enforce them. Parties also do not abide by their terms because they think preliminary agreements are contracts. They simply abide by the terms because it is in their best interest to do so—to send the right signals, for instance.

# Implications for Enforcement and Deal Design

Thus far, this Article has investigated the positive question: how do parties use preliminary agreements? With that question answered, this Part turns to the normative questions: if we understand preliminary agreements are signposts for deal momentum, rather than contract-like tools, how *should* parties use these tools?

This Part discusses implications for deal design and contract enforcement. It also builds on previous work, which began the process of trying to understand the theoretical and contractual boundaries of the deal. Section A argues that enforcing preliminary agreements is not only unnecessary, but potentially deters efficient use of preliminary agreements. This contravenes the conventional wisdom that enforcement is necessary to induce efficient use. This Section also considers the implications of this Article for contract enforcement more generally. Specifically, it argues that while preliminary agreements ought not to be enforced as contracts, formal contracts between sophisticated parties should still be enforced. Section B discusses the implications of how changed enforcement of preliminary agreements can—and should—change how deal parties use preliminary agreements. In particular, deal parties should embrace preliminary agreements as organizational tools, rather than as contracts.

Finally, Section C follows up on previous work examining the boundaries of a complex bargain. A previous article introduced the idea that the boundaries of a deal might exceed the four corners of an acquisition agreement, and, in fact, exist also in the many ancillary agreements that parties sign. This Section argues that perhaps the boundaries of a deal can be stretched temporally, too—to the preliminary agreement phrase. Just because the theoretical boundaries of a deal extend temporally, however, does not mean that enforcement must map on to the deal boundaries—in fact, enforcement to the edges of a deal’s boundaries may crowd out efficient private ordering.

## Enforcement

A clearer understanding of how parties use preliminary agreements also provides fresh insight for how courts should enforce preliminary agreements. It also provides courts with more clarity on how sophisticated parties memorialize deals, and, in turn, may provide courts with guidance on how to interpret and enforce contracts between sophisticated parties more generally. In this case, understanding how sophisticated parties use preliminary agreements suggests that preliminary agreements need not be enforced—and that, perhaps, enforcement actually disincentivizes parties from making efficient deals. Enforcing formal contracts between sophisticated parties, however, continues to be an important tool for motivating efficient dealmaking.

Contracts theory suggests that contract enforcement affects party behavior. In addition, more negative enforcement outcomes (for example, awards of expectation damages) should do more to motivate parties’ behavior than less negative enforcement outcomes (such as reliance damages). But that observation seems to miss an important point: that the *probability* of the negative outcome also plays a role in affecting parties’ behavior.

Consider, for example, this scenario: Jane and Anne are parties to a contract. They also agree that, if Anne breaches the contract, Anne will suffer some completely unreasonable consequence—for instance, Jane will take all of Anne’s personal belongings and set them alight on the sidewalk. In this scenario, the enforcement outcome is very negative—a breach might result in the loss of all of one’s personal belongings, in a potentially public, traumatizing, and humiliating way. However, the parties may know that the probability of enforcement is low. Even if Jane breaches, she can rest assured that the Anne is very unlikely to enforce in the way that is described. Perhaps Anne will be tempered by personal aversion to this form of enforcement, or perhaps Anne will be tempered by cost—the cost of gathering all of Jane’s belongings and building an appropriately large pyre may be too high.

Thus, when Anne is considering whether to breach a contract, the cost of breach is not that she loses her belongings. Rather, the cost of breach is the probability of enforcement—in this scenario, zero—multiplied by the negative utility of the enforcement. In other words, Anne considers the expected value of breach, rather than assuming that the probability of enforcement as 1. In this scenario, then, the expected cost of breach is close to zero. Thus, even though the enforcement outcome is very negative, Anne can breach with impunity, safe in the knowledge that the probability of enforcement is very low.

When probability of enforcement is close to zero, even very negative enforcement outcomes do very little to motivate parties to adhere to contract terms—and that appears to be true in the case of preliminary agreements. This observation is not entirely new, although it is has received limited attention in the literature. What analysis exists is situated in research about the use of rules and standards in particular contract provisions. For example, Choi and Triantis made a similar observation in an earlier article on the strategic vagueness of material adverse change clauses in acquisition agreements. In their article, they note that to parties, the cost of a contract provision is the sum of its ex ante negotiating/drafting costs, and its ex post enforcement costs. There is a trade-off between the two: more investment on ex ante drafting makes a provision clearer, which reduces ex post enforcement costs by eliminating some litigations and abbreviating others. Choi and Triantis note that material adverse change clauses have a very low probability of enforcement. That low probability might explain why those clauses are vague—parties rationally choose not to invest the high cost of ex ante negotiation and drafting, on the theory that the expected ex post cost of enforcement is low.

In the context of preliminary agreements, breaching parties can expect that the cost of breach is particularly low. For one thing, preliminary agreements are rarely enforced—which means the probability of enforcement is close to zero. Even when enforced, moreover, the breaching party pays only reliance damages—a very low cost. In other words, parties to a preliminary agreement can breach with impunity, with the understanding that the expected cost of that breach is close to zero.

This means, of course, that ex post enforcement of preliminary agreements already does very little to deter bad behavior from parties. But a clearer understanding of how parties use preliminary agreements suggests not only that enforcement does little to deter behavior—it suggests, perhaps, that formal enforcement of preliminary agreements ought to be reconsidered entirely, for several reasons.

First, and most importantly, the threat of enforcement may deter parties from using preliminary agreements as an organizational tool. Consider, for example, a scenario in which preliminary agreement breaches are enforced like contract breaches—breaching parties are responsible for expectation damages. Under this scenario, parties may be deterred from using preliminary agreements, for fear that writing down even vague, preliminary, conditional intent to do a deal might result in expectation damages for breach. To a lesser extent, attaching the possibility of reliance damages to breach may already have a similar deterring effect. In fact, parties can already be observed to behave differently because of the consequences of writing down a preliminary agreement. Public company deals, for example, almost never involve a preliminary agreement, because parties fear that writing down the preliminary agreement will trigger onerous disclosure obligations.

While a preliminary agreement is certainly not necessary to dealmaking, it may still be helpful—and the law ought to be formulated in a way that incentivizes the use of helpful tools. For example, deal lawyers describe preliminary agreements as useful organizational tools: they can be useful in forcing businesspeople to decide on deal terms, and they can be a touchstone when parties stray from the intent of the original deal. Dialing back the threat of formal enforcement may mean that parties feel more comfortable writing down their preliminary agreements, which is good, because it means that parties are able to be more organized in early dealmaking.

Second, making formal enforcement an available remedy—even if it is a rarely used one—is not costless to the public. The cost of formal enforcement is borne by both private parties (who incur litigation costs) and the public (through the expenditure of judicial resources in adjudicating these disputes).[[125]](#footnote-125) Few preliminary agreements are litigated to opinion—but it is hard to say how many preliminary agreements litigations are commenced. As soon as a litigation commences, the public begins to incur costs—reviewing a complaint, setting a motion schedule, and adjudicating motions to dismiss, for example, tie up judicial resources that could be spent elsewhere. Using judicial resources to adjudicate preliminary agreement disputes seems particularly wasteful, because parties, for the most part, appear to be able to sort through their differences without judicial intervention.

Although it may make sense to dial back on preliminary agreement enforceability, this Article does not argue that we ought to do away entirely with enforcing contracts between parties. Here, it is important to highlight a distinction between preliminary agreements (between sophisticated parties) and formal contracts (between the same).

Preliminary agreements are not contracts—they are signposts and organizational tools. When parties sign a preliminary agreement, they do not mean to create an obligation to perform—rather, they intend to organize their thoughts and actions. However, the moment when parties can organize their thoughts on paper happens to coincide with the moment when parties have already done enough diligence on each other and on the potential deal that the deal is likely to go through. The fact that these moments occur at the same time creates the illusion that preliminary agreements work like contracts—that parties agree on something, and then they perform because they are obligated to do it. In reality, however, preliminary agreements are not meant to be contracts—they create no obligation, and parties’ performance is not because of any obligation.

In contrast, contracts create a binding and enforceable obligation under the law. When parties sign a contract, they do mean to create an obligation to perform. Their performance of a particular agreed-upon term after the fact is because they are obligated to perform. The key, then, is parties’ intent: in preliminary agreements, parties do not intend to create an obligation, so they ought not be punished for failing to meet that non-obligation. In contracts, parties do intend to create an obligation, so they ought to be punished for failing to meet that obligation. And, as discussed here, the punishment—through formal enforcement and award of appropriate damages—is what motivates parties to perform the obligation they previously agreed to. Thus, keeping enforcement intact—and making that enforcement powerful—when parties intend to create obligations is important to motivating parties to keep their promises.

## Deal Design

If preliminary agreements are not enforced as contracts, parties will be more likely to use them in deals—which is a positive outcome. Thus far, this Article has spent much time arguing that preliminary agreements do not help to solve for uncertainty. Instead, it has argued that most deal uncertainty is resolved before the parties sign a preliminary agreement. But just because preliminary agreements do not increase dealmaking efficiency by solving for uncertainty does not mean that preliminary agreements do not increase efficiency in other ways. In particular, a preliminary agreement can be a valuable organizational tool, for several reasons.

From a teamwork perspective, a preliminary agreement can help to focus deal teams around a common deliverable. One lawyer, for example, noted that he went through “great pains to put in the [preliminary] agreement in ten different ways” that it was not binding, but still liked to use a preliminary agreement because “it helps me and the deal team focus on whether there’s a deal to be had.”[[126]](#footnote-126) He noted that “too many times, the business people come and they think they have a great idea. Like, I’m going to put my chocolate in your peanut butter. You have sit back and be like, that’s great, but who’s going to pay for the packaging? The marketing? How about employees? [A preliminary agreement] helps both sides knock out the material terms and figure out if there’s a skeleton to get the deal done.”[[127]](#footnote-127) Preliminary agreements are so useful as organizational tools that one lawyer described using them even when they were not shared with the other side—in other words, even when they were unilateral, and bore no resemblance to contracts. That lawyer noted that “[a t]erm sheet might be prepared even just for internal use,” to be used for talking points, and that it “may form the basis for the discussion at an early stage.”[[128]](#footnote-128)

A preliminary agreement can also help to ensure that parties are in general agreement at the start of the deal, which helps parties establish whether there is enough agreement to move forward in the deal. For instance, several lawyers loosely described preliminary agreements as a way to ensure that there was a “meeting of the minds.”[[129]](#footnote-129) One lawyer noted that he used preliminary agreements because “[y]ou want some kind of meeting of the minds before you get the bankers spinned up and the attorneys spinned up and getting the internal people and the accounting/finance involved.”[[130]](#footnote-130) Another described preliminary agreements as a way to save money and save time by ensuring that there was a “meeting of the minds on fundamental deal provisions” before engaging advisors and beginning diligence.”[[131]](#footnote-131) He noted that a preliminary agreement was a way to “make sure the parties are in the same ballpark.”[[132]](#footnote-132) Still another lawyer noted that “You generally want to make sure there’s a meeting of mind on both sides before you crank out [diligence, advisors].”[[133]](#footnote-133)

Finally, a preliminary agreement can help to minimize the costs of renegotiation. As parties move forward toward signing definitive documentation, they might legitimately forget previously agreed-to terms, or disingenuously suggest that they have “forgotten” deal terms in order have a chance to renegotiate them. A preliminary agreement—written (and possibly signed) evidence of how the parties agreed to proceed—can help to stop some of those renegotiations before they become too costly. One lawyer, for instance, noted that “If someone tries to renegotiate something in a term sheet, and if I’m not trying to renegotiate, then I’ll point to the term sheet. I’ll say ‘we entered into this term sheet for a reason.’”[[134]](#footnote-134)

Although preliminary agreements are valuable organizational tools, they are under-utilized in public deals. At present, deal lawyers use preliminary agreements almost exclusively in private deals. Deal lawyers shy away from using preliminary agreements in public deals, for fear that signing a preliminary agreement will trigger a public disclosure obligation.[[135]](#footnote-135) There are many reasons to avoid public disclosure of a preliminary agreement. For one thing, filing a public disclosure requires additional cost. For another, preliminary agreements are, by nature, preliminary and subject to change. Disclosing their terms before the parties have fully vetted each other through the diligence process can send incorrect signals to the public, and cause the market to react in ways that are unforeseen—and, in the parties’ eyes, inaccurate. Perhaps most importantly, parties might fear that a change in the preliminary agreement after it has been publicly disclosed will be received poorly by the market. For instance, after the parties sign a preliminary agreement, the buyer may cancel the deal because it is unable to secure financing, or because it has changed its business plan. The public, however, might interpret the deal cancelation as evidence of a defect in the target company. Fear of these misinterpretations causes parties in public deals to avoid—rationally—the risk associated with filing a preliminary agreement.

But deals—whether public or private—face similar organizational challenges. In fact, public deals may be harder to organize than private deals—for instance, disclosure and reporting requirements imposed upon public companies add another layer of complexity to deals. Already, lawyers in both public and private deals use some of the same tools to address organizational complexity. For example, deal lawyers use signing and closing checklists to keep track of the deal’s many tasks and documents.[[136]](#footnote-136) These detailed to-do lists outline each step of the deal, who is responsible, and the status of completion.[[137]](#footnote-137) Deal lawyers in both types of deals also use working group lists, which help parties organize and identify the many players involved in the transaction—deal lawyers representing all parties, regulatory specialists, and in-house point people, among others.[[138]](#footnote-138)

Preliminary agreements can be another useful organizational tool in a deal lawyer’s toolkit. Making a clearer distinction between preliminary agreements and contracts is a first step toward incentivizing deal parties to use preliminary agreements as organizational tools. Parties in public deals shy away from *signing* preliminary agreements, for fear that signed agreements might be construed as contracts that need to be publicly disclosed. Parties and courts can both take steps to mitigate those fears. First, parties can choose—as they already sometimes do—to use preliminary agreements, but not to sign them. Already, parties use unsigned organizational tools—such as checklists—that serve similar collaborative purposes, and do not publicly disclose those tools’ contents. Second, courts can embrace—as this Article suggests—the view that preliminary agreements are not contracts, and should not be enforced as such. A uniform interpretation of preliminary agreements as organizational tools rather than as contracts may help to build a norm of using them, and a norm against classifying them as contracts, for securities-law and other purposes.

## The Temporal Boundaries of the Deal

Previous work argued that, contrary to conventional assumptions, deal boundaries are not defined by the definitive acquisition agreement. Rather, deals are struck—and their theoretical boundaries must expand to include—myriad contemporaneous ancillary agreements that, together with the acquisition agreement, interact to form a deal. Previous work further argued that if deals consist of many contracts, contract disputes involving one contract should, perhaps, be considered with reference to related contracts within the same deal.

Of note, however, is that previous work limited the boundaries of the deal only to contracts that are entered into at the same time as the acquisition agreement. It specifically excluded—and marked as areas for further study—non-contract agreements, and agreements and contracts entered into non-contemporaneously with the acquisition agreement. In other words, it clearly defined contemporaneous contracts as within the boundaries of the deal, and noted that other contract-like tools were too hard to categorize without further study.

By investigating preliminary agreements, this Article tries to understand whether those non-contemporaneous, non-contract agreements can be considered within a deal’s boundaries. More clearly defining which documents are within the deal’s boundaries can aid in contract interpretation—judges, for instance, can look to other documents within the deal’s boundaries to help sharpen their understanding of the deal, or to help interpret vague provisions.

Preliminary agreements are a particularly interesting part of the deal-boundary puzzle. On one hand, a preliminary agreement bears strong resemblance to the document at the very center of a deal—the acquisition agreement. Unlike an ancillary agreement, which contains provisions that supplement an acquisition agreement’s provisions, the preliminary agreement’s provisions *are* the acquisition agreement’s provisions, by and large. Because preliminary agreements bear such close resemblance to acquisition agreements, preliminary agreements appear very much at the center of deals, and therefore firmly within the deal’s boundaries. Placing the preliminary agreement so firmly within the deal’s boundaries, however, has consequences that appear, plainly, to be against the intent of the drafting parties. For example, if preliminary agreements are at the center of deals, their terms might be useful in interpreting ambiguities in the acquisition agreement. But parties plainly intend for preliminary agreements not to be binding, which means that parties intend to leave room for acquisition agreement terms to sometimes, by design, deviate from the preliminary agreement’s terms. Thus, it seems unreasonable to use the preliminary agreement to interpret ambiguities in the acquisition agreement.

While preliminary agreements do look very much like acquisition agreements in some ways, they also deviate quite substantially from the other documents that are clearly within the boundaries of the deal. Employment contracts for key employees, for instance, are clearly within the boundaries of the deal—but preliminary agreements are not very much like employment agreements at all. Employment agreements are often necessary to the deal—and preliminary agreements are not. Employment agreements also provide supplemental provisions to the acquisition agreement, which suggests that employment agreements and acquisition agreements ought to be read together to resolve ambiguity. In contrast, preliminary agreements are not supplemental to the acquisition agreement. Ambiguities cannot be resolved by reading the two agreements together, because differences between them are likely by design. Perhaps the most important difference, however, is that employment agreements—and most other ancillary agreements that are clearly within the boundaries of the deal—are *contracts.* In contrast, preliminary agreements are not contracts. At best, they are contract-like—and this Article has argued that they really ought not to be considered even contract-like.

On balance, it appears that preliminary agreements ought not to be considered part of the bargain. Perhaps one important principle that can be distilled from this Article’s investigation into preliminary agreements is that only deal *contracts* ought to be eligible to be considered part of the bargain. Preliminary agreements, which are prone to change, are not contracts—so they cannot be used to interpret other parts of the deal. One important note, however: although preliminary agreements are not signed at the same time as the acquisition agreement, it is not this timing mismatch that makes preliminary agreements not part of the bargain. In fact, there are other contracts signed before the acquisition agreement that clearly are part of the bargain. Confidentiality agreements, for example, are binding contracts, and they are often incorporated by reference into the acquisition agreement. Their incorporation by reference indicates that parties intend for them to be part of the bargain—even though parties enter into them well in advance of the acquisition agreement. Exclusivity agreements—and even the binding exclusivity provisions of otherwise non-binding preliminary agreements—fall into the same category. They are far removed, temporally, from the acquisition agreement. However, because they are contracts, and because parties show clear intent for them to be part of the bargain, they clearly are part of the bargain. In contrast, non-contract documents, no matter their temporal proximity to the signing of the acquisition agreement, are not within the boundaries of the bargain.

# Conclusion

Existing scholarship misunderstands the role of non-binding preliminary agreements in high-value, complex M&A deals. This Article argues that non-binding agreements should not be treated as minor contracts, but as signposts for the accumulation of deal momentum. They enhance deal efficiency through their formal, rather than substantive, functions. Understanding non-binding agreements has significant implications for enforcement, theory, and deal design. But while this Article has focused on non-binding agreements in the context of M&A deals, the concept of deal momentum has broad applicability in the law, and may shed light on non-binding agreement use in areas from family law to international treaty-making.

# Appendix A: Interviews

All interviews were conducted by telephone, on an anonymous basis, on the dates indicated. All interviewees are attorneys whose primary practices are M&A, or who had many years M&A experience before moving into general corporate or hybrid M&A/business roles in-house. All interviees practiced at or were trained at Vault 50 firms. For brevity and anonymity, each attorney is identified within the text of the Article by reference to a reference term, which is noted below.

|  |  |  |
| --- | --- | --- |
| ***Date*** | ***Interviewee*** | ***Reference Term*** |
| **New York Attorney Interviews** | | |
| May 7, 2016 | Recently retired from top legal position at investment bank; previously M&A partner in New York; 25+ years of experience | NY Firm Attorney I |
| May 17, 2016 | Senior M&A associate with experience in New York and Chicago; 12+ years of experience | NY Firm Attorney II |
| May 26, 2016 | Senior M&A associate in New York; 15+ years of experience | NY Firm Attorney III |
| May 26, 2016 | Senior M&A associate in New York; 7+ years of experience | NY Firm Attorney IV |
| Silicon Valley Attorney Interviews | | |
| May 31, 2016 | M&A partner in Silicon Valley; 20+ years of experience | SV Firm Attorney I |
| June 2, 2016 | M&A partner in Silicon Valley; 25+ years of experience | SV Firm Attorney II |
| June 15, 2016 | M&A partner in Silicon Valley; 25+ years of experience | SV Firm Attorney III |
| June 13, 2016 | M&A partner in Silicon Valley; 25+ years of experience | SV Firm Attorney IV |
| June 20, 2016 | M&A partner in Silicon Valley; 25+ years of experience | SV Firm Attorney V |
| **In-House Attorney Interviews** | | |
| May 23, 2016 | In-house counsel at Silicon Valley company; previously M&A attorney practicing in Silicon Valley and Virginia; 10+ years of experience | In-House Attorney I |
| May 25, 2016 | In-house counsel at Texas company; previously senior corporate associate practicing in Texas (firms in in-house); 20+ years of experience | In-House Attorney II |
| June 20, 2016 | In-house counsel at Silicon Valley company; previously senior M&A associate at Silicon Valley firm; 10+ years of experience | In-House Attorney III |

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2. SIGA Technologies Inc. v. PharmAthene Inc., 67 A.3d 330 (Del. 2013) (*SIGA I*); SIGA Technologies Inc. v. PharmAthene Inc., 132 A.3d 1108 (Del. 2015) (*SIGA II*, and, with SIGA I, the *SIGA decisions*). [↑](#footnote-ref-2)
3. *See* Fried, Frank, Harris, Shriver & Jacobson LLP, *Practice Points for Term Sheets, Letters of Intent, and Undertakings to Negotiate in Good Faith—Based on Delaware Supreme Court’s* SIGA *Decision* (Feb. 8, 2016); http://www.friedfrank.com/siteFiles/Publications/FINALv8-2-8-2016-Practice%20Points%20on%20Use%20of%20Term%20Sheets%20and%20Letters%20of%20Intent.pdf (emphasizing “the importance of clarity in a term sheet or letter of intent with respect to whether there is a binding obligation to negotiate in good faith and what the scope of that obligation is); Ropes & Gray LLP, *The Ropes Recap: Mergers & Acquisitions Law News* 10 (Feb. 19, 2016), https://www.ropesgray.com/newsroom/alerts/2016/February/The-Ropes-Recap-Mergers-Acquisitions-Law-News.aspx (describing the Delaware Supreme Court’s decision in *SIGA* and the history of the case, and noting that in a dissent, Justice Karen L. Valihura noted that the majority’s decision “would move Delaware out of alignment with other major commercial jurisdictions . . . by eroding the requirement that damages be provded with reasonable certainty”); Patrick Klingborg, Lincoln, Gustafson & Cercos, LLP, *When a “Non-Binding” Letter of Intent is Binding After All* (June 1, 2016) (noting that Delaware’s decision in *SIGA* was “different from the California approach” and that “[t]he best practice, therefore, is to be sure a letter of intent accurately characterizes what you intend to negotiate in good faith regardless of whether the letter of intent states it is ‘non-binding.’”); Philip Richter, Fried, Frank, Harris, Shriver & Jacobson LLP, “Negotiation in Good Faith—*SIGA v. PharmAthene*,” (Jan. 27, 2016),https://corpgov.law.harvard.edu/2016/01/27/negotiation-in-good-faith-siga-v-pharmathene/ (noting that, “[b]ased on *SIGA*, as a practical matter, expectation damages will now be a real possibility in Delaware for breaches of agreements to negotiate in good faith”). [↑](#footnote-ref-3)
4. *See, e.g.,* Lisa Bernstein, *Opting out of the Legal System: Extralegal Contractual Relationships in the Diamond Industry*, 21 J. Leg. Stud. 115 (1992) (describing trade association enforcement of contractual breaches); Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms, and Institutions*, 99 Mich. L. Rev. 1724 (2001); Robert C. Ellickson, *A Hypothesis of Wealth-Maximizing Norms: Evidence from the Whaling Industry*, 5 J. L. Econ. & Org. 85 (1989) (presenting evidence of informal enforcement—norms—overtaking formal enforcement in the whaling industry); Robert C. Ellickson, *Of Coase and Cattle: Dispute Resolution Among Neighbors in Shasta County*, 38 Stan. L. Rev. 623 (1986) (describing how rural cattle ranchers in Shasta County, California, abide by norms rather than rules, and how animal trespass disputes are settled by self-help, rather than formal legal enforcement mechanisms); W. Bentley MacLeod, *Reputations, Relationships, and Contract Enforcement*, 45 J. Econ. Lit. 595 (2007) (describing the use of informal enforcement to police contract defaults). [↑](#footnote-ref-4)
5. Richter, *supra* note 2 (noting that “[i]n SIGA’s case, a damages award based on reliance would have led to a far better economic result than it would have received from entering into the license agreement on the contemplated terms. The real potential in Delaware for *expectation damages* for breach of an obligation to negotiate an agreement in good faith should change the calculus for a party considering whether to breach this type of obligation.”). [↑](#footnote-ref-5)
6. Other scholars have approached contract questions from the perspective of ex ante design, rather than ex post enforcement, with interesting results. See, e.g., Robert E. Scott & George G. Triantis, *Anticipating Litigation in Contract Design*, 115 Yale L. J. 814 (2006) (examining the efficiency of investment in the design and enforcement phase of the contracting process, and arguing that parties can lower overall contracting costs by using vague contract terms ex ante and shifting investment to the ex post enforcement phase); Robert E. Scott & George G. Triantis, *Incomplete Contracts and the Theory of Contract Design*, 56 Case Western L. Rev. 187 (2005) (considering the role of litigation in motivating contract design); Albert H. Choi & George G. Triantis, *Strategic Vagueness in Contract Design: The Case of Corporate Acquisitions*, 119 Yale L. J. 848 (2010) (arguing that it is parties can use vague contract provisions efficiently—for example, material adverse change clauses in acquisition agreements may remain vague because they are rarely litigated). [↑](#footnote-ref-6)
7. Ralph B. Lake & Ugo Draetta, Letters of Intent and Other Precontractual Documents: Comparative Analysis and Forms 5-6 (2d ed. 1994) (describing term sheets, letters of intent, memoranda of understanding and other precontractual instruments as “a precontractual written instrument that reflects preliminary agreements and understandings of one or more parties to a future contract”). In the seminal case about preliminary agreements, Teachers Insurance and Annuity Assn’ of America v. Tribune Co., 670 F. Supp. 491, 498 (S.D.N.Y. 1987), Judge Pierre Leval makes a distinction between “Type I” preliminary agreements and “Type II” preliminary agreements. Type I agreements are those where the parties have agreed to material terms, but intend to follow-up with a formal, binding document. This Article is concerned with Type I agreements. But Type II agreements are also possible. Type II agreements are binding preliminary agreements, where “parties agree on certain times but leave potentially important terms open to further negotiations. This requires courts to determine *whether* such an agreement had been made, *what* the duty to bargain in good faith entails, and *which* remedy should be awarded for breach of that duty.” Ronald J. Gilson, Charles F. Sabel, & Robert E. Scott, *Braiding: The Interaction of Formal and Informal Contracting in Theory, Practice, & Doctrine*, 110 Colum. L. Rev. 1377, n. 163 (2010); Alan Schwartz & Robert E. Scott, *Precontractual Liability and Preliminary Agreements*, 120 Harv. L. Rev. 661, n.7 and accompanying text (2007) (describing a Type II agreement as one in which “the parties have agreed to all material terms and intend to memorialize this agreement in a formal document”). [↑](#footnote-ref-7)
8. Cathy Hwang, *Unbundled Bargains: Multi-agreement Dealmaking in Complex Mergers & Acquisitions*, 164 U. Pa. L. Rev. 1403, 1409 n. 27 (2016) (describing the difference between contracts and agreements. “Agreements” describe a written bargain that might be a contract. In contrast, a “contract” creates a binding, enforceable obligation under the law). [↑](#footnote-ref-8)
9. To the extent parties include binding and enforceable provisions, they are provisions related to the process of the deal, and not to the material business terms. For example, provisions related to confidential exchange of information during initial investigation may be marked binding, and breaches may be enforceable. However, those limited binding terms are carefully called out in the agreement. [↑](#footnote-ref-9)
10. Hwang, *supra* note 7 (describing the group of contracts and agreements that parties enter into as an “unbundled bargain”). [↑](#footnote-ref-10)
11. Schwartz & Scott, *Precontractual Liability and Preliminary Agreements*, *supra* note 6, at 671 (describing their case survey methodology). [↑](#footnote-ref-11)
12. Id. at 662-63 (describing how parties enter into preliminary agreements). [↑](#footnote-ref-12)
13. Id. at 703-704 (arguing that “courts have a further facilitative role: to encourage exploration of investment opportunities by protecting the promisee’s verifiable reliance”—in other words, by attaching contract liability to parties who breach preliminary agreements). [↑](#footnote-ref-13)
14. Albert Choi & George Triantis, *Multi-Stage Contracting* (Feb. 15, 2014 draft, on file with author) at 2 (noting that “some agreements are simply too complex to be completed in a single stage . . . . The purpose of agreement in the first stage is to address complexity and set a distinct stage for expert agents, rather than to protect specific investments under an incomplete contract.”). [↑](#footnote-ref-14)
15. Id. [↑](#footnote-ref-15)
16. Id. at 7 (noting that “the court’s intervention to find a commitment in an earlier stage can improve the contracting outcome when one or more of the assumptions to the indifference proposition do not hold. To take one example, when the threat of reputational sanctions impedes one party from walking away from the negotiations, the court can improve

    efficiency by finding a commitment by the other party in the preliminary agreement.”) [↑](#footnote-ref-16)
17. *See* Lon L. Fuller and William R. Perdue, *The Reliance Interest in Contract Damages*, 46 Yale L.J. 52, 57 (1936) (“Some rule or combination of rules effects a sifting out for enforcement of those promises deemed important enough to society to justify the law's concern with them”); Ronald J. Gilson, Charles F. Sabel, & Robert E. Scott, *Braiding: The Interaction of Formal and Informal Contracting in Theory, Practice, & Doctrine*, 110 Colum. L. Rev. 1377, 1379 (2010) (noting that “the expectation of formal enforcement creates incentives for parties to perform their obligations); Robert E. Scott, *The Law and Economics of Incomplete Contracts,* 2 Annu. Rev. L. & Soc. Sci. 279, 280 (2006) (“In particular, parties wish to make credible (i.e., enforceable) promises to motivate their contracting partners to invest in jointly profitable activities”); Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 Yale L.J. 541, 546 (2003) (noting that contracts are either “self-enforcing”—i.e., “gains from breach are lower than the expected profit stream from future contracts that breach would cause to vanish”—enforced informally through reputational sanctions, or enforced formally. “When contracts fall outside of the self-enforcing range, however, legal enforcement is necessary to ensure performance . . . when a party’s failure to perform could threaten its contract partner’s survival; and when contractual surplus would be maximized if one or both parties make relationship-specific investments”). [↑](#footnote-ref-17)
18. Dealmakers with a wide breadth of experience—at firms and in-house, working with repeat players and one-off deal parties, in private and public deals, in a variety of firms and cities, representing financial parties and strategic parties—report that preliminary agreements have exceptional binding power. The [13] interviewees include nine senior law-firm partners, counsels, and senior associates with significant private M&A practices, and two senior in-house attorneys with significant M&A experience. Interviewees practiced at law firms or companies in New York, Silicon Valley, Chicago, and Houston. For a full list and description of interviews, see *infra* App. A. [↑](#footnote-ref-18)
19. Choi & Triantis, *supra* note 13, at 1 (noting that “[c]ommerical agreements are often entered into in stages”). [↑](#footnote-ref-19)
20. Jonathan M. Barnett, *Hollywood Deals: Soft Contracts for Hard Markets*, 64 Duke L.J. 605, 618 (2015) (describing the deal timeline). [↑](#footnote-ref-20)
21. Barnett, *supra* note 19 at 618 (noting that most negotiation occurs before signing). [↑](#footnote-ref-21)
22. Public M&A deals are those that involve at least one public company party that is obligated by securities laws to disclose the terms of any material agreements to shareholders. Parties to public M&A deals are substantially less likely to use preliminary agreements, because they fear that entering into a preliminary agreement may trigger disclosure obligations. In contrast, private M&A deals do not trigger disclosure obligations. *See* George Georgiev, *Too Big to Disclose: Firm Size and Materiality Blindspots in Securities Regulation*, 64 UCLA L. Rev. \_\_\_ (forthcoming, 2017), at n. 2 for a discussion of public company disclosure obligations. [↑](#footnote-ref-22)
23. Barnett, *supra* note 19, at n. 36, citing Ralph B. Lake & Ugo Draetta, Letters of Intent and Other Precontractual Documents: Comparative Analysis and Forms 15-16 (2d ed. Supp. 1996) (noting that “[f]irst, after some initial discussion, the parties enter into a preliminary agreement, often called a ‘memorandum of understanding’ or ‘letter

    of intent,’ which describes the basic terms of the proposed transaction and usually states that the document is nonbinding”). [↑](#footnote-ref-23)
24. Id. [↑](#footnote-ref-24)
25. Id. [↑](#footnote-ref-25)
26. Id. [↑](#footnote-ref-26)
27. Barnett, *supra* note 19 at 618 (describing the package of documents that parties sign at signing). [↑](#footnote-ref-27)
28. Lou R. Kling et al., *Summary of Acquisition Agreements*, 51 U. Miami L. Rev. 779, 781 (1997) (describing the signing as “the time when the parties become legally obligated to effect the transaction”). [↑](#footnote-ref-28)
29. Ronald J. Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 94 Yale L.J. 239, 260 (1984) (noting that “many portions of a typical acquisition agreement result from the fact that many acquisition transactions contemplate a significant gap between the date on which the acquisition agreement is signed and the date on which the transaction is closed”); and Kling et al., *supra* note 27 at 781 (identifying the need to secure financing as a reason for a delay between signing and closing). [↑](#footnote-ref-29)
30. Kling et al., *supra* note 27, at 781 (describing the closing as the moment “when the acquisition actually occurs”). [↑](#footnote-ref-30)
31. Schwartz & Scott, *Precontractual Liability and Preliminary Agreements*, supra note 6, at 663 (describing parties’ signing a preliminary agreement as “After the parties agree on what they can, and *before* uncertainty is resolved, one or both of them make a sunk-cost investment. This pattern of commercial behavior suggests that the parties have made a ‘preliminary agreement’ . . . .”). [↑](#footnote-ref-31)
32. In *The Nature of the Firm*, Ronald Coase argued that firms grow larger if it is cheaper to produce a particular component internally, and do not grow if it is cheaper to purchase that component from outside the organization. See R. H. Coase, *The Nature of the Firm*, 4 Economica 386, 387-89 (1937). This theory has been used to explain why some firms are highly integrated (and large), and others are more specialized (and rely on outside suppliers to produce most components). See generally Peter G. Klein, The Make-or-Buy Decision: Lessons from Empirical Studies (surveying the empirical literature on firms’ vertical integration, and providing a summary of Coase’s theory of the firm), in Handbook of new Institutional Economics 435 (Claude Ménard & Mary M. Shirley eds., 2008). In previous work, I argued that the boundaries of the deal extend beyond the central, definitive acquisition agreement. This Article that the boundaries of the deal can also be extended temporally—that is, the deal can begin earlier in time than the central acquisition agreement. See *infra* Part III. [↑](#footnote-ref-32)
33. Schwartz & Scott, *Precontractual Liability and Preliminary Agreements*, supra note 6, at 664 (noting that “[t]he parties do not agree and, indeed, may never have attempted to agree on important terms such as the price. After the parties agree upon what they can, and before uncertainty is resolved, one or both of them make a sunk-cost investment”). [↑](#footnote-ref-33)
34. Id. at 662-63 (noting that parties enter into preliminary agreement “*before* uncertainty is resolved”). [↑](#footnote-ref-34)
35. Id. at 667 (“A reliance recovery will encourage parties to make preliminary agreements and will deter some strategic behavior”). [↑](#footnote-ref-35)
36. Choi & Triantis, *Multi-Stage Contracting*, *supra* note 13, at 2 (“As Howard Raiffa put it, there is a tradeoff between maximizing gains from trade by allowing log rolling across a large number of issues, and the cognitive load of dealing with all at the same time”). [↑](#footnote-ref-36)
37. Id. (noting that “[i]n many cases, the deferred issues are turned over to experts, such as architects, engineers, accountants, and, in particular, lawyers. While the motivation may be either the cognitive load or the need for experts, we call this second category as being multi-stage contracting motivated by *complexity*”). [↑](#footnote-ref-37)
38. Id. [↑](#footnote-ref-38)
39. Henry E. Smith, *Modularity in Contracts: Boilerplate and Information Flow*, 104 MICH. L. REV. 1175, 1176 (2006) (describing modular contracting as a way to break down complex systems into smaller, easier-to-understand chunks). [↑](#footnote-ref-39)
40. Hwang, *supra* note 7 at 1418 (describing the practice of breaking out complex, regulatory-heavy parts of a deal into a module so that experts can weigh in on those parts). [↑](#footnote-ref-40)
41. Choi & Triantis, *Multi-Stage Contracting*, *supra* note 13, at 20. [↑](#footnote-ref-41)
42. Bidish Sarma, *Deterrence and Prosecutorial Accountability*, 21 Lewis & Clark L. Rev. \_\_, at \_\_ (forthcoming, 2017) (describing deterrence as “a justification for punishment premised on the theory that the threat of punishment can deter individuals from breaking the law”). [↑](#footnote-ref-42)
43. See, e.g., Aron M. Levin, Mary Conway Daton-on & Chris Manolis, *Deterring Illegal Downloading: The Effects of Threat Appeals, Past Behavior, Subjective Norms, and Attributions of Harm*,6 J. Consumer Behavior 111 (2007) (finding that stronger threats of punishment, such as fines or jail time, were more effective than weaker threats in reducing illegal music downloads). [↑](#footnote-ref-43)
44. Choi & Triantis, *Strategic Vagueness in Contract Design*, *supra* note 5, at 852 (noting that, “[d]rawing on the line of scholarship that analyzes the rules-standards dichotomy in the design of legal rules, recent work frames the choice between vague and precise contract terms as a tradeoff in information costs: precise contract provisions raise contracting costs on the front end, but reduce enforcement costs at the back end”); and Richard A. Posner, *The Law and Economics of Contract Interpretation*, 83 Tex L. Rev. 1581, 1583 (2005) (defining the cost of a contract as the ex ante negotiating and drafting costs, plus the probability of litigation multiplied by the sum of the parties’ litigation costs, the judiciary’s litigation costs, and judicial error costs). [↑](#footnote-ref-44)
45. Choi & Triantis, *Strategic Vagueness in Contract Design*, *supra* note 43. [↑](#footnote-ref-45)
46. Id. at852 (noting that contract provisions are sometimes intentionally vague because “If a provision matters only in remote contingencies, . . . then the back-end costs should be discounted by that remote probability, and it may be correspondingly efficient to save frontend costs by using a standard (or a vague term) rather than a rule”). *See also* Scott & Triantis, *Anticipating Litigation in Contract Design*, *supra* note 5; Posner, *The Law and Economics of Contract Interpretation*, *supra* note 43; and Steven Shavell, *On the Writing and Interpretation of Contracts*, 22 J.L. Econ. & Org. 289 (2006). [↑](#footnote-ref-46)
47. Scott & Triantis, *Anticipating Litigation in Contract Design*, *supra* note 5, at 835 (noting that “[w]hen contracts scholarship is concerned with front-end (transaction) costs, such as the cost of negotiating and writing contracts, vague terms reduce these costs by letting the enforcing court complete the contract”). [↑](#footnote-ref-47)
48. Choi & Triantis, *Strategic Vagueness in Contract Design*, *supra* note 43. [↑](#footnote-ref-48)
49. Id. [↑](#footnote-ref-49)
50. *See* Sasha S. Hahn, Note, *“Between” a Rock and a Hard Place:* Martin Marietta v. Vulcan *and the Rise of the Backdoor Standstill*, 65 Hastings L.J 1393 (2014),for a detailed analysis of the *Martin Marietta* case. [↑](#footnote-ref-50)
51. Id. [↑](#footnote-ref-51)
52. Posner, *The Law and Economics of Contract Interpretation*, *supra* note 43, at 1583 (noting that the cost of a contract is the sum of both ex ante and ex post costs). [↑](#footnote-ref-52)
53. George Baker, Robert Gibbons, & Kevin J. Murphy, *Relational Contracts and the Theory of the Firm*, 117 Quarterly J. of Econ. 39 (2002); Lisa Bernstein, *Private Commercial Law in the Cotton Industry*, 99 Mich. L. Rev 1724 (2001) (describing how sales contracts for domestic cotton are not consummated under the Uniform Commercial or enforced in courts—rather, they are drafted under private contract default rules and disputes are arbitrated in merchant tribunals); Bernstein, *Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, *supra* note 3; Robert C. Ellickson, *A Hypothesis of Wealth-Maximizing Norms*, J. L. Econ. & Org. 85 (1989) (describing the norms that high-sea whalers use to resolve disputes over the ownership of harvested whales); and Robert C. Ellickson, *Of Coase and Cattle: Dispute Resolution Among Neighbors in Shasta County*, 38 Stan. L. Rev. 623 (1986) (describing the extra-legal, norms-based dispute resolution between cattle ranchers in rural Shasta County, California). [↑](#footnote-ref-53)
54. Contracts create a binding obligation to perform. Those who breach a contract obligation are usually obligated to pay expectation damages. Fuller & Perdue, *supra* note 16, at 60 (arguing that “[s]ince the expectation interest furnishes a more easily-administered measure of recovery than the reliance interest, it will in practice offer a more effective sanction against contract breach”). It is worth underscoring the fact that an award of expectation damages is a significant sanction. Expectation damages are designed to put a non-breaching party in the same position it would have been if the deal had been completed. Gilson, et al., *Braiding*, *supra* note 6, at n.158 (“Expectation damages purport to put the injured party in the position she would have been in had the collaborative exploration not only been successfully concluded, but a joint project also agreed upon and realized.”). In their seminal work on reliance damages, Lon Fuller and William Perdue identify a spectrum of possible damages, ranging from no damages to expectation damages. *Reliance damages* represent one spot along that spectrum: reliance damages are designed to compensate a non-breaching party who has suffered a harm as a result of relying on the breaching party. Fuller & Perdue, *supra* note 16, at 54 (describing reliance as a remedy when “the plaintiff has in reliance on the promise of the defendant changed his position. For example, the buyer under a contract for the sale of land has incurred expense in the investigation of the seller's title, or has neglected the opportunity to enter other contracts. We may award damages to the plaintiff for the purpose of undoing the harm which his reliance on the defendant's promise has caused him. Our object is to put him in as good a position as he was in before the promise was made. The interest protected in this case may be called the *reliance interest*”). [↑](#footnote-ref-54)
55. Dealmakers with a wide breadth of experience—at firms and in-house, working with repeat players and one-off deal parties, in private and public deals, in a variety of firms and cities, representing financial parties and strategic parties—report that preliminary agreements have exceptional binding power. The twelve interviewees include nine senior law-firm partners, counsels, and senior associates with significant private M&A practices, and three senior in-house attorneys with significant M&A experience. Interviewees practiced at law firms or companies in New York, Silicon Valley, Chicago, and Houston. For a full list and description of interviews, see *infra* App. A. [↑](#footnote-ref-55)
56. Barnett, *supra* note 19, at 618 (noting that a letter of intent or term sheet in a conventional deal “describes the basic terms of the proposed transaction and usually states that the document is nonbinding.”); Telephone Interview with In-House Attorney I, in Palo Alto, Cal. (May 23, 2016) (stating that “[p]retty much on every page we have something that says that this is a non-binding agreement—this is non-binding except exclusivity/no shop, confidentiality, governing law, fee sharing”). [↑](#footnote-ref-56)
57. Telephone Interview with NY Firm Attorney II, in Palo Alto, Cal. (May 17, 2016) (noting that “[t]ypically, we advise people not to sign term sheets”). [↑](#footnote-ref-57)
58. *See* SIGA decisions, *supra* note 1 and accompanying text. [↑](#footnote-ref-58)
59. The SIGA deal was litigated to an opinion four times: the Delaware Chancery Court issued opinions twice, and the parties appealed those decisions to the Delaware Supreme Court twice. Each time the Delaware courts issued an opinion, law firms that advised clients in M&A deals issued a flurry of client alerts and memoranda, the issuance of which indicated that the SIGA decision was out of the ordinary and worth highlighting. With regard to SIGA I, *see, e.g.,* Mintz Levin Cohn Ferris Glovsky & Popeo PC, *When a Non-Binding Term Sheet Becomes Binding* (Jul. 8, 2013), https://www.mintz.com/newsletter/2013/Advisories/3203-0713-NAT-COR/index.html (noting that the Delaware Supreme Court’s decision in SIGA I may require breaching parties to pay expectation damages to non-breaching parties in preliminary agreement cases, and “propos[ing] ways to mitigate the risk at the court might award expectation damages based on a ‘non-binding’ term sheet or letter of intent”); Morrison & Foerster LLP, *Delaware Supreme Court: Bad-Faith Attempt to Renegotiate Term Sheet May Create Liability for ‘Benefit-of-the-Bargain’ Damages* (Jun. 10, 2013), http://www.jdsupra.com/legalnews/delaware-supreme-court-bad-faith-attemp-60366/ (noting that in SIGA I, the Delaware Supreme Court’s “message to negotiators is clear: Don’t agree to a term sheet unless it is explicitly non-binding or you are prepared to continue negotiations in good faith, consistent with the term sheet”). With regard to SIGA II, *see, e.g.,* Fried, Frank, Harris, Shriver & Jacobson LLP, *Negotiation in Good Faith—*SIGA v. PharmAthene (Jan. 27, 2016), https://corpgov.law.harvard.edu/2016/01/27/negotiation-in-good-faith-siga-v-pharmathene/ (noting that “[b]ased on *SIGA*, as a practical matter, expectation damages will now be a real possibility in Delaware for breaches of agreements to negotiate in good faith”). *See also* note 2, *supra.* [↑](#footnote-ref-59)
60. Telephone Interview with In-House Attorney I, *supra* note 55 (“We are aware of weird DE cases that talk about duty to negotiate in good faith.”); Telephone Interview with SV Firm Attorney II, in San Francisco, Cal. (June 2, 2016) (“I know there’s case law out there saying that [parties] have been sued for walking away [from a preliminary agreement].”) [↑](#footnote-ref-60)
61. Telephone Interview with SV Firm Attorney I, in Palo Alto, Cal. (May 31, 2016) (“Usually, you’ll have an express statement that’s the opposite [of a duty to negotiate in good faith] in the letter of intent—that parties can walk away for any reason at all. [You] contract away that obligation”); Telephone Interview with In-House Attorney I, *supra* note 55 (nothing that his company uses a letter with language that “represents that we will negotiate in good faith the terms of the letter. However, notwithstanding, we can terminate this letter for any and all reasons any time”); Telephone Interview with In-House Attorney II, in Palo Alto, Cal. (May 25, 2016) (noting that “occasionally, I have put in that the parties do agree to negotiate in good faith. So there are times when it’s talked about, and we say each have a right to walk away”). [↑](#footnote-ref-61)
62. Telephone Interview with SV Firm Attorney I, *supra* note 60. [↑](#footnote-ref-62)
63. Telephone Interview with SV Firm Attorney II, *supra* note 59 (noting that “[s]ome clients take the approach that they do want to have some binding provisions in the term sheet”—confidentiality or exclusivity. “It’s not uncommon to see some binding provisions in the term sheet. People are pretty clear about what’s binding and not binding”); Telephone Interview with SV Firm Attorney III, in Palo Alto, Cal. (Jun. 15, 2016) (noting that although “From a legal standpoint, I like to keep the binding and non-binding documents separate,” he has “moved to using non-binding term sheets along with binding exclusivity”); and Telephone Interview with In-House Attorney III, in Palo Alto, Cal. (Jun. 20, 2016) (noting that term sheets are “normally signed, because the term sheets are non-binding, but some things are binding, such as confidentiality provisions, governing law”). [↑](#footnote-ref-63)
64. Telephone Interview with NY Firm Attorney I, in Palo Alto, Cal. (May 7, 2016) (“LOIs are, as a general proposition, non-binding”); and Telephone Interview with In-House Attorney II, *supra* note 60(“I tend to say that the presumption [is that] this is a non-binding letter of intent, except for sections. Confidentiality and sometimes exclusivity”). [↑](#footnote-ref-64)
65. Telephone Interview with In-House Attorney I, *supra* note 55 (“Pretty much on every page we have something that says that this is a non-binding agreement); and Telephone Interview with In-House Attorney II, *supra* note 60. [↑](#footnote-ref-65)
66. Telephone Interview with NY Firm Attorney IV, in Palo Alto, Cal. (May 26, 2016). [↑](#footnote-ref-66)
67. Telephone Interview with NY Firm Attorney I, *supra* note 63 (“It may be binding, but good luck proving failure to negotiate in good faith”). [↑](#footnote-ref-67)
68. Id. [↑](#footnote-ref-68)
69. Id. [↑](#footnote-ref-69)
70. Telephone Interview with SV Firm Attorney V, in Palo Alto, Cal. (Jun. 20, 2016). [↑](#footnote-ref-70)
71. Only NY Firm Attorney II and SV Firm Attorney V had heard of a threat of litigation. *See* Telephone Interview with NY Firm Attorney II, *supra* note 56, and Telephone Interview with SV Firm Attorney V, *supra* note 69. [↑](#footnote-ref-71)
72. Telephone Interview with SV Firm Attorney II, *supra* note 59. [↑](#footnote-ref-72)
73. Telephone Interview with NY Firm Attorney I, *supra* note 63 (noting that it is not typical for a party to enforce an obligation to negotiate in good faith, because the litigation is fact-intensive and expensive). [↑](#footnote-ref-73)
74. Telephone Interview with SV Firm Attorney I, *supra* note 60. [↑](#footnote-ref-74)
75. *See* Bernstein, *Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, *supra* note 3. [↑](#footnote-ref-75)
76. *See* Ellickson, *A Hypothesis of Wealth-Maximizing Norms*, *supra* note 52. [↑](#footnote-ref-76)
77. Gilson, et al., *Braiding*, *supra* note 6, at 1379. [↑](#footnote-ref-77)
78. Id. at 1392-93 (“Even where the particular parties do not expect to deal with each other in the future, the tit-for-tat informal enforcement structure will still work if a misbehaving party expects to trade with others in the future—i.e., if trade will be multilateral rather than bilateral—so long as that party’s reputation—i.e., the collective experience of others who have previously dealt with that person—becomes known to future counterparties. The actions of future counterparties then serve to discipline the misbehaving party” (internal citations omitted)). [↑](#footnote-ref-78)
79. Telephone Interview with In-House Attorney I, *supra* note 55. [↑](#footnote-ref-79)
80. Telephone Interview with NY Firm Attorney III, in Palo Alto, Cal. (May 17, 2016). [↑](#footnote-ref-80)
81. Id. [↑](#footnote-ref-81)
82. Telephone Interview with SV Firm Attorney III, *supra* note 62. [↑](#footnote-ref-82)
83. *See* American Bar Association, Report of the Committee on Commercial and Business Litigation (Winter 2007), https://apps.americanbar.org/litigation/committees/newsletter\_gratis/commercial\_business\_litigation.pdf (noting that “[m]ost civil lawsuits settle”). [↑](#footnote-ref-83)
84. For more information on the interviewees, see App. A. [↑](#footnote-ref-84)
85. Deloitte, *M&A Trends Report 2015* 2(Mar. 2015), https://www2.deloitte.com/content/dam/Deloitte/au/Documents/mergers-acqisitions/deloitte-au-ma-2015-trends-240415.pdf (noting that “[i]n 2014, merger and acquisition activity accelerated meaningfully with those factors well entrenched. The number of deals in the U.S. rose 10 percent to 9,802”). [↑](#footnote-ref-85)
86. FactSet, *US M&A News and Trends* 1 (Jan. 2017), https://www.factset.com/mergerstat\_em/monthly/US\_Flashwire\_Monthly.pdf (reporting that “U.S. private equity activity decreased in December, down 2.8% from November. There were 106 deals in December compared to 109 in November”). While not all private equity deals are private, many are. In the absence of data on the number of private deals, data on private equity deals, like data on overall deal volume, provides a benchmark that shows that 21 cases is a very small fraction of deals. [↑](#footnote-ref-86)
87. Choi & Triantis, *supra* note 13, at 1 (noting that “[c]ommerical agreements are often entered into in stages”); Schwartz & Scott, *Precontractual Liability and Preliminary Agreements*, *supra* note 6, at 662-63 (describing the initial process of dealmaking). [↑](#footnote-ref-87)
88. Douglas Godfrey & Charles Fox, *All About Due Diligence*, 11 Tenn. J. Bus. L. 357 (2009) (describing the process of due diligence). [↑](#footnote-ref-88)
89. Id. at 357-359 (describing the conflicts and liabilities that attorneys attempt to uncover in the due diligence process). [↑](#footnote-ref-89)
90. Id. at 359. [↑](#footnote-ref-90)
91. Stout Risius Ross Advisors, LLC, *The M&A Buy Side Process: An Overview for Acquiring Companies* 3-6 (Aug. 2013), http://www.srr.com/assets/pdf/mabuysideprocess.pdf (describing the bulk of due diligence as complete before parties sign a preliminary, and of the post-agreement diligence as “final diligence” or “full diligence” which “confirms the consistency and material accuracy of representations made by the target company”). [↑](#footnote-ref-91)
92. Godfrey & Fox, *supra* note 87, at 359 (describing the due diligence process as “not just first-year associates looking through boxes of documents. The process also includes experts in various areas looking at any subject that the buyer, in the case of an acquisition, is interested in . . . . Thus, the due diligence process as a whole covers any issue that a buyer or an investor would possibly care about”); Telephone Interview with SV Firm Attorney II, *supra* note 59 (“Most term sheets are finalized before the real due diligence begins”). [↑](#footnote-ref-92)
93. Telephone Interview with In-House Attorney III, *supra* note 62 (“Some of the legal stuff gets renegotiated based on diligence”); Telephone Interview with SV Firm Attorney II, *supra* note 59 (“There are buyers that have a reputation for being willing to renegotiate some of the terms. But it’s often based on stuff that they find in due diligence”). [↑](#footnote-ref-93)
94. Stout Risius Ross Advisors, LLC, *supra* note 90, at 5 (noting that “Shortly after the management presentation is concluded, the target will typically provide the acquirer with access to an online information ‘datasite’ where select legal, financial, operational and other information on the business can be found so that the acquirer can determine an appropriate valuation to submit a [letter of intent]”). [↑](#footnote-ref-94)
95. Id. (noting that “[t]he [letter of intent] highlights the acquirer’s intention to acquire the target and sets forth the proposed purchase price along with all relevant key terms, in much greater detail than did the [indication of interest].” [↑](#footnote-ref-95)
96. Id. at 5-6. [↑](#footnote-ref-96)
97. Of course, this separation demands an answer to another question: if the material diligence is done, what is the bulk diligence that is being done after the preliminary agreement is signed? After all, deal lawyers suggest that, while rare, information is found while lawyers do the bulky due diligence, and that information can occasionally change material price terms—what information is being examined? The answer is that much of the post-preliminary agreement diligence involves reviewing contracts for “change of control” or “assignment” provisions—that is, determining which supplier contract, for instance, will be automatically terminated when control of the target company changes over from the seller to the buyer. In examining those kinds of contracts, material information can be found that changes price terms. For instance, the buyer might discover that, while the target has been profitable for many years, it will soon become less profitable because particular lower price terms will soon take effect. *See* Id. at 6 (describing “full due diligence,” in which the buyer examines the target’s “financial statements, operating reports and other private and confidential company documents (both financial and non-financial in nature)”). [↑](#footnote-ref-97)
98. Choi & Triantis, *Multi-Stage Contracting*, *supra* note 13, at 2 (noting that even when uncertainty does not stand in the way of a deal, “complexity of the deal may be a reason for agreeing to a subset of issues initially and turning to the remaining issues later. In many cases, the deferred issues are turned over to experts, such as architects, engineers, accountants, and, in particular, lawyers”). [↑](#footnote-ref-98)
99. Schwartz and Scott, for instance, note that a preliminary agreement is entered into when “the parties do not agree and, indeed, may never have attempted to agree on important terms such as price. After the parties agree upon what they can, and *before* uncertainty is resolved, one or both of them make a sunk-cost investment.” *See* Schwartz & Scott, *Preliminary Agreements and Precontractual Liability*, *supra* note 6, at 663. Similarly, Choi and Triantis describe preliminary agreements as early-stage contracts. They deviate slightly from Schwartz and Scott in the reasons that parties enter into preliminary agreements—they note that some deals proceed in multiple stages because “the complexity of the joint undertaking and the difficulty in negotiations” necessitate a certain time lag to allow parties to turn some issues “over to experts, such as architects, engineers, accountants, and, in particular, lawyers.” In other words, preliminary agreements are described as putting in place some initial rules to which the parties agree. Then, within the boundaries of those rules, parties resolve uncertainty and agree to final terms. *See* Choi & Triantis, *Multi-Stage Contracting*, *supra* note 13, at 2. [↑](#footnote-ref-99)
100. Lon Fuller, *Consideration and Form,* 41 Colum. L. Rev. 799, 799 (1941) (distinguishing between the formal and substantive reasons that courts and parties attach consideration to contracts). [↑](#footnote-ref-100)
101. Id. at 800-801 (describing the functions performed by legal formalities). [↑](#footnote-ref-101)
102. Parties may enter into a confidentiality agreement, in which they agree to keep the information they exchange confidential. However, after the confidentiality agreement is signed, there is little else. [↑](#footnote-ref-102)
103. Stout Risius Ross Advisors, LLC, *supra* note 90, at 3-4 (describing the valuation process). [↑](#footnote-ref-103)
104. Telephone Interview with NY Firm Attorney III, *supra* note 79 (remarking that “If there was someone who routinely didn’t get deals done, that would become market knowledge, and be taken into account when thinking about whether the deal will go through,” but that everything was “so facts and circumstances” and that ultimately “the color of their money is the same as everyone else’s”). But note that is not the case in certain tight-knit subsets of the M&A community. SV Firm Attorney V, for instance, noted that reputations may matter in venture capital deals. Telephone Interview with SV Firm Attorney V, *supra* note 69. [↑](#footnote-ref-104)
105. Telephone Interview with NY Firm Attorney I, *supra* note 63 (“There is certainly moral suasion to [a preliminary agreement]. I think that most people—there are exceptions—in the business world, even if they aren’t repeat players in the market, most players want to be seen as integrity players”); Telephone Interview with In-House Attorney I, *supra* note 55 (“One of the lawyers I worked with in Virginia always he thought about the term sheet as a gentleman’s agreement. He would say, ‘You gave me your word, and now you’re trying to walk away from your word?’”); Telephone Interview with NY Firm Attorney IV, *supra* note 65 (noting that “[parties] felt morally obligated not to ask for a bigger escrow because they’d asked for a smaller one [in the term sheet]. They can suffer though this problem or they cannot go back on their word. The business people want to not go back on their word”). [↑](#footnote-ref-105)
106. Stout Risius Ross Advisors, LLC, *supra* note 90 (describing the multiple rounds of interaction, due diligence, and negotiation that are involved in the dealmaking process). [↑](#footnote-ref-106)
107. Telephone Interview with NY Firm Attorney II, *supra* note 56. [↑](#footnote-ref-107)
108. Telephone Interview with In-House Attorney II, *supra* note 60. [↑](#footnote-ref-108)
109. Telephone Interview with NY Firm Attorney III, *supra* note 79. [↑](#footnote-ref-109)
110. Id. [↑](#footnote-ref-110)
111. Telephone Interview with NY Firm Attorney I, *supra* note 63. [↑](#footnote-ref-111)
112. Telephone Interview with In-House Attorney I, *supra* note 55. [↑](#footnote-ref-112)
113. Telephone Interview with NY Firm Attorney III, *supra* note 79 (noting that ““Often times the existence of a [letter of intent] or [memorandum of understanding] that is not binding will be simply done for execution purposes. For example, you can make a Hart-Scott filing on a [letter of intent]”). [↑](#footnote-ref-113)
114. Telephone Interview with NY Firm Attorney I, *supra* note 63. [↑](#footnote-ref-114)
115. Interview with NY Firm Attorney IV, *supra* note 65. [↑](#footnote-ref-115)
116. Telephone Interview with In-House Attorney I, *supra* note 55. [↑](#footnote-ref-116)
117. Telephone Interview with SV Firm Attorney I, *supra* note 60 (“There’s a moral obligation to live up to the handshake agreement. Most people try to live up to that. And honestly there has to be some trust. If there’s not trust between the parties, no deal gets done. They shake hands at that price and they both behave that they will a certain way”); Telephone Interview with In-House Attorney I, *supra* note 55 (describing non-binding preliminary agreements as “gentlemen’s agreements”). [↑](#footnote-ref-117)
118. Telephone Interview with NY Firm Attorney I, *supra* note 63 (“There is certainly moral suasion to [a preliminary agreement]”). [↑](#footnote-ref-118)
119. John C. Coffee, Gatekeepers: The Professions and Corporate Governance 2 (1st ed. 2006). [↑](#footnote-ref-119)
120. Id. [↑](#footnote-ref-120)
121. Elisabeth de Fontenay, *Law Firm Selection and the Value of Transactional Lawyering*, \_\_ J. Corp. L. \_\_, 4 (forthcoming, 2017) (arguing that law firms add value because certain elite law firms “repeatedly engage in the same type of high-stakes

     transactions acquire private information about the range of plausible deal terms and their current market prices that other players cannot replicate”). [↑](#footnote-ref-121)
122. Telephone Interview with SV Firm Attorney II, *supra* note 59. [↑](#footnote-ref-122)
123. *See supra* note 105 and accompanying text. [↑](#footnote-ref-123)
124. One might argue that in public deals, there is sufficient readily-available information about the target such that parties do not need a preliminary agreement in order to create a framework for more thorough diligence of the target. This argument, however, does not account for the fact that even in deals where public companies acquire private ones in deals of sufficient size to trigger securities filings for the public acquirer, the parties try not to use preliminary agreements. In these types of public-private deals, there is not sufficient information about the private target to resolve uncertainty about the target. Nonetheless, the parties do not need to enter a preliminary agreement in order to do a deal. [↑](#footnote-ref-124)
125. Posner, *The Law and Economics of Contract Interpretation*, *supra* note 43. [↑](#footnote-ref-125)
126. Telephone Interview with In-House Attorney II, *supra* note 60. [↑](#footnote-ref-126)
127. Id. [↑](#footnote-ref-127)
128. Telephone Interview with NY Firm Attorney III, *supra* note 79. [↑](#footnote-ref-128)
129. Telephone Interview with In-House Attorney I, *supra* note 55; Telephone Interview with NY Firm Attorney I, *supra* note 63; Telephone Interview with NY Firm Attorney III, *supra* note 79; Telephone Interview with SV Firm Attorney V, *supra* note 69. [↑](#footnote-ref-129)
130. Telephone Interview with In-House Attorney I, *supra* note 55. [↑](#footnote-ref-130)
131. Telephone Interview with NY Firm Attorney III, *supra* note 79. [↑](#footnote-ref-131)
132. Id. [↑](#footnote-ref-132)
133. Telephone Interview with SV Firm Attorney V, *supra* note 69. [↑](#footnote-ref-133)
134. Telephone Interview with In-House Attorney I, *supra* note 55. [↑](#footnote-ref-134)
135. Telephone Interview with SV Firm Attorney II, *supra* note 59 (noting that public companies usually do not want to use letters of intent because they do not want to trigger disclosure obligations). [↑](#footnote-ref-135)
136. Hwang, *supra* note 7, at 1413 (describing the M&A deal checklist, which keeps track of all deal documents, action items, and who is in charge of that item). [↑](#footnote-ref-136)
137. Id. [↑](#footnote-ref-137)
138. Matthew Jennejohn, *The Private Order of Innovation Networks*, 58 Stan. L. Rev 281 (2016) (describing cross-firm collaborations). [↑](#footnote-ref-138)