ARTICLE

CONTRACT REALISM AND FORMALISM IN PRELIMINARY ACQUISITION AGREEMENTS AND NEGOTIATIONS

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Preliminary negotiations in which a binding contract is imputed, and formal preliminary agreements, which may create a binding contract of undetermined scope, have special prominence in the corporate acquisition context. Case law in this area of preliminary dealings is arguably confused and unsatisfying. In recent years, contract scholars (including M&A scholars) have theorized about the purpose of such preliminary dealings primarily in the context of formal preliminary agreements, and they have also considered the role of informal negotiations and non-binding agreements in contract creation. Notwithstanding differences, these scholarly analyses have uniformly maintained that common law principles (if applied correctly) provide a coherent approach to preliminary dealing conduct. In contrast to this approach to preliminary dealings, this paper argues that, in the corporate acquisition context, preliminary dealings should be addressed under a different regime of formal contracting standards. The existing common law regime protects the integrity of preliminary dealing conduct (both formal and informal) at the risk of mistakenly imposing contract obligations on an unsuspecting party. In the distinctive context of corporate acquisitions, this approach fails to minimize efficiently the costs arising from the mistaken imposition of contractual obligations. Specifically, corporate

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acquisitions invariably conjoin features that alter the marginal social costs and benefits associated with contract formation, features which are uncharacteristic of many, if not most, contracting situations. Salient features in the corporate acquisition context jointly include: (i) an intrinsically multi-step bargaining process; (ii) the routine participation of sophisticated business counsel; (iii) potentially enormous contractual liability arising from contested (and generally equivocal) inferences where contractual clarity can be obtained at relatively low cost; and (iv) disproportionate windfalls or forfeitures for third-party stakeholders in the case of mistakenly imposed obligations.

This paper proposes an alternative formal regime: an enhanced statutory signed acquisition agreement requirement ("SAAR+"). The requirement would directly address preliminary negotiations in acquisitions where a binding contract might otherwise be imputed, as well as the ill-defined contractual status and scope of formal preliminary acquisition agreements. Drawing inspiration from Judge Friendly's observation advocating a fairly simple bright-line approach in complex business negotiations generally, a SAAR would preclude the formation of a binding agreement based on preliminary negotiations regardless of specificity in the absence of a signed acquisition agreement. A simple SAAR formality, however, would do little to eliminate the contractual opacity that inheres in signed formal preliminary acquisition agreements which may or may not be binding and, if binding, whose scope may be ill-defined. This inherent opacity of formal preliminary agreements is addressed with the enhanced SAAR+ regime: a simple SAAR coupled with a default rule that would limit damage remedies to reliance damages unless the parties expressly contract otherwise, either to eliminate damages, or to allow damages in excess of reliance damages. The default rule would incentivize contracting parties to make their intentions explicit with respect to the intended status and scope of any formal preliminary acquisition agreement.

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"Under a view conforming to [the realities of complex business agreements], there would be no contract in such cases until the document is signed and delivered; until then either party would be free to bring up new points of form or substance, or even to withdraw altogether."[1]

I. INTRODUCTION

Preliminary dealings, whether in the form of negotiations that create an informal agreement or formal preliminary agreements, have attained special prominence in the context of acquisition agreements. This is hardly surprising. Business acquisitions by their very nature are complex, fact-specific, and even existential, transactions that invariably involve the controlled exchange (or, alternatively, the indirect revelation) of significant amounts of commercially sensitive information and the weighing of numerous business risks and contingencies. Such transactions are naturally suited to a multi-step process of negotiation and contract formation that is dissimilar to the simple and commonly invoked offer-and-acceptance model of mutual assent characteristic of many, if not most, ordinary commercial transactions.

Numerous contract formation issues can beset preliminary dealings, and the common law provides various doctrines that govern contract formation generally that affect the contracting status of preliminary dealings, including preliminary agreements.[2] Mere negotiations that contemplate an

[1] Int'l Telemeter Corp. v. Teleprompter Corp., 592 F.2d 49, 57–58 (2d Cir. 1979) (Friendly, J., concurring). Judge Friendly's lament, which he freely conceded was not the established view of the common law, was not made in connection with an acquisition transaction, but nevertheless provides an apt point of departure for the themes developed herein.

[2] *See* Richard Craswell, *Offer, Acceptance and Efficient Reliance*, 48 STAN. L. REV. 481, 482 (1996) ("While the question [of formation] is straightforward enough, contract law attempts to answer it with a bewildering array of doctrines."). The insight of Craswell's article is developed in the

agreement, either explicitly or implicitly, but that never result in one are well-recognized as outside the scope of contractual relations.[3] Nevertheless, in the absence of a formal written agreement or an explicit oral agreement, negotiations in the colloquial (i.e., non-legal sense) can inadvertently trigger creation of binding contractual obligations.[4]

Formal preliminary acquisition agreements represent a more advanced stage in the contracting process. Such agreements (whether couched as preliminary agreements or as a letter of intent, memorandum of understanding, or agreement in principle), by definition, contemplate a fuller and final specification of rights and obligations in a subsequently executed definitive agreement. The subsequent contemplated definitive agreement refers to the final expression of the parties' respective rights and obligations in connection with the transaction. In contemporary practice, the difference between a formal preliminary agreement and a definitive acquisition agreement (notwithstanding obvious differences among acquisition agreements based on the nature of the contemplated transaction) is facially apparent in terms of detail and specificity; the former typically run fewer than 10 pages while the latter tend to run 40 to 50 pages. The very nature of formal preliminary

context of offer and acceptance contract doctrine, a simpler method of establishing contract formation than the fact-intensive alternative approach relevant to preliminary dealing, namely an approach heavily reliant on determining the parties' intent to contract through an extended negotiation process.

[3] *See* RESTATEMENT (SECOND) OF CONTRACTS §26 (AM. L. INST. 1981) (explaining that a person's "manifestation of willingness to enter a bargain" is without contractual consequence if the counterparty "has reason to know that the person . . . does not intend to conclude a bargain" without taking subsequent action). The preliminary negotiation principle precludes characterization of many preliminary dealings as an offer, a result that would otherwise give the counterparty the "power" to create a binding contract through acceptance. *See* Arthur Corbin, *Offer and Acceptance, and Some of the Resulting Legal Relations*, 26 YALE L.J. 169, 181–82 (1917); *see also* RESTATEMENT (SECOND) OF CONTRACTS §24 (AM. L. INST. 1981). Strict offer and acceptance problems in the acquisition context are infrequent. Nevertheless, the proposal advocated here would also alter this dynamic in the acquisition context.

[4] *See infra* Section II.A.

acquisition agreements is thus a strange contractual bird, potentially creating obligations that may govern subsequent negotiations or even the substantive rights and obligations of participants in a proposed transaction, but at the same time denoting in some sense that the terms of the intended contemplated agreement are incomplete and remain to be negotiated.

To avoid confusion, it is useful before proceeding to sketch out terminological conventions followed in this Article (and anticipated in the preceding paragraphs). First, this Article is focused only on formation of bilateral contractual agreements and not related to issues of precontractual liability (i.e., promises enforceable based on reliance that may precede contract formation).[5] Second, this Article addresses negotiations that may give rise to a binding "final agreement" that is oral.[6] Such acquisition agreements will be denominated as informal acquisition agreements. Third, the Article refers to formal agreements, meaning executed (that is, signed) written documents. Formal acquisition agreements can be framed as a "preliminary agreement" (i.e., an agreement that

[5] *See, e.g*, Hoffman v. Red Owl Stores, Inc., 133 N.W.2d 267 (Wis. 1965) (holding that franchisor had made enforceable promises to a prospective franchisee over extended negotiations, even though the negotiations of the franchisor and prospective franchisee never resulted in an enforceable franchise agreement). The issue of non-consensual pre-contractual liability arising in the context of negotiations (i.e., quasi-contractual promissory liability absent contract formation) has elicited significant scholarly commentary. *See generally* Avery Katz, *When Should and Offer Stick? The Economics of Promissory Estoppel in Preliminary Negotiations*, 105 YALE L.J. 1249 (1996); Omri Ben-Shahar, *Contracts without Consent: Exploring a New Basis for Contractual Liability*, 152 U. PA. L. REV. 1829 (2004); Juliet P. Kostritsky, *Uncertainty, Reliance, Preliminary Negotiations and the Holdup Problem*, 61 SMU L. REV. 1377 (2008). Although not addressed explicitly, the proposal advanced herein would foreclose pre-contractual liability in the context of acquisition-related preliminary dealings.

[6] In this sense, an oral agreement is used broadly to encompass agreements that are the product merely of oral negotiations, but also may include oral negotiations supplemented by written materials, such as correspondence, draft documents or unsigned term sheets that disclaim any independent binding effect. In other words, as used here, an oral acquisition agreement that purports to be a final agreement is meant to contrast with a formal agreement (as defined in the text below) that memorializes either a preliminary agreement or definitive agreement.

contemplates a subsequent agreement that will fully express the terms of a final agreement for a proposed transaction)[7], or a "definitive agreement" (i.e., a longer agreement that purports to be a complete expression of the terms of the agreement for a proposed transaction).[8]

Contract formation principles are a source of uncertainty in the acquisition context. The uncertainty stems directly from the fact that common law principles tolerate a fair degree of opacity both in formation (i.e., uncertainty regarding whether a binding agreement exists because the determination must be inferred from facts and circumstances) and outcome (i.e., where an agreement exists, uncertainty whether the agreement is binding and, if binding, the scope of the binding agreement). Formation opacity can lead to contract surprise: one or the other party's subjective expectations regarding whether an agreement has been reached may diverge from the law's conclusion as to the existence of an agreement. Specifically, for example, a party engaged in negotiations may be surprised that a binding contract has been inadvertently formed,[9] or conversely, a counterparty may be frustrated to learn that no binding contract has been created, notwithstanding the appearance of the trappings of a binding agreement.[10] For the sake of clarity, this Article distinguishes

[7] In theory, a preliminary agreement could be expressed in an oral or unsigned agreement. This issue can be ignored in this Article since oral or unsigned preliminary agreements will be treated the same as other forms of informal preliminary negotiations (i.e., under the SAAR+, they too will be unenforceable). In contract, as discussed below, formal preliminary agreements (i.e., signed written agreements) exhibit a different kind of analytical issue. For this reason, throughout the Article, preliminary agreements is a term used interchangeably with formal preliminary agreements.

[8] To be sure, a definitive agreement will also be a final agreement. However, to maintain a sharp distinction between informal and formal final agreements, this Article will refer to the informal oral agreement as a final agreement and the formal final agreement as a definitive agreement.

[9] For example, a party may exclaim after the fact: "I didn't think there was a deal until we signed a document."

[10] For example, a counterparty after a handshake deal (e.g., "We have a deal, let's shake on it") may be frustrated to learn that because the deal involved a land contract subject to a statute of frauds provision, the handshake deal cannot be enforced.

between two different types of generic contract surprise. Surprise that a binding agreement has been formed will be referred to as "inadvertent contract formation surprise" (or sometimes merely as "contract formation surprise"), while frustration arising from a finding of no agreement when one party believes an agreement exists is referred to as "contract formation frustration" (or merely "contract frustration").[11] For the most part, common law principles of mutual assent and certainty (or definiteness) can be viewed as attempting to balance reasonably between these conflicting sources of contract formation surprise and contract frustration.[12]

Under the common law, contract formation principles governing acquisitions are, in theory, no different from the principles applicable in other contracting contexts, though facts and circumstances in each context may inform their application. As a result, contracts casebooks frequently use preliminary dealings in acquisition case law to illustrate problems in contract formation generally.[13] Typically, case law reduces to

[11] Of course, the concepts of "surprise" and "frustration" are very much in the eye of the beholder and the notational convention adopted here is merely to capture the twin unanticipated effects when the contracting parties view of a putative agreement diverge as to the issue of formation. One might be tempted to think of the concepts of surprise and frustration as symmetrical problems, but that itself may prove to be a contested assertion as argued below, if the costs of mistaken enforcement and non-enforcement and the costs of avoidance of contract surprise are context specific.

[12] The common law requirements of mutual assent and certainty are respectively summarized in general terms in RESTATEMENT (SECOND) OF CONTRACTS §§17, 33 (AM. L. INST. 1981).

[13] For example, established acquisition cases in the preliminary dealing canon—Texaco, Inc. v. Pennzoil, Co., 729 S.W.2d 768 (Tex. App. 1987) (affirming jury verdict on claim of tortious interference with contract based on jury's subsidiary finding as to the existence of a binding acquisition agreement in light of partially signed preliminary agreement and oral negotiations); Empro Mfg. Co. v. Ball-Co Mfg., Inc., 870 F.2d 423 (7th Cir. 1989) (holding that binding preliminary acquisition agreement requiring further negotiation was not breached by subsequent failure to reach a definitive agreement); Copeland v. Baskin Robbins U.S.A., 117 Cal. Rptr. 2d 875, 885 (Cal. Ct. App. 2002) (distinguishing binding preliminary agreements from "agreement[s] to agree" and imposing duty to negotiate in good faith on the former, but limiting damages for breach to reliance damages); SIGA Techs., Inc. v. PharmAthene, Inc., 67 A.3d 330, 346–47 (Del. 2013)

a very practical determination in the case of informal agreements: did the parties have a contract?

In the case of a formal preliminary agreement where parties to the preliminary agreement ultimately fail to execute a definitive written agreement, uncertainty arises as to outcome in several senses. Of course, there is the garden variety outcome uncertainty relating to issues of meaning, construction and performance. However, as relevant here, a radical form of outcome uncertainty inheres in formal preliminary agreements. As in the case of inadvertent informal agreements, formal preliminary agreements have underlying existential outcome issues unlike garden variety outcome uncertainty issues. The issues include: (i) whether the formal preliminary agreement is binding; (ii) if binding, is it binding as to the contemplated final transaction or, merely as to an obligation to negotiate in good faith toward execution of a definitive agreement; and (iii) what are the remedial consequences of failure to negotiate in good faith.[14]

[hereinafter *SIGA I*] (finding party breached duty to negotiate in good faith by insisting on "drastically different and significantly more favorable" terms than set forth in term sheet attached to preliminary agreement)—are commonly used in casebooks to illustrate issues of contract formation. *See, e.g.*, RANDY E. BARNETT & NATHAN B. ORMAN, CONTRACTS: CASES AND DOCTRINE 221 (7th ed. 2021) (featuring *Empro* and *Copeland* to illustrate written memorials contemplated in formation contexts); JOHN P. DAWSON, WILLIAM BURNETT HARVEY, STANLEY D. HENDERSON & DOUGLAS G. BAIRD., CONTRACTS, CASES AND COMMENTS 428-34 (11th ed. 2019) (including *SIGA I* to demonstrate liability arising from preliminary negotiations); E. ALLAN FARNSWORTH, CAROL SANGER, NEIL B. COHEN, RICHARD R.W. BROOKS & LARRY T. GARVIN, CONTRACTS, CASES AND MATERIALS 190–91 (10th ed. 2023) (referencing *Texaco* and another acquisition case).

14 To distinguish the ways in which contract surprise figures in discussing preliminary dealing, this Article will use the qualifier "formation" with respect to contract surprise or uncertainty when talking about inadvertent informal agreements (i.e., formation surprise) and the qualifier "outcome" with respect to contract surprise or uncertainty regarding formal preliminary agreements (i.e. outcome surprise). In addition, it is important to underscore that the use of outcome surprise is in the specific radical sense discussed above rather than in the generic sense of any number of sources of outcome uncertainty than may inhere in any binding contract.

Issues involving preliminary dealings, including issues regarding formal preliminary agreements, have received much attention from legal commentators over the last twenty-five years.[15] Preliminary agreements, in particular, have garnered significant attention from contract scholars. Some scholars have honed in on the economic logic of binding preliminary agreements and argue that contract law should facilitate the objectives of the contracting parties in entering such agreements, or even argue that the common law actually provides an optimizing framework for contracting.[16] In addition, others have sought to explain the utility of non-binding preliminary agreements that rely on self-enforcing mechanisms to serve their purpose.[17]

As evidenced by their widespread use, preliminary agreements and other forms of preliminary dealing are viewed as advantageous by contracting parties. Nevertheless, as this article will demonstrate, the desirability of the current regime of common law principles governing preliminary dealings in the corporate acquisition context is not free from doubt. Conventional accounts which provide rationalizations for existing

[15] *See* E. Allan Farnsworth, *Precontractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations*, 87 COLUM. L. REV. 217, 218–20 (1987). Farnsworth's comprehensive discussion of the common law approach is widely regarded as a foundational contribution to the literature. For a slightly earlier statement of the need for doctrinal clarity with respect to formal preliminary agreements, see generally Charles L. Knapp, *Enforcing the Contract to Bargain*, 44 N.Y.U. L. REV. 673 (1969).

[16] *See* Alan Schwartz & Robert E. Scott, *Precontractual Liability and Preliminary Agreements*, 120 HARV. L. REV. 661 (2007); Albert H. Choi & George Triantis, *Designing and Enforcing Preliminary Agreements*, 98 TEX. L. REV. 439 (2020).

[17] This literature emphasizes the use of agreements to effectuate self-enforcing mechanisms rather than legally binding obligations, such as the importance of non-legal norms in preliminary acquisition agreements. *See* Cathy Hwang, *Faux Contracts*, 105 VA. L. REV. 1025 (2019) [hereinafter *Faux Contracts*]; Cathy Hwang, *Deal Momentum*, 65 UCLA L. REV. 376 (2018) [hereinafter *Deal Momentum*]. *See generally* Robert E. Scott, *A Theory of Self-Enforcing Indefinite Agreements*, 103 COLUM. L. REV. 1641 (2003). Scott's leading article frames the issue of self-enforcing agreements more broadly in the contracts literature apart from preliminary agreements per se.

common law norms suffer from a flawed shared assumption. They assume normatively that largely the same common law contract formation principles should apply with respect to preliminary dealings across contracting contexts and ignore the possibility of alternative contracting formation frameworks that might be more desirable from a policy perspective in the case of corporate acquisitions.[18]

This article challenges this received wisdom in two respects. It rejects the idea that the common law approach to contract formation should be applied in the context of corporate acquisitions without qualification. More generally, certain contracting contexts (and, as relevant here, acquisition scenarios) may be better suited for modified contract formation regimes.[19] Second, the contracting formation regime

[18] Farnsworth is unapologetic in this respect. Farnsworth, *supra* note 15, at 220 ("Some observers have concluded that existing contract doctrines are not adequate to the task of protecting the parties. I argue that, on the contrary, those doctrines, imaginatively applied, are both all that are needed and all that are desirable."). The position of other scholars may be more hedged, but they embrace the same type of unified common law approach. *See, e.g.*, Schwartz & Scott, *supra* note 16, at 691**,** 705 (deriving general "framework for treating early reliance cases that . . . would improve efficiency if courts were to adopt it" and applying the model to case law to show consistency with decisional law); Gregory Klass, *Intent to Contract*, 95 VA. L. REV. 1437, 1440, 1499 (2009) ("examin[ing] various common-law rules that condition the enforcement of an agreement on the parties' intent to contract" and "demonstrat[ing] the potential value of tailored [common law] defaults and opt-out rules that condition legal liability on the parties' intent to contract"). In rejecting a unitary approach in this area, this Article practically embraces a more instrumental approach. *See* Avery W. Katz, *The Economics of Form and Substance in Contract Interpretation*, 104 COLUM. L. REV. 496, 524 (2004) (challenging "a unitary theory for choosing between form and substance, since the answer in any particular case will turn on a comparison of various types of transaction costs"). This rejection of the dominant unitary view suggests that formalism might indeed be preferred for instrumental reasons in some categories of cases, as argued here.

[19] Indeed, what is rather surprising about the unconscious assumption that preliminary dealings be governed by a uniform corpus of principles is that scholars who have adopted such an approach would never dispute the core premise of the U.C.C.'s Article 2—that contract formation principles should give way to commercial realities in the context of contracts for the sale of goods. *See*, *e.g.*, Architectural Metal Sys., Inc. v. Consolidated Sys,

for corporate acquisitions would benefit from contracting rules (rules or standards imposed by statute rather than rules or standards derived solely from common law principles) that prescribe a higher degree of formality in formation. The basic argument advanced here is essentially one where the proof is in the pudding: that is, the ability to provide clearer and more predictable formal contract rules governing formation in the context of preliminary dealings in corporate acquisitions necessitates rejecting the common law status quo and legislatively mandating an alternative regime.

In particular, this article proposes a concise legislative proposal (with model language set forth in an appendix) that offers a pragmatic alternative to the common law with respect to preliminary dealings in corporate acquisitions. The statutory-based alternative would bring clarity and predictability to contracting outcomes in this area. The proposed statutory mandate consists of two basic requirements. First, all acquisition agreements (preliminary and definitive) would be subject to a signed acquisition agreement requirement ("SAAR"). This mandate would put the onus on the contracting parties to make their contracting intent explicit in the form of a signed written agreement before judicially enforceable contractual obligations would attach. A second requirement, applicable to formal preliminary agreements alone, would fix the remedy for breach to reliance damages unless the preliminary agreement explicitly provided otherwise. For example, an agreement could provide for expectation damages (or some reasonable liquidated measure thereof) or eliminate any right to damages in the event of a breach. Together, the two requirements embrace a formalist approach to contracting in the

Inc., 58 F.3d 1227, 1230 (7th Cir. 1995) ("The Uniform Commercial Code, its draftsmen mindful of the haste and sloppiness, and disregard for lawyerly niceties, that characterize commercial dealing, tolerates a good deal of incompleteness and even contradiction in offer and acceptance."). The U.C.C.'s formation principles are famously more lenient than the common law, and the common law's certainty requirements are considerably relaxed by the U.C.C.'s gap-filler provisions. *See*, *e.g.*, U.C.C. §§ 2-204–2-207, 2-305–2-310 (AM. L. INST. & UNIF. L. COMM'N 2022).

acquisition context, mandating expressed intent. This is referred to herein as the SAAR+ regime.[20]

The formal bright-line contracting principle (the simple SAAR alone) is superior than the common law in the context of acquisition agreements because it preserves the ability of one or both parties to remain free from contract with certainty, an element of contracting that assumes unusual importance in acquisition transactions. In contrast, as noted, the common law approach deliberately favors formation opacity because formation opacity meets other objectives appropriate in other contracting contexts. The common law regime seeks to promote the integrity of informal negotiation processes to protect legitimate contractual expectations, but it does so at the risk of mistakenly imposing contract obligations on an unsuspecting party. In short, the common law regime is tied to an implied balancing of costs and benefits. However, as this article will argue, the balance of benefits and harms in the context of acquisition agreements dramatically differs from other contracting contexts in ways that warrant imposing a higher evidentiary burden in establishing contractual intentionality. Four features in the acquisition context are particularly salient: (i) an intrinsically multi-step bargaining process; (ii) the routine participation of sophisticated business counsel; (iii) the costs of potentially enormous contractual liability arising from contested (and generally equivocal) inferences where contractual clarity can be obtained at relatively low cost; and (iv) disproportionate windfalls or forfeitures for

[20] To sharpen the reader's intuitions about the Article's argument, another way to think about its thesis is as follows: just as the U.C.C. relaxed common law contract formation principles in the context of the sale of goods, this Article is suggesting a higher degree of formality in contract formation than the common law with respect to corporate acquisitions. Indeed, as is well known, statute of frauds ("SOF") principles also impose a higher degree of formality in certain contract formation contexts. Although the SAAR+ proposal advanced here may sound like an SOF proposal for corporate acquisitions, it is more exacting in that it requires more than merely a sufficient signed writing evidencing an agreement and functions dramatically differently with respect to formal preliminary acquisition agreements where damage remedies would need to be specified. *See infra* Section II.C.

third-party stakeholders in the case of mistakenly imposed obligations.[21]

Although a simple SAAR requirement standing alone would resolve the issue of inadvertent contract surprise with respect to preliminary negotiations, it offers little clarity as to other issues arising from formal preliminary agreements. The simple SAAR requirement will, by definition, always be satisfied in the case of a formal preliminary agreement. Nevertheless, preliminary agreements can give rise to a different type of inadvertent contract surprise: uncertainty as to scope of any binding obligations with respect to a final definitive agreement. Courts have recognized three loose categories of preliminary agreements: non-binding agreements to agree; preliminary agreements that bind the participants to a final agreement because they are materially complete (so-called Type I agreements); and preliminary agreements that impose a duty to negotiate in good faith with respect to a final agreement (so-called Type II agreements).[22] These categories of agreement entail drastically different contractual obligations and remedial consequences for contracting parties. Application of recognized common law principles to formal preliminary agreements entails fact-specific determinations which engender uncertainty as to the scope of any resulting obligations. This uncertainty is unresolved by a simple SAAR requirement since the issue arises from a formal agreement. Hence, the purpose of a second requirement (SAAR+).

[21] In other words, the proposal envisions elevating *freedom from contract* considerations (inherent in inadvertent contract formation surprise) in corporate acquisitions over *freedom to contract* considerations (arising from contract formation frustration).

[22] Of course, preliminary agreements can also implicate subsidiary enforceable contractual obligations arising from ancillary promises relating to the ultimate transaction (such as, confidentiality or exclusivity obligations). These issues are not dealt with in this Article and would be unaffected by the SAAR+ proposal. *See, e.g.*, EV3, Inc. v. Lesh, 114 A.2d 527 (Del. 2014) (distinguishing between binding confidentiality and non-binding funding obligations in letter of intent); SCS Commc'ns, Inc. v. Herrick Co., Inc., 360 F.3d 329, 341 (2d Cir. 2004) (holding that although the preliminary agreement's ultimate acquisition objective was not enforceable, the agreement's covenant to "acquire it together or not at all" was).

The second requirement (the "+" in "SAAR+") would impose a formal requirement on the contracting parties with respect to the remedial consequences of formal preliminary agreements. The second requirement would make reliance damages the default remedy for breach of a preliminary agreement regardless of type, unless the parties explicitly negotiate around the default. Thus, in the case of formal preliminary acquisition agreements, SAAR+ mitigates contractual surprise by requiring the contracting parties to unambiguously agree ex ante to any remedy measure other than the default of reliance damages. The practical consequence of such a requirement is to force contracting parties to negotiate ex ante with respect to a default that otherwise fixes the preliminary agreement's status and scope rather than rely on courts to ascertain the preliminary agreement's status and scope by hindsight or, if binding, to determine how damages should be measured.

The article is structured in three parts. Part II addresses the conventional common law formation issues posed by preliminary dealings. Part III describes current scholarly explanations for formal preliminary agreements and discusses how these explanations both clarify and obscure legal policy as to corporate acquisitions. Part IV shows how an alternative to existing common law formation principles and policies based on contract formalism provides a superior approach to contracting with respect to corporate acquisition agreements. Specifically, Part IV describes the SAAR+ proposal and demonstrates why such an approach would improve bargaining outcomes in that context.

II. THE FORMATION PROBLEM IN PRELIMINARY DEALINGS: FORMATION OPACITY AND CONTRACT SURPRISE

Preliminary dealings that result in either informal or formal acquisition agreements implicate a number of overlapping common law contract formation issues. These issues highlight the risk of "formation opacity" in the contracting process. Doctrines that permit formation opacity may advance legitimate policy considerations, but they also entail cost for

contracting participants, especially in the context of complex acquisition negotiations. This Part provides an overview of the most salient formation challenges faced by contract participants in preliminary dealings, highlighting how they can contribute to formation opacity. Even conceding that formation opacity arising under the common law may be beneficial in many contracting contexts, the doctrinal principles operate across all contracting contexts, posing a question of whether the same level of formation opacity is desirable in all contexts—a presumption challenged in this article.[23] Formation opacity gives rise to instances of avoidable unexpected contract formation surprise. The problem of contract surprise is especially costly and unnecessary in the case of corporate acquisitions and, accordingly, this article advocates for greater formalism in contract formation principles in that context.

Generally, preliminary dealings raise two practical issues: (i) when do preliminary dealings (oral negotiations or unexecuted documents, including drafts) give rise to a binding agreement; and (ii) what is the nature and scope of the binding obligations in formal preliminary agreements that contemplate definitive agreements. These practical considerations are heavily affected by two related common law contract formation doctrines: mutual assent and definiteness. The two doctrinal concepts assume different significance in the two contracting contexts: informal agreements and formal preliminary agreements. Preliminary dealings result in a binding informal agreement only if the parties mutually assent to an agreement.[24] This issue assumes unusual significance in informal agreements because assent may be reasonably inferred from conduct even if a party "does not in fact assent" (or did

[23] As noted already, contracting regimes, depending on the context, may be more or less tolerant of formation opacity. Formality requirements minimize formation opacity, but can increase the potential for seemingly arbitrary outcomes that either impose excessive costs to contracting or frustrate the legitimate expectations of a contracting parties. This provides the basis for widely shared critiques of the statute of frauds, see *infra* Section II.C.

[24] *See infra* Section II.A (discussing requirement of parties' mutual assent to form binding agreement).

not subjectively intend to be bound).[25] In such circumstances, courts also consider the definiteness of the proposed arrangement as a factor in analyzing the parties' assent.[26]

In the case of formal preliminary agreements, the issue of mutual assent recedes into the background because both parties have explicitly assented to the arrangement. As a result, the requisite definiteness, rather than some proxy for intent to be bound in the abstract, assumes critical significance in determining whether an enforceable obligation exists and what its scope is.

This Part addresses the basic common law principles and case law in contributing to what in this article is referred to as formation opacity—the lack of clarity in determining the existence of a binding informal agreement based on the totality of facts and circumstances or in determining the scope of any binding obligation under a formal preliminary agreement. As noted, tolerance of formation opacity in the common law serves the important function of allowing parties to conclude binding agreements in routine contracting contexts (as discussed below, inferring what parties would reasonably infer from the course of negotiations). Nevertheless, it is necessary to consider how common law principles contribute to formation opacity in the context of complex business transactions, such as acquisitions. Formation opacity may figure in both informal acquisition agreements and formal preliminary acquisition agreements, and in each context, formation opacity contributes to the incidence of contract surprise.

A. Formation Opacity in Informal Agreements Generally and in Acquisitions

In the context of informal agreements, a binding agreement must be inferred from the parties written or spoken

[25] *See* RESTATEMENT (SECOND) OF CONTRACTS §19(1) (AM. L. INST. 1981).

[26] Definiteness functions as an independent principle that imposes a constraint on enforceability. *See* RESTATEMENT (SECOND) OF CONTRACTS § 33 cmt. a, b (AM. L. INST.1981) ("[T]he agreement must be capable of being given an exact meaning and . . . . the degree of certainty required may be affected by the dispute which arises and by the remedy sought.").

words or their conduct.[27] Preliminary dealings (such as extended oral negotiations) may create a binding agreement where the parties' dealings culminate in mutual assent based on the contracting parties' objective manifestations of assent to be bound to an agreement.[28] The manifestation of assent is in many contexts viewed as coincident with evidence of an intent to be bound, but while the former is required, the latter is not.[29]

In the absence of a signed written agreement, the common law relies on reasonable inferences drawn from objective manifestations of bargaining behavior of the contracting parties in determining assent.[30] As a result, the requisite assent for contract formation in the case of informal agreements may not necessarily be subjectively intended by a contracting party. Contract law is replete with examples of the potential divergence between objective manifestations of assent and instances where intent to be bound are contested based on asserted subjective expectations to the contrary.[31] This tendency

[27] *See* RESTATEMENT (SECOND) OF CONTRACTS §19(1) (AM. L. INST. 1981) (providing that assent manifested by written words, spoken words, or other acts).

[28] *See id.* (noting that a party may manifest assent even without assenting in fact).

[29] *See* Klass, *supra* note 18, at 1447 (discussing distinction between American contract law where intent to be bound is not required and English contract law where it is); *see also* RESTATEMENT (SECOND) OF CONTRACTS § 21 cmt. a (AM. L. INST. 1981) ("[Facts relating to intention to be legally bound] may be important in interpreting their manifestations of intention and in determining legal consequences, but they are not essential to the formation of contract.").

[30] *See* RESTATEMENT (SECOND) OF CONTRACTS § 19(1) (AM. L. INST. 1981) ("The manifestation of assent may be made wholly or partly by written or spoken words or by other acts or by failure to act.").

[31] *See, e.g.*, Lucy v. Zehmer, 84 S.E.2d 516, 522 (Va. 1954) (rejecting defendant-seller's defense that he and his wife had been joking when they signed a document of sale in order to fool the putative purchaser and explaining: "The mental assent of the parties is not requisite for the formation of a contract. If the words or other acts of one of the parties have but one reasonable meaning, his undisclosed intention is immaterial except when an unreasonable meaning which he attaches to his manifestations is known to the other party.").

is only further underscored in the offer and acceptance context, where very specific consequences follow from acceptance of an offer which, though definite, may not even involve an integrated statement of the terms of the agreement.[32]

The potential divergence between acts of assent and subjective intent to be bound may be enhanced when an informal agreement evolves out of multi-step negotiation process that relies heavily on multiple inferences about conduct, progress in the negotiation, and the relationship among the issues raised. Although courts may seek objective manifestations of assent, the analysis in such situations will likely incorporate proxies for assent that try to ascertain intent to be bound.[33] Nevertheless, the common law's emphasis on objective manifestations of assent (such as an offer and acceptance) in negotiating an unexecuted complex business agreement means that a binding informal agreement may arise even though the parties reasonably diverge in their belief as to the existence of a binding agreement.[34] In such circumstances, what may be

[32] *See, e.g.*, Embry v. Hargadine, McKittrick Dry Goods Co., 105 S.W. 777, 779 (Mo. Ct. App. 1907) (holding that the parties' subjective intent was not relevant to jury's finding of a binding agreement when defendant-employer stated "don't let that worry you" in response to employee's request for clarification of continued employment term).

[33] *See* Craswell, *supra* note 2, at 537 ("The courts seem to agree that the issue in [cases involving preliminary agreements] is whether parties intended to be bound, keeping in mind that intentions must be interpreted objectively, and that secret intentions undisclosed by one party are irrelevant."); Klass, *supra* note 18, at 1444 (noting in discussing difference in American and English rules regarding the necessity of showing intent to be bound that "[t]he rules agree that an agreement is enforceable where there is a manifest intent to be bound and that it is unenforceable when there is a manifest intent not to be bound. They differ on those cases in which one or both parties manifest no intent with respect to legal liability, neither an intent to be bound, nor an intent not to be bound."); *see also* Melvin Aron Eisenberg, *Expression Rules in Contract Law and Problems of Offer and Acceptance*, 82 CALIF. L. REV. 1127, 1131 ("A deep difference between classical contract law and modern contract law is that classical contract law tended to be objective and standardized, while modern contract law tends to include subjective and individualized elements as well.").

[34] A frequent lament of commentators has been the deficiencies of the offer-and-acceptance paradigm as a basis for inferring an intent to be bound across a wide variety of contracting contexts, including complex business

regarded as merely continued preliminary dealings by one of the contracting parties may be sufficient to sustain a finding that an agreement exists (though such an agreement may seem to be incomplete in some respects). In short, at common law, there can be significant opacity as to formation in inferring an informal agreement from a multi-step negotiation process.

Over the last fifty years, the United States Court of Appeals for the Second Circuit, putatively interpreting New York law, has taken a leading role in carving out a widely followed jurisprudence regarding enforceability of both informal agreements in complex business transactions, and, as discussed in the following section, formal preliminary agreements that constitute a binding final agreement. As to the binding nature of informal agreements, the Second Circuit standard is formulated as a four-part multi-factor test:

transactions. *See* Jason Scott Johnston, *Communication and Courtship: Cheap Talk Economics and the Law of Contract Formation*, 85 VA. L. REV. 385, 465–66 (1999) (arguing that "[t]he process by which complex business deals are arranged differs markedly from that presumed by the offer-and-acceptance paradigm[,]" and as a result, the common law has struggled to avoid "doctrinal uncertainty" with respect to formation issues in the former context). Some commentators have sought to blunt the rigid and mechanical aspects inherent in the offer-and-acceptance paradigm by stressing alternative analytical approaches. *See* Craswell, *supra* note 2, at 483–84 (arguing that underlying economic incentives of the contracting parties should be used to aid in inferring the "parties most likely intentions"); Eisenberg, *supra* note 33, at 1148 (noting that modern contract law has moved away from black-letter expression rules that define the offer-and-acceptance paradigm in cases where those rules are not "highly congruent with general principles of interpretation."); *see also* Shawn J. Bayern*, Offer and Acceptance in Modern Contract Law: A Needless Concept,* 103 CALIF. L. REV. 67, 73 (2015) (arguing that "general interpretive principles should replace not just individual expression rules (operating within the offer-and-acceptance paradigm) but the whole notion of offer and acceptance"). These critiques of the offer-and-acceptance paradigm suggest greater reliance on multi-factor fact-intensive approaches to inferring contractual intent. The SAAR+ proposal advocated here, however, suggests a far different approach and less fact-intensive approach to inferring intent to be bound in preliminary dealings by specifically insisting on formal statements of express intent within a written agreement.

1) whether there has been an express reservation of the right not to be bound in the absence of a writing;
2) whether there has been partial performance of the contract;
3) whether all of the [material] terms of the alleged contract have been agreed upon; and
4) whether the agreement at issue is the type of contract that is usually committed to writing.[35]

As a preliminary matter, two methodological features are notable in this multi-factored approach. First, the test commits courts to a facts-and-circumstances determination which is likely to produce outcomes in which courts (or the finder of fact if a question of fact) could reach different ultimate conclusions based on similar facts by virtue of weighting different factors differently. Second, while the test is nominally objective in its application (i.e., what a reasonable observer would infer from the observable conduct of the contracting parties), its application is likely to be open-ended in complex contracting contexts. Thus, an outcome under the multifactor approach is less likely to produce bright-line outcomes than say, for example, classic offer-and-acceptance sequences to establish mutual assent.

In practice, two of the test's four factors have assumed outsized significance: the first, regarding an express reservation of the right not to be bound, and the third, whether there has been agreement to the agreement's essential terms.[36]

[35] *See* Winston v. Mediafare Ent. Corp., 777 F.2d 78, 80 (2d Cir. 1986) (Judge Pratt's decision restating four factors identified in his earlier authored opinion in R.G. Group, Inc. v. Horn & Hardart Co., 751 F.2d 69 (2d Cir. 1984) and declining to find a binding informal agreement based on oral negotiations and unexecuted drafts).

[36] The fourth factor is generally answered by courts in the affirmative since complex business transaction are expressed in writing. *See, e.g.*, Texaco, Inc. v. Pennzoil, Co., 729 S.W.2d 768, 795 (Tex. Ct. App. 1987) (noting that while in complex corporate acquisition transactions "a signed contract would ordinarily be expected before the parties would consider themselves bounds[,] . . . we cannot say, as a matter of law, that this factor alone is determinative of the question of the parties' intent"). The second factor does not generally figure as dispositive since the level of partial performance in preliminary agreement cases may be merely marginal or equivocal at best.

Interestingly, the first factor elevates the significance of the parties' intent to be bound as part of the analysis of complex business transactions, and potentially invites a reasoned assessment of parties' subjective intentions.[37] There are two ways to think about this element of the analysis. If emphasis is put on an actual "express reservation," then the factor functions as a means by which one party can unilaterally opt out from the possibility that the preliminary negotiations might be treated as binding.[38] However, sometimes this feature is reframed, as Klass refers to it, as an "all-things-considered" factor that is not an explicit reservation but rather one inferred from the circumstances.[39] In that sense, a generalized

See, e.g., *id.* at 792 (in relegating this factor to the jury's factfinding discretion, asserting: "[W]e find little relevant partial performance in this case that might show that the parties believed that they were bound by a contract. However, the absence of relevant past performance in this short period of time does not compel the conclusion that no contract existed.").

[37] *See Embry*, 105 S.W. at 779. As reflected in the RESTATEMENT (SECOND) OF CONTRACTS § 21 (AM. L. INST. 1981), demonstrated intent not to be bound typically precludes finding a binding agreement. *See, e.g.*, Arcadian Phosphates, Inc. v. Arcadian Corp., 884 F.2d 69, 72–73 (2d Cir. 1989) (finding language referring to the possibility that negotiations may fail and referencing a future binding sales agreement as evidence that Arcadian did not intend to be bound). However, as reflected in the footnotes below, in preliminary dealings involving complex business transaction, an understanding of the parties' affirmative intent to contract may assume virtually equal importance.

[38] *See, e.g.*, Reprosystem, B.V. v. SCM Corp., 727 F.2d 257, 261 (2d Cir. 1984) (reversing district court's finding of contract based on preliminary dealings where evidence "clearly showed that the intent of both parties was not to be bound prior to execution of a formal, written contract"); Scheck v. Francis, 260 N.E.2d 493, 494 (N.Y. 1970) ("The writings before us likewise evidence the intention of the parties not to be bound until the agreements were signed."); *see also* Klass, *supra* note 18, at 1487 (arguing for express opt-out rule found in common law).

[39] In many cases, intent to be bound or not to be bound is inferred from the totality of facts and circumstances. *See, e.g.*, *Winston*, 777 F.2d at 80–81 ("In any given case it is the intent of the parties that will determine the time of contact formation [i.e., the exact point at which an agreement becomes binding]. To discern that intent a court must look to 'the words and deeds [of the parties] which constitute objective signs in a given set of circumstances . . . . Although neither party expressly reserved the right not to be bound," the lower court erred in enforcing a settlement agreement based on

inquiry of an intent to not be bound becomes virtually symmetrical with a generalized inquiry of an affirmative intent to be bound.[40]

The other factor that assumes great significance is the third factor which correlates with the definiteness of the agreement's material terms, a requirement that has become increasing elastic under the common law.[41] The fact that essential terms in a purported agreement are unresolved is evidence of indefiniteness, precluding finding a binding agreement.[42] While the definiteness requirement serves as a partial

a definitive draft where language in earlier correspondence to the appellate court "reveal[ed]" an intent not to be bound. (quoting *R.G. Group, Inc.*, 751 F.2d at 74)); *R.G. Group, Inc.*, 751 F.2d at 73–76 (holding that notwithstanding oral affirmation that "we have a handshake deal," failure of other party to take exception to language in correspondence and drafts that expressly referenced a final written agreement supported finding that an intent not to be bound existed and therefore that no contract came into being); *see also* Int'l Telemeter Corp. v. Teleprompter Corp., 592 F.2d 49, 57 (2d Cir. 1979) ("Whether or not the parties have manifested an intent to be bound must depend in each case on all the circumstances.").

40 As reflected in the cases cited in the preceding footnote, absence of evidence of an "intent to be bound" becomes interchangeable with an "intent not to be bound." *See, e.g.*, Schwartz v. Greenberg, 107 N.E.2d 65, 67 (N.Y. 1952) ("But there is no evidence of an intention of the parties to be bound by any mere oral understanding . . . . It is entirely plain, then, that the parties did not intend to be bound until a written agreement has been signed and delivered.").

41 *See* RESTATEMENT (SECOND) OF CONTRACTS § 33(3) (AM. L. INST. 1981) ("The fact that one or more terms of a proposed bargain are left open or uncertain *may* show that a manifestation of intention is not intended to be understood as an offer or as an acceptance.") (emphasis added); U.C.C. § 2-204(3) (AM. L. INST. & UNIF. L. COMM'N 2022) ("Even though one or more terms are left open a contract for sale does not fail for indefiniteness if the parties have intended to make a contract and there is a reasonably certain basis for giving an appropriate remedy."). But there are limits in this regard. *See* Joseph Martin Jr., Delicatessen, Inc. v. Schumacher, 417 N.E.2d. 541, 543 (N.Y. 1981) ("Thus, definiteness as to material matters is of the very essence in contract law. Impenetrable vagueness and uncertainty will not do."). *Accord* RESTATEMENT (SECOND) OF CONTRACTS § 33(1), (2) (AM. L. INST. 1981).

42 The third factor, which is an implicit definiteness test, alternatively states that "there was literally nothing left to negotiate." R.G. Group, Inc. v. Horn & Hardart Co., 751 F.2d 69, 76 (2d Cir. 1984). In some cases,

check to inadvertent contract formation, a definiteness requirement alone is hardly a sufficient standard to preclude inadvertent contract formation. As discussed below, unexecuted agreements may be sufficiently definite when given binding effect, even though one of the contracting parties subsequently contends that it reserved the right to withdraw from a planned arrangement by never signing a draft agreement.[43]

Two notable scenarios for informal agreements have arisen in complex business transactions: (i) informal agreements premised entirely on oral negotiations alone; and (ii) informal agreements based on oral negotiations coupled with written drafts or unexecuted formal agreements. As to the first scenario, binding informal agreements are certainly possible in the case of relatively simple arrangements.[44] Unsurprisingly, however, courts have generally declined to find a binding transaction in the case of complex business transactions, such as acquisitions, based on oral negotiations alone.[45] The dearth of cases may reflect the fact that disappointed contracting parties realize that such actions are unlikely to succeed.

indefiniteness is a close factual call, while in other cases, the purported agreement is plainly deficient in its terms, precluding its enforceability. *Compare* Shann v. Dunk, 84 F.3d 73 (2d Cir. 1996) (remanding the case to the district court to determine whether critical contract terms was unresolved (rendering the agreement unenforceable) or resolved (in which case the agreement was binding)) *with* Adjustrite Sys. v. GAB Bus. Servs., 145 F.3d 543 (2d Cir. 1998) (affirming grant of summary judgment finding that signed two-page preliminary asset purchase agreement was not binding because it omitted material terms).

[43] *See infra* note 47 (discussing courts' diverging treatment of unexecuted formal agreements). In these cases, the drafts may well establish reasonable definiteness, but may not always be sufficient to establish mutual assent.

[44] *See, e.g.*, Embry v. Hargadine, McKittrick Dry Goods Co., 105 S.W. 777 (Mo. Ct. App. 1907) (extending an employee's term of employment).

[45] *See, e.g.*, United Acquisitions Corp. v. Banque Paribas, 631 F. Supp. 797 (S.D.N.Y. 1985) (holding that an oral agreement was not binding where parties contemplated written agreement and much was left to negotiate); *see generally* Mich. Broad. Co. v. Shawd, 90 N.W.2d 451 (Mich. 1958) (holding that an oral agreement for sale of stock was not binding where negotiation of complex business issues was spread over several conversations that made reference to a final agreement).

The other category—oral negotiations conjoined with draft or unexecuted agreements—represents a more challenging scenario where outcomes have varied with the facts and circumstances. When negotiations become protracted, application of the Second Circuit's multi-factor test becomes less predictable since the ultimate determination turns on evaluation of the totality of facts and circumstances. Fully negotiated formal agreements which remain unexecuted represent an extreme illustration where results have diverged.[46] In such cases, notwithstanding the fact that the parties (or their agents) may have verbally agreed to the terms of a written agreement in draft form and all that may be lacking is each party's signature, courts must infer what significance should be attached to the unexecuted agreement.[47] It does not appear

[46] *Compare* Winston v. Mediafare Ent. Corp., 777 F.2d 78, 83 (2d Cir. 1986) (holding that a partially executed final draft was unenforceable, notwithstanding execution of preceding draft); Ciaramella v. Reader's Dig. Ass'n, 131 F.3d. 320, 321, 323 (2d Cir. 1997) (holding that an unexecuted settlement agreement was unenforceable, notwithstanding the party's attorney previously orally affirming "We have a deal," where other factors weighed against finding an intent to be bound) *with* Turner Broad. Sys., Inc. v. McDavid, 693 S.E.2d 873 (Ga. Ct. App. 2010) (holding that an unsigned asset purchase agreement relating to sports franchise related arena operating rights was enforceable); Int'l Telemeter Corp. v. Teleprompter Corp., 592 F.2d 49, 56 (2d Cir. 1979) (holding that an unsigned settlement agreement relating to an intellectual property dispute was enforceable). Of course, a signature might well be required as in the case of an agreement within the scope of the statute of frauds absent other signed writings evidencing the agreement. *See, e.g.*, Scheck v. Francis, 260 N.E.2d 493, 495 (N.Y. 1970) (holding that an asserted signed writing was non-compliant with statute of frauds requirements); *R.G. Group, Inc.*, 751 F.2d at 77–78.

[47] In a number of cases, courts have exhibited extreme reluctance to find a binding agreement, even where the objective manifestations appear very close to crossing the formation line. *See, e.g.*, *Winston*, 777 F.2d at 80–82 (holding that a signed copy of final agreement accompanied by payment where oral negotiations continued as to agreement's language was not binding); *R.G. Group, Inc.*, 751 F.2d at 73, 76 (parties' oral affirmation of "handshake deal" not a binding agreement where unexecuted franchise agreement made reference to "when duly executed" trigger and contained an integration clause); Schwartz v. Greenberg, 107 N.E.2d 65 (N.Y. 1952) (holding that no agreement came into being though parties had signed counterparts of a formal agreement, when delivery of counterparts withheld

unreasonable in such circumstances that one party psychologically believes that there is an agreement, notwithstanding the absence of an unexecuted formal agreement, or that another party psychologically believes that by withholding its signature (i.e., preventing the formal agreement from coming into being) there cannot be a binding agreement (i.e., a binding informal agreement cannot be inferred).[48] Notwithstanding similarity of circumstances, courts have reached diametrically opposing results on enforceability when confronted by the absence of a signature and a fully complete draft agreement.[49]

While successful contract formation claims arising from informal preliminary dealings in acquisitions is relatively rare,[50] this is in part because of the extreme caution exercised by deal lawyers to prevent such outcomes.[51] Nevertheless, the issue is illustrated in spectacular fashion by the celebrated Texaco/Pennzoil litigation.[52] The case memorably involved a

while awaiting delivery of a cashier's check and subsequently one party changed its mind).

48 *See* Reprosystem, B.V. v. SCM Corp., 727 F.2d 257, 261 (2d Cir. 1984). The infamous decision discussed in the next paragraph, Texaco, Inc. v. Pennzoil, Co., 729 S.W.2d 768 (Tex. Ct. App. 1987), illustrates the divergence in subjective understandings among participants—a bidder (Pennzoil), a selling oil company (Getty Oil company), and Getty's jointly controlling shareholders (the Getty Trust and its trustee, and the Getty Museum)—in a complex business transaction involving interdependent agreements.

49 *See supra* note 47 (discussing courts' disparate enforcement of unexecuted formal agreements).

50 *See, e.g.*, United Acquisitions Corp. v. Banque Paribas, 631 F. Supp. 797 (S.D.N.Y. 1985) (holding that an oral agreement was not binding where parties contemplated written agreement and much was left to negotiate); Mich. Broad. Co. v. Shawd, 90 N.W.2d 451 (Mich. 1958) (holding that an oral agreement for sale of stock was not binding where negotiation of complex business issues was spread over several conversations that made reference to a final agreement).

51 *See* Hwang, *Faux Contracts*, *supra* note 17, at 1048.

52 Texaco, Inc. v. Pennzoil, Co., 729 S.W.2d 768, 805 (Tex. Ct. App. 1987). While the decision of the Texas appellate court proved to be the final decision on the merits of the tortious interference claim, related litigation proceeded in Delaware, where Pennzoil initially sought relief. *See* Pennzoil Co. v. Getty Oil Co., No. CIV. A. 7425, 1984 WL 15664, at *20 (Del. Ch. Feb.

successful $10.5 billion tortious interference claim brought by Pennzoil, a jilted bidder for a controlling stake in Getty Oil, in an action against Texaco, the eventual successful acquiror of Getty Oil in its entirety.[53] The claim was premised on Texaco's interference with Pennzoil's informal agreement with Getty and its principal shareholders to acquire a substantial stake of Getty Oil.[54] The informal agreement was allegedly breached when the Getty group agreed to be acquired by Texaco after Texaco made an offer for all Getty shares at $125 per share (compared to the informal agreement which involved a Pennzoil proposal to acquire all Getty public shares and those of one of the principal shareholders at $110 per share, later supplemented with an additional contingent $5 face-amount stub security).[55]

The events unfolded over a ten day period at the end of 1983 and the beginning of 1984 involving four parties—Pennzoil, Getty, a Trust that controlled 40.2% of Getty's common shares, and the Getty Museum which controlled an 11.8% of Getty's common shares.[56] The initial informal agreement would have had Pennzoil acquiring joint control of Getty with the Trust, with the Trust holding 57% of Getty and Pennzoil the remaining 43%.[57] As part of the "agreement," the Trust

6, 1984) (denying Pennzoil's motion for a preliminary injunction); Pennzoil Co. v. Getty Oil Co., 473 A.2d 358, 359 (Del. Ch. 1984) (finding that plaintiff had an absolute right to dismiss action with respect to Texaco where Texaco had yet to file a response to the complaint). The U.S. Supreme Court's related decision arising from the same core facts turned on a collateral constitutional challenge to the enforcement of remedies. *See* Pennzoil Co. v. Texaco, Inc., 481 U.S. 1, 17 (1987).

[53] *Texaco, Inc.*, 729 S.W.2d at 784.

[54] *Id.* This characterization is subject to possible challenge. Pennzoil and the Getty Group members never signed a definitive agreement. There was, however, a partially executed formal preliminary agreement. As discussed below, Pennzoil's argument was that the earlier partially executed agreement became fully binding upon board approval of a modified offer. The totality of the circumstances, according to the Texas Appeals Court, supported the jury's finding of a fully binding agreement (that is, an informal agreement, although not phrased as such by the court).

[55] *Id.* at 786–87.

[56] *Id.* at 785.

[57] *Id.*

and Pennzoil would subsequently determine whether (i) to restructure Getty in a new arrangement in which one or the other party would buy out the other; or (ii) divide Getty's assets and operations among the two shareholders.[58]

This basic transaction structure was reflected in a partially executed January 2 formal preliminary agreement, an agreement that was not executed by Getty Oil or its senior officer pending approval by Getty's board.[59] However, the obligations of the two Getty shareholder signatories were subject to conditions. The Museum's agreement was conditioned upon approval at the Getty board's January 2 meeting, which did not occur until a reconvened meeting on January 3.[60] The trustee's obligation was subject to a fiduciary out set forth in a side letter between the Trust and Pennzoil.[61]

The January 3 meeting did, after revised price terms, result in an affirmative vote, though members of the board differed as to the vote's meaning.[62] Nevertheless, the parties issued a joint press release on January 4 announcing that a preliminary agreement had been subject to negotiation and execution of a final definitive agreement.[63] During the ensuing 48-hour period of continued negotiations relating to a definitive agreement and attempting to secure an executed formal preliminary agreement, Getty, with the willing participation of the Trust, the Museum, various parties' outside counsel and Getty's investment banker, continued to solicit other potential bidders, including Texaco, which in short order successfully submitted a topping bid and completed a definitive agreement.[64] Texaco's topping bid resulted in the Getty's group decision to not proceed with a definitive agreement with Pennzoil.[65]

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58 *Id.*

59 Pennzoil Co. v. Getty Oil Co., No. CIV. A. 7425, 1984 WL 15664, at *3–4 (Del. Ch. Feb. 6, 1984).

60 *Id.* at *4.

61 *Id.* at *17.

62 *Id.* at *5–6, *8–9.

63 *Id.* at *6; *Texaco, Inc.*, 729 S.W.2d at 789.

64 *Pennzoil Co.*, 1984 WL 15664, at *7–8.

65 *Texaco, Inc.*, 729 S.W.2d at 787 .

Pennzoil prevailed in a jury trial that yielded a verdict for $10.5 billion.[66] The existence of a binding preexisting agreement between the Getty group and Pennzoil for its partial acquisition of Getty represented a critical threshold legal issue.[67] A Texas appellate court sustained the verdict and, in particular, the jury's determination that Pennzoil had a binding agreement with the Getty Group based on the well-established New York multi-factor test described above, especially in light of sufficient evidence on two of four factors.[68]

The first of the four factors was perhaps the most contested. Texaco argued that the preliminary agreement that was partially executed by the parties contained language referencing the fact that it was "subject to" execution of a final agreement that was never completed.[69] The court held that the language, as a matter of law, did not "clearly express the intent of the parties not to be bound" (i.e, did not preclude the jury finding of a binding agreement).[70] The court also rejected Texaco's challenge to the agreement's failure to resolve all essential terms, merely concluding that the jury was free to conclude otherwise.[71] In particular, the court held that Getty's failure to execute the partially executed formal preliminary agreement did not preclude the jury's finding because the jury could reasonably infer that Getty board approval concluded the agreement and was not, as Texaco contended, merely an approval of Pennzoil's revised pricing proposal.[72] The court noted that any partial performance had been minimal[73] and agreed that the fourth factor (a formal agreement was

66 *Id.* at 784 (summarizing jury findings, including damage awards).

67 *Id.* at 788 (summarizing Special Issue No. 1 and considering sufficiency of evidence to support jury's finding that Getty intended to bind itself to an agreement with Pennzoil).

68 *Id.* at 788–95.

69 *Id.* at 789.

70 *Id.* at 790.

71 *Id.* at 792–95.

72 *Id.* at 794. According to the court, the jury was warranted in concluding that an oral agreement to the transaction was merely conditioned on board approval and not execution of an agreement effectuating board approval. *Id.* at 786.

73 *Id.* at 792.

normally expected to conclude negotiations) favored Texaco.[74] However, these factors did not preclude the jury's ultimate determination that Getty had intended to be bound by the transaction.[75]

The Texaco/Pennzoil litigation demonstrates the significant weaknesses of common law formation principles when applied to acquisitions. The jury's ultimate determination emerged from an ambiguous and contested factual record and represented one of two plausible versions of the facts. At the very least, the underlying facts suggest that the actual intent to contract of some parties was at odds with a legally inferred intent to contract.[76] In this respect, the record of subjective cognitive dissonance regarding contract formation is quite stark: a collection of sophisticated deal lawyers and bankers believed that no binding agreement existed given the fluid state of negotiations.[77] Second, the litigation's outcome—that a binding agreement existed between Pennzoil, as acquiror, and the Getty Group—shows the inherent unpredictability of factual inferences using a multi-factored test in making ultimate determinations regarding contract formation in complex acquisition negotiations. Even if strictly correct as a matter of law, the result underscores the precarious nature of the foundations for such a determination where such a determination could easily have been resolved indisputably by a low-cost alternative legal standard, namely a requirement that

[74] *Id.* at 795.

[75] *Id.* at 792, 795.

[76] *Cf.* Tess Wilkinson-Ryan & David A. Hoffman, *The Common Sense of Contract Formation*, 67 STAN. L. REV. 1269, 1286–87 (2015) (conducting a study showing a high subjective dissonance surrounding contract formation and demonstrating subjects' tendency to believe that a contract becomes binding upon formal execution as opposed to verbal acknowledgement).

[77] *Id.* at 786–87. Specifically, several sophisticated New York law firms simultaneously participated in independent drafting sessions with the two competing bidders, including negotiations relating to a definitive agreement with Pennzoil, and Goldman Sachs, one of the preeminent M&A investment banks in the United States, continued soliciting competing bids.

agreements of such magnitude be governed by formal expressions of intent.[78]

B. Formation Opacity in Formal Preliminary Agreements Generally and in Acquisitions

Formal preliminary agreements fundamentally differ from informal agreements in two obvious respects. First, formal agreements are signed writings while informal agreements encompass all other forms of agreements. Second, a formal preliminary agreement does not purport to be a definitive agreement. The agreement (whether labelled as a preliminary agreement, letter of intent, agreement in principle, or memorandum of understanding) explicitly contemplates a subsequent definitive agreement.[79] In this sense, preliminary

[78] *Compare* Robert M. Lloyd, Pennzoil v. Texaco*, Twenty Years Later: Lessons for Business Lawyers*, 6 TRANSACTIONS: TENN. J. BUS. L. 321, 352 (2005) ("Lesson 1: Make it clear whether you have a contract.") *with* Mark G. Yudof & John L. Jeffers, Pennzoil v. Texaco, 27 ALBERTA L. REV. 77, 81 (1988) ("In our view, however, a major concern is whether corporate giants must live with the same standards of commercial morality and contract law as are applicable to the rest of us."); *see also* David Crump, *Halfway Deals: Or, When Is a Non-Contract a Contract*, 46 UA LITTLE ROCK L. REV. 1, 7 (2023) (arguing forty years after the fact that, as a matter of legal policy, "*Texaco v. Pennzoil* is wrongly decided"); *cf.* Robert H. Mnookin & Robert B. Wilson, *Rational Bargaining and Market Efficiency: Understanding* Pennzoil v. Texaco, 75 VA. L. REV. 295, 329 (1989) (in discussing bargaining strategies relating to litigation, concluding "*Pennzoil v. Texaco* appears to have been a case where rational choices by each party led to less than optimum outcomes for both").

[79] In general, these different labels—letter of intent, agreement in principle, and memorandum of understanding—reflect different ways of styling the tentative (that is, preliminary) agreement. The preliminary agreement does not have to be captioned as such to be binding—it is sufficient if the document, however styled, contains adequate terms to give rise to obligations either to negotiate further, or to fully perform (notwithstanding contemplation of a fuller memorialization of the arrangement). *See, e.g.*, Cox Commc'ns, Inc. v. T-Mobile US, Inc., 273 A.3d 752, 761–62 (Del. 2022) (finding binding preliminary agreement to negotiate in good faith implied where one sentence of contract provision established parameters of future business relationship, anticipated a future definitive agreement, set a duration, and left any additional terms to be "mutually agreed upon" by the parties); *see also* Brown v. Cara, 420 F.3d 148, 151 (2d Cir. 2005) (holding that fully

agreements are preliminary because they do not purport to fully reflect the final agreement's anticipated terms. Use of a formal preliminary agreement, whether binding or not, evidences the parties' recognition that attaining a definitive agreement will entail additional steps, such as to resolve ancillary contractual issues, to resolve core issues that have greater complexity, or to resolve issues that require a sequential negotiating process because they are contingent on or interdependent with other issues that that have not been resolved.[80]

executed MOU setting forth terms and financing of partnership arrangement created a binding preliminary agreement to negotiate in good faith). Because of the elastic nature of each label, a "preliminary" document may contain a few or many terms, but typically the document will at least commit to the price and structure of the contemplated transaction. *See, e.g.*, Cambridge Cap. LLC v. Ruby Has LLC, 565 F. Supp. 3d 420, 431 (S.D.N.Y. 2021) (involving a fully executed LOI in which the private equity sponsor was to invest $40 million in seller in exchange for 51% fully-diluted ownership interest). In many litigated cases, the issue is whether the preliminary document (however labelled) is a binding preliminary agreement or, if too vague, non-binding. *Compare id.* at 440–42 (explaining that the LOI at issue created a triable issue of fact regarding whether it was a binding preliminary agreement to negotiate), *with* CKSJB Holdings LLC v. Epam Sys., 837 F. App'x 901, 904–05 (3d Cir. 2020) (explaining that the LOI at issue did not create an enforceable obligation to negotiate in good faith because it was merely aspirationally optimistic). *See also* Raymond L. Veldman, *Letters of Intent-Look Before You Leap*, 9 M&A LAW. 11, 13 (2005) https://1.next.westlaw.com/Document/Id8e9af21e6a411db98cd8b9e3c2e32f9/View/FullText.html?VR=3.0&RS=cblt1.0&__lrTS=20240515181950251&transitionType=Default&contextData=%28sc.Default%29 [on file with the Columbia Business Law Review] ("[T]here is no uniform standard by which these agreements are judged and, as recent cases illustrate, the outcome is often unpredictable and may be surprising."); Hwang, *Faux Contracts,* supra note 17, at 1053 ("Deal lawyers, for instance, uniformly reported that M&A term sheets, while formal-looking, are almost never binding or formally enforceable.").

80 There is general consensus on the salience of this feature in motivating use of preliminary agreements. *See* Farnsworth, *supra* note 15, at 249–51; Schwartz & Scott, *supra* note 16, at 691–702 (discussing a caselaw dataset involving the use of preliminary agreements that address contractual complexity of simultaneous and sequential pre-closing participant investments); Hwang, *Faux Contracts*, *supra* note 17, at 1027–29 (discussing the nature of non-binding preliminary agreements).

In contrast to informal agreements, formal preliminary agreements provide a straightforward objective manifestation of assent and simultaneously unambiguous evidence of an intent to be bound to something, but the real question is what are the parties actually bound to (i.e., an ultimate transaction? a commitment to negotiate in good faith? or merely a commitment of willingness to agree in the future—a so-called "agreement to agree"?)?[81] In other words, do the parties intend to be bound as to substantive, definite, and enforceable contractual obligations (i.e., an agreement having reasonably definite terms where a court can determine the existence of a breach, if any)[82] or merely intend to memorialize the progress of their negotiations to date?

Preliminary agreements present three subsidiary issues: (i) does the particular preliminary agreement create any binding obligations; (ii) if so, what are the parties' obligations with respect to a definitive agreement in the future; and (iii) what remedies should be afforded to a non-breaching party in the event of a breach of a binding preliminary agreement. Traditionally, these three issues are intertwined and the answers vary depending on how a particular preliminary agreement is categorized. As discussed below, extensive case law has evolved regarding such agreements, evidencing their common usage in complex multi-step contracting arrangements.

The Second Circuit's case law once again has proven highly influential in developing a basic taxonomy in thinking about such agreements. This approach builds upon a three-part framework laid out in a seminal federal district court decision in *Teacher's Insurance and Annuity Association v. Tribune Co.* ("*TIAA*").[83] The court's framework sought to balance the twin

[81] *See* Murphy v. Inst. of Int'l Educ., 32 F.4th 146, 150–51 (2d Cir. 2022) (noting a distinction in caselaw between cases involving oral informal agreements where intent to be bound is critical and cases involving formal preliminary agreements where "the question instead is what kind of agreement did the parties make").

[82] *See* RESTATEMENT (SECOND) OF CONTRACTS § 33(2) (AM. L. INST. 1981).

[83] 670 F. Supp. 491 (S.D.N.Y. 1987) [hereinafter *TIAA*]; *accord Murphy*, 32 F.4th at 151 ("We subsequently adopted [*TIAA*'s framework] for analyzing preliminary agreements in [a 1989 decision], and we continue to apply

concerns of enforcement and non-enforcement that is, "to avoid trapping parties in surprise contractual obligations that they never intended" and "enforce[ing] and preserv[ing] agreements that were intended as binding, despite a need for further documentation or further negotiation."[84]

Type I preliminary agreements, though characterized as preliminary, are in fact binding final agreements, even absent the ability of the parties to conclude an actual definitive agreement.[85] This is so because the preliminary agreement is complete with respect to the essential terms of the intended final agreement or, at the very least, because courts are reasonably able to infer or supply any missing essential terms in the preliminary agreement.[86] In other words, the absence of non-essential terms that might have appeared in a final agreement does not preclude a Type I preliminary agreement from being as binding as an intended final agreement, even though the final formal agreement is never completed.[87]

If a preliminary agreement falls short of a binding Type I preliminary agreement, the agreement is not binding as to the contemplated final arrangement, but it may nevertheless entail an enforceable contractual obligation to negotiate in good faith to resolve any open terms relating to a final agreement.[88]

this framework today."). *TIAA*'s taxonomy is widely accepted. *See* Schwartz & Scott, *supra* note 16, at 664 n.7 (noting in particular *TIAA*'s pervasive influence with respect to the emergence of Type II agreement jurisprudence).

84 *See TIAA*, 670 F. Supp at 497–98.

85 *See* Shann v. Dunk, 84 F.3d 73, 77 (2d Cir. 1996) ("[A] Type I [agreement] is where all essential terms have been agreed upon in the preliminary contract, no disputed issues are perceived to remain, a further contract is envisioned primarily to satisfy formalities.").

86 *Id.*

87 *See* Vacold LLC v. Cerami, 545 F.3d 114, 124 (2d Cir. 2008) ("Agreements of this type render the parties 'fully bound to carry out the terms of the agreement even if the formal instrument is never executed.'" (quoting Adjustrite Sys. v. GAB Bus. Servs., 145 F.3d. 543, 548 (2d Cir. 1998))).

88 *See* Brown v. Cara, 420 F.3d 148, 151 (2d Cir. 2005) ("[W]hile [a Type II] preliminary agreement is not enforceable as to the ultimate contractual goal contemplated in the document, it is enforceable as an obligation between the parties to negotiate in good faith within the framework of the agreement."); *see also* Cox Commc'ns v. T-Mobile US, Inc., 273 A.3d. 752,

This represents the second category of binding preliminary agreement (i.e., so-called Type II).[89] Such an agreement, though imposing a binding obligation, does not compel the eventual achievement of a binding final agreement, but rather merely requires each party to act in good faith to resolve open issues.[90] Breach of an obligation to negotiate in good faith typically affords recovery for less damages than for breach of a Type I agreement for the obvious reason that the outcome of any such negotiations is uncertain.[91]

Unlike either Type I or Type II preliminary agreements, an agreement to enter into discussions regarding a possible transaction is too general to be binding.[92] These preliminary agreements are in the form of agreements to agree.[93] They merely reflect a desire to enter into a binding contract in the future (e.g. a definitive agreement), but are not themselves binding because they lack essential terms necessary to an agreement's enforcement, definite mutual obligations of

761 (Del. 2022) ("Type II agreements 'do[ ] not commit the parties to their ultimate contractual objective but rather to the obligation to negotiate the open issues in good faith[.]'" (quoting SIGA Techs., Inc. v. PharmAthene, Inc., 67 A.3d 330, 349 & n.82 (Del. 2013) (*SIGA I*))).

89 *See Shann*, 84 F.3d at 77 ("Type II is where the parties recognize the existence of open terms, even major ones, but, having agreed on certain important terms, agree to bind themselves to negotiate in good faith to work out the terms remaining open. In Type II agreements, the parties do not bind themselves to conclude the deal but only to negotiate in good faith toward conclusion within the agreed framework").

90 *Id.*

91 *See, e.g.,* Goodstein Constr. Corp. v. City of New York, 604 N.E.2d. 1356, 1360–62 (N.Y. 1992); Copeland v. Baskin Robbins U.S.A., 117 Cal. Rptr. 2d 875, 885 (Cal. Ct. App. 2002). *But see* SIGA Techs. v. PharmAthene, Inc., 132 A.3d 1108, 1131 (Del. 2015) (*SIGA II*) (explaining that expectation damages for a Type II agreement are established with reasonable certainty, "[w]here the injured party has proven the fact of damages – meaning that there would have been some profits from the contract," even though proof of the amount of damages is established with "less certainty").

92 *See* Joseph Martin, Jr., Delicatessen, Inc. v. Schumacher, 417 N.E.2d 541, 543 (N.Y. 1981) ("Dictated by these principles, it is rightfully well settled in the common law of contracts in this State that a mere agreement to agree, in which a material term is left for future negotiations, is unenforceable.").

93 *Id.*

promise or performance,[94] and ascertainable standards to inform courts how to fill gaps that exist.[95]

This framework has been widely applied in decisions in the Second Circuit and other jurisdictions.[96] Not surprisingly, the Second Circuit resorted to a multi-factor test that draws heavily on its multi-factored approach used to determine enforceability of informal agreements in complex business negotiations.[97] In the formal preliminary dealing context no less than informal contexts, "intention [to] create binding obligations" figures prominently.[98] In the case of informal agreements, as noted, courts have gleaned intent not to be bound from the totality of facts and circumstances.[99] In Type I agreement cases, courts appear to give greater scrutiny to what has been actually expressed by the parties. In addition, in such cases, the third factor, namely resolution of all essential terms, can be framed more concretely since the text of the preliminary agreement may give greater insight into the issues that remain to be decided.[100]

94 *See* Tchrs. Ins. & Annuity Ass'n of Am. v. Trib. Co., 670 F. Supp. 491, 497 (S.D.N.Y. 1987) ("[I]f the agreement is too fragmentary, in that it leaves open terms of too fundamental importance, it may be incapable of sustaining binding legal obligation."); Murphy v. Inst. of Int'l Educ., 32 F.4th 146, 151 (2d Cir. 2022) ("[T]here is a strong presumption against finding binding obligation in agreements which include open terms, call for future approval[,] and expressly anticipate future preparation and execution of contract documents." (quoting *TIAA*, 670 F. Supp. at 499, as quoted in Arcadian Phosphates, Inc. v. Arcadian Corp., 884 F.2d 69, 73 (2d Cir. 1989))).

95 *See, e.g.,* Adjustrite Sys. v. GAB Bus. Servs., 145 F.3d 543, 545 (2d Cir. 1998) (affirming summary judgment for defendant that signed two-page agreement was merely an agreement to agree where many open terms remained to be negotiated).

96 *See, e.g.*, *Murphy*, 32 F.4th 146; *Adjustrite Sys.*, 145 F.3d 543; Vacold LLC v. Cerami, 545 F.3d 114 (2d Cir. 2008).

97 *See Vacold,* 545 F.3d at 124 n. 2 (providing multi-factor tests for Type I and Type II agreements).

98 *Id.* at 124 (quoting *Adjustrite Sys.*, 145 F.3d at 548).

99 *Id.* at 127.

100 *Id.* at 124.

A similar multi-factored approach is employed to determine whether a Type II agreement exists.[101] The relevant test uses five rather than four factors[102] and focuses on a binding obligation to negotiate in accordance with an agreed upon framework rather than a binding commitment to an ultimate contractual objective.[103] In addition to a new factor—the context of the negotiations—the other factors, some of which are modified, are evaluated from a different vantage point. The first factor focuses on an affirmative intent to be bound to negotiate rather than whether there has been an express reservation not to be bound.[104] This reflects the undisputed aspect of the Type II agreements, namely that such agreements presuppose the contracting process is incomplete (i.e., further negotiation in good faith is needed before there is a binding agreement as to the intended object of a final agreement). As a result, the existence of open terms is characteristic (i.e., well-defined unresolved terms to be negotiated must exist) whereas the existence of essential open terms is inimical to the requisite definiteness required for a binding Type I agreement.[105]

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101 The multi-factored approach in this area, as in the case of formation with respect to informal and formal preliminary dealings that constitute final agreements, necessarily suffers from the inherent ex ante unpredictability of a facts and circumstances type inquiry. *See* Klass, *supra* note 18, at 1481 (agreeing with criticism leveled by other scholars that multi-factored tests are imprecise in determining whether formal preliminary agreements are binding).

102 *See* Brown v. Cara, 420 F.3d 148, 157 (2d Cir. 2005) ("(1) . . . the language of the agreement; (2) the context of the negotiations; (3) the existence of open terms; (4) partial performance; and (5) the necessity of putting the agreement in final form, as indicated by the customary form of such transactions.").

103 *Id.*; *see also Vacold*, 545 F.3d at124.

104 *See* Adjustrite Sys. v. GAB Bus. Servs., 145 F.3d 543, 548 (2d Cir. 1998) ("[Type II] preliminary agreement[s] . . . do[] not commit the parties to their ultimate contractual objective but rather to the obligation to negotiate the open issues in good faith in an attempt to reach the . . . objective within the agreed framework." (quoting Tchrs. Ins. & Annuity Ass'n of Am. v. Trib. Co., 670 F. Supp. 491, 498 (S.D.N.Y. 1987))).

105 *Compare id.*, *with* SIGA Techs. v. PharmAthene, Inc., 132 A.3d 1108, 1141 (Del. 2015) (*SIGA II*) ("Type I preliminary agreements are . . .

Type II agreements introduce two additional contractual issues beyond the basic formation issue. First, assuming there is a binding Type II agreement, how should courts determine whether one or the other party has breached its obligation to negotiate in good faith? The issue of breach is not an easy one, since, as courts have recognized, even good faith negotiations may not culminate in a final agreement.[106] Thus, parties retain wide latitude in bargaining with respect to unresolved issues. However, the obligation to negotiate in good faith does carry with it, at the very least, certain negative covenants that "bar a party from renouncing the deal, abandoning the negotiation, or insisting on conditions that do not conform to the preliminary agreement."[107] In other words, even though Type II agreements do not ensure a final agreement, they carry substantive bite in locking in certain essential terms of the final agreement that have already been agreed to.[108]

Second, if there is a breach of a Type II agreement, what is the appropriate measure of damages? In theory, any recovery should be less than recovery for a breach of Type I preliminary agreements because the obligation of the former is greater than the latter (i.e., a final agreement versus a still-to-be completed negotiation). The general problem in Type II scenarios

'created when the parties agree on all the points that require negotiation (including whether to be bound) but agree to memorialize their agreement in a more formal document.'" (quoting *Vacold*, 545 F.3d at 124)).

106 *See*, *e,g.*, Empro Mfg. Co. v. Ball-Co Mfg., Inc., 870 F.2d. 423 (7th Cir. 1989) (holding parties to a Type II agreement not in breach merely because no final agreement was reached); Venture Assocs. v. Zenith Data Sys., 987 F.2d 429 (7th Cir. 1993) (holding that a binding Type II agreement existed, but remanding the matter for trial to determine whether the defendant breached its duty to negotiate in good faith).

107 *TIAA*, 670 F. Supp. at 498; *see also* SIGA Techs., Inc. v. PharmAthene, Inc., 67 A.3d 330, 346–47 (Del. 2013) (*SIGA I*) (affirming Chancery court determination that party breached duty to negotiate in good faith by insisting on "drastically different and significantly more favorable" terms than set forth in term sheet attached to preliminary agreement).

108 Of course, even this generalization can be overstated. As the obligations with respect to further negotiation become more diffuse, one might encounter a horse-trading situation in which someone wants to renegotiate a settled essential term in return for concessions on as yet undetermined essential terms.

lies in gauging what the resulting contract would have provided had the negotiations proceeded in good faith. Common law principles generally preclude recovery of expectation damages where the amount cannot be ascertained with "reasonable certainty."[109] As a result, in most jurisdictions considering a breach of a Type II duty to negotiate in good faith, expectation damages are foreclosed and recovery is limited to reliance damages. Delaware is notable exception in this regard,[110] although other courts have acknowledged the possibility of expectation damages in such cases.[111]

Like contract surprise involving informal preliminary dealings, uncertainty as to applicable measures of damages (not so much the underlying facts relating to any calculation) for Type II breaches underscores one aspect of the contract surprise puzzle for formal preliminary agreements. The extent of contractual damages involving a breach of good faith negotiation duty is murky at best, but such uncertainty is readily avoidable in the acquisition context through formal requirements relating to damages.[112]

The Delaware Supreme Court's decision in SIGA Technology/PharmAthene litigation illustrates the practical effects of this uncertainty. The litigation arose out of a failed merger agreement between SIGA Technologies, the developer of an innovative drug therapy to treat smallpox, and PharmAthene, Inc., another biodefense research and development company with the funding to support this development.[113] The merger

109 RESTATEMENT (SECOND) OF CONTRACTS § 352 (AM. L. INST. 1981).

110 *Compare SIGA II*, 132 A.3d at 1131, *with* Goodstein Constr. Corp. v. City of New York, 604 N.E.2d. 1356, 1360–62 (N.Y. 1992) (finding reliance damages proper remedy for breach of Type II agreement duty to negotiate in good faith and rejecting expectation damages as remedy because it would effectively make the preliminary agreement a final binding agreement); Copeland v. Baskin Robbins U.S.A., 117 Cal. Rptr. 2d 875, 885 (Cal. Ct. App. 2002) (similarly finding reliance damages as proper remedy and rejecting expectation damages for lack of knowing the existence or ultimate terms of final binding agreement).

111 *See* Fairbrook Leasing, Inc. v. Mesaba Aviation, Inc., 519 F.3d 421, 429 (8th Cir. 2008).

112 *SIGA I*, 67 A.3d at350-51; *SIGA II*, 132 A.3d at 1131.

113 *See SIGA I*, 67 A.3d at 334–39.

agreement had two supplementary features of great importance to the transaction: (i) a bridge loan from the prospective buyer prior to closing which served as a financial lifeline for the seller, and (ii) a contingent good faith obligation to negotiate a licensing agreement that backstopped the merger agreement, if for any reason the merger agreement was terminated.[114] A License Agreement Term Sheet (the so-called "LATS") appended to the merger agreement set forth the license's material terms and further stated that the terms were "non binding."[115] SIGA terminated the merger agreement after the agreement's drop dead date passed because the SEC failed to clear the requisite proxy materials necessary for a shareholder vote.[116] SIGA's actions appeared commercially self-interested in light of highly positive developments with respect to the drug therapy which vastly improved the company's prospects (thereby, making the company more valuable than at the time of the original agreement's execution).[117] Thereafter, SIGA balked at negotiating a licensing agreement in accordance with the terms of the LATS and instead pushed for a substantially more favorable arrangement.[118]

In its initial decision in the case, the Delaware Supreme Court affirmed a judgment that SIGA breached its duty to negotiate in good faith.[119] Although the LATS terms were nonbinding, the court agreed with the lower court that incorporation of the term sheet constrained SIGA's behavior to negotiate in good faith.[120] Because SIGA failed to honor these constraints, it breached its duty to negotiate in good faith.[121] The Supreme Court, however, reversed the chancery court's determination as to remedy.[122] Given the chancellor's finding that SIGA had preliminarily agreed to negotiate in good faith, and

114 *Id.* at 336–38.
115 *Id.* at 335–36.
116 *Id.* at 339, 346–347.
117 *Id.*
118 *Id.* at 339–40, 346–347.
119 *Id.* at 343–44, 347.
120 *Id.* at 345–46.
121 *Id.* at 347.
122 *Id.* at 351–52.

that but for its bad faith, a license agreement would have been completed, the Supreme Court reasoned that the non-breaching party was entitled to recover expectation damages.[123]

The Supreme Court's holding in SIGA I left open a significant issue regarding determination of expectation damages: determining lost profits with reasonable certainty rather than mere speculation. The reasonable certainty requirement normally has precluded expectation damages under the prevailing law in most state jurisdictions.[124] In its second decision after remand, a majority of the Delaware Supreme Court (over a vigorous dissent) affirmed the chancery court's award of expectation damages and elaborated on its views of an expectation damages remedy for breach of a duty to negotiate under a preliminary acquisition agreement.[125] Specifically, the court added considerable nuance to the traditional reasonable certainty requirement. While adhering to a traditional reasonable certainty requirement as to the fact of damages (i.e., that there would be some quantum of lost profit), the court expressly embraced a relaxed requirement in determining the magnitude of such lost profits, including the willfulness of the

[123] *Id.* at 350–51 ("We now hold that where the parties have a Type II preliminary agreement to negotiate in good faith, and the trial judge makes a factual finding, supported by the record, that the parties would have reached an agreement but for the defendant's bad faith negotiations, the plaintiff is entitled to recover contract expectation damages.").

[124] *See, e.g.*, Goldstein Constr. Corp. v. City of New York, 604 N.E.2d. 1356, 1360–62 (N.Y. 1992); Copeland v. Baskin Robbins, 117 Cal. Rptr. 2d 875, 883 (Cal. Ct. App. 2002).

[125] SIGA Tech. v. PharmAthene, Inc., 132 A.3d 1108, 1130 (Del. 2015) ("[T]he standard remedy for breach of contract is based upon the reasonable expectations of the parties ex ante. This principle of expectation damages is measured by the amount of money that would put the promisee in the same position as if the promisor had performed the contract. Expectation damages thus require the breaching promisor to compensate the promisee for the promisee's reasonable expectation of the value of the breached contract, and, hence, what the promisee lost" (quoting Duncan v. Theratx, Inc., 775 A.2d 1019, 1022 (Del. 2001)). *But see id.*, 132 A.3d at 1140 (Valihura, J., dissenting) ("Ordinarily, expectation damages are not awarded for the breach of a preliminary agreement due to difficulties in establishing such damages with sufficient certainty.").

breach and even post-breach evidence.[126] While the majority opinion offers justification for its approach, the more relevant consideration for purposes here is its expansion of the scope of uncertainty in calculating damages for breach of a Type II agreement.

SIGA II itself illustrates how numerous factors at various stages of complex negotiations relating to an agreement to negotiate introduce substantial uncertainty in the ex ante prediction of liability and resulting damages. While courts ex post may have very good reasons for imposing one measure of damage remedy over another, it seems dubious that parties can reliably predict ex ante which measure of damages will apply. Fundamental uncertainty regarding the appropriate measure of damages in this context provides some support for imposing a formal contracting requirement (as argued in Section IV.C) designed to diminish ex ante contractual opacity relating to the creation of and scope of such obligations.

In short, formation opacity figures as a concern no less pressing as to formal preliminary agreements than as to informal agreements. As stated in *TIAA*, "[a] primary concern for courts in such disputes is to avoid trapping parties in surprise contractual obligations that they never intended."[127] The opacity problem for preliminary agreements is whether both parties accurately distinguish ex ante between the different types of binding and non-binding preliminary agreements. If they do not, then preliminary agreements will lead to contract suprise just as informal agreements do, albeit surprise of a different sort.

Although both contracting parties have an ex ante understanding that they have formally entered a preliminary

126 *SIGA II*, 132 A.3d at 1131 ("Where the injured party has proven the *fact* of damages—meaning that there would have been some profits from the contract—less certainty is required of the proof establishing the *amount* of damages. In other words, the injured party need not establish the amount of damages with precise certainty 'where the wrong has been proven and injury established.'").

127 Tchrs. Ins. & Annuity Ass'n v. Trib. Co., 670 F. Supp. 491, 497 (S.D.N.Y. 1986); *accord* Murphy v. Inst. Int'l. Educ., 32 F.4th 146, 151 (2d Cir. 2022); Arcadian Phosphates, Inc. v. Arcadian Corp., 884 F.2d 69, 72 (2d Cir.1989).

agreement, they may not share the same understanding as to the type of preliminary agreement they have entered. Opacity arises in the case of binding preliminary agreements in that an agreement denominated as preliminary may be treated as an enforceable final agreement or as an agreement requiring negotiation in good faith. Because judicial analyses of these agreements turn on multi-factor tests similar to that used to analyze whether an informal agreement is binding, the parties lack bright-line certainty ex ante regarding the agreement's contractual consequences for the parties. [128]

Even in the case of agreements to agree, it is not always clear that what one party regards as an agreement to agree is nothing more. The common law's multi-factor test accords great significance to the language of the preliminary agreements, but its application is frequently not resolved by express language, but by interpretive inferences regarding its significance.[129] In short, although great weight is accorded to the language, it frequently falls short of shared certainty among the parties' subjective intentions. Notwithstanding the common law's preference for standards that balance facts and circumstances, perhaps a case can be made that, in certain circumstances, formal requirements regarding the parties' express language should be dispositive as to the contractual status of preliminary agreements. It is sufficient for purposes at this point in the argument to note that the formation opacity that arises in informal agreements has its corollary in the case of formal preliminary agreements: the contractual status of any formal preliminary agreement will likely be shrouded

[128] In this regard, Type I agreements are analogous in some respects to informal agreements inferred from the conduct of the parties. At least one or the other participant in the Type I agreement almost surely may not fully appreciate the contractual implications of the Type I formal preliminary agreement. Otherwise, they would note regard it as merely "preliminary." Accordingly, like informal agreements, Type I preliminary agreements are binding final agreements as to the Type I agreement's ultimate intended objective. Thus, actual intent, as in the case of informal agreements, may not be dispositive in determining whether a binding final agreement has come into existence.

[129] *See* RESTATEMENT (SECOND) OF CONTRACTS § 33 cmt. a & b (AM. L. INST. 1981).

in opacity in which one or the other contracting party may believe that the signed agreement did not create any binding obligation, or that if one did, it is unclear what type of obligation they have assumed.

* * *

While *TIAA*'s original classification scheme for formal preliminary agreements has proven influential, it has also elicited reservations both judicial[130] and academic.[131] This article advances a separate challenge: even if otherwise useful in many contexts, the scheme does not address the normative issue of whether an alternative contracting regime (i.e., the imposition of formal requirements) should be used to legislatively supplant the *TIAA* framework in the context of acquisition agreements. Obviously, Judge Leval in *TIAA* did not, and courts generally do not, have the luxury of formulating tailored legislative solutions. Thus, the many judicial decisions that have considered these issues, and largely adopted or acquiesced to the *TIAA* approach, do not reflect any judgment about possible legislative alternatives, such as the one advanced here. As noted, *TIAA*'s approach, and indeed any alternative common law approach, shares a common contestable assumption: a uniform approach to formal preliminary agreements should be pursued in all contracting contexts. Perhaps that is the problem. Part III explores the possibility that a different regime may be warranted in the contexts of corporate acquisition arrangements based on different

130 *See* IDT Corp. v. Tyco Grp., 918 N.E.2d 913, 915 n.2 (N.Y. 2009) ("While we do not disagree with the reasoning in federal cases [such as *TIAA*], we do not find the rigid classifications into "Types' useful."). The qualification from New York's highest court is notable since *TIAA* involved the application of New York contract law, reflecting a prediction by federal courts of the correct statement of New York law. *TIAA* was subsequently quoted approvingly in a later phase of the same case. *See* IDT Corp. v. Tyco Grp., 15 N.E.3d 329, 332 (N.Y. 2014).

131 *See, e.g.*, Schwartz & Scott, supra note 16, at 667. One caveat should be noted. The Schwartz and Scott critique is explicitly directed at *TIAA's* Type II analysis. *Id.* at 675 (explicitly noting different preliminary dealing scenarios and limiting the critique to only one of the scenarios).

features informing the costs and benefits of particular contracting requirements in the context of corporate acquisitions.

C. The Relevance of Confounding Considerations in Contract Law and Corporate Law Affecting Creation of Binding Obligations

As previously discussed, formation opacity is a potential effect of the common law's primary reliance on inferences from contracting parties' observed behavior (i.e., parties' "manifestations") to determine whether a contract has been formed.[132] Not surprisingly, as discussed below, contract strategies to counter the common law's perceived potential to mistakenly infer contract formation emerged whereby one or both parties sought to prevent formation absent an intent to contract expressed in a formal agreement. Two formation prevention devices are reflected in pre-commitment negotiation or drafting strategies: (i) a disclaimer of intent to contract,[133] and (ii) express language contemplating memorialization of a fuller expression of any final agreement.[134] However, as discussed below, the common law constrains the ability of contracting parties to prevent contract formation through such pre-commitment devices.[135] At the very least, the governing standards are notoriously fuzzy in practice. Another formation prevention device is embodied in statutory writing formalities, such as the Statute of Frauds or the U.C.C.'s approach to written modifications, which operate outside of the common law.[136] Finally, corporate acquisition practice itself, aside from or in conjunction with formation prevention contract strategies, has evolved over the last forty years to provide additional sources of incremental protections against inadvertent

132 *See supra* notes 23–334 and accompanying text.

133 *See* RESTATEMENT (SECOND) OF CONTRACTS § 21 (AM. L. INST. 1981) (providing that disclaiming intent to be bound may prevent formation of contract).

134 *See* RESTATEMENT (SECOND) OF CONTRACTS § 27 (AM. L. INST. 1981) (explaining that circumstances may show agreements to be non-binding preliminary negotiations when contemplating memorialization).

135 *See infra* Sections III.C.1-.2.

136 *See infra* Section III.C.3.

contract formation.[137] Thus, as discussed below, even though the effectiveness of these strategies is uneven, their potential availability is relevant in understanding why a more robust form of pre-commitment mechanism may be desirable to prevent inadvertent contract formation in the context of corporate acquisitions. This subsection reviews the basic contours of contract anti-formation principles and corporate practice developments that discourage inadvertent contract formation.

1. Disclaiming Intent

Disclaiming intent to be bound is a commonly employed device to forestall formation of contracts during negotiations but is hardly dispositive in all cases. For example, in rejecting the notion that real or apparent intention is legally necessary or sufficient to make an agreement legally binding, the Restatement indicates that an explicit manifestation not to be bound "may prevent the formation of a contract."[138] There is obviously some comfort for contracting parties presented by recognition of this prophylactic principle. However, there are obvious cautionary aspects as well. The Restatement's use of the modal verb "may" indicates that any protection is a possible outcome and not dispositive.

This principle is reflected in the analysis of preliminary dealings discussed above.[139] The Second Circuit's multi-factored test incorporates disclaimer as the first element of the test. However, that discussion also highlights the uncertainty of disclaimer. For example, it is not clear whether disclaimer must be an express opt out or can also be inferred from the facts and circumstances. Moreover, problems can arise if a disclaimer must be reiterated at each stage of the negotiation. Otherwise, the subsequent dealings (communications) short of an executive definitive agreement could be construed as a changed intent of the parties to move directly to a binding

137 *See infra* Section III.C.4.

138 RESTATEMENT (SECOND) OF CONTRACTS § 21 (AM. L. INST. 1981).

139 *See supra* text accompanying notes 35–48 (discussing Second Circuit's multi-factored approach to analyze enforceability of informal agreements).

agreement, notwithstanding the fact that an executed agreement has not be attained. This problem is exemplified in cases involving unexecuted agreements.[140] As discussed previously, some courts find an agreement in the face of an unexecuted agreement, while others have not.[141] The seemingly divergent results reflect two contrasting perspectives: an unsigned written agreement evidences that the prior negotiations failed to culminate in a final binding agreement, or an unsigned agreement evidences a binding informal agreement among the parties that represents an inability of the parties to memorialize the agreement that was struck.

While not always effective, a disclaimer can be very effective in many contexts and this best exemplified by the practice relating to "TINALEA" clauses.[142] One contracts scholar has indicated this device is typically effective.[143] Indeed, the use of TINALEA clauses in the world of M&A practice is commonplace and undoubtedly this is true the more explicit and

[140] *See supra* note 46 (noting courts' application of multi-factored test to unexecuted agreements with unpredictable results).

[141] *Id.*

[142] *See* Klass, *supra* note 18, at 1466. A TINALEA—This Is Not a Legally Enforceable Agreement—in some form is common to many types of formal preliminary agreements such as a letter of intent or memorandum of understanding. *Id.*

[143] *Id.* at 1466-67 & n.82 ("In practice . . . U.S. courts refuse enforcement" in TINALEA clause commercial cases, although such clauses will not "always suffice to avoid legal liability."). Of course, TINALEA clauses presuppose written communication of some sort between the contract parties, such as a preliminary agreement, draft, or cover letter. In addition, Klass's assertion refers to situations where a TINALEA clause appears in a document that a litigant seeks to enforce. However, courts have employed analogous forms of analysis in some situations to preclude formation where a litigant seeks to enforce a subsequent putative agreement arising from preliminary dealings after the original communications containing the TINALEA clause. *See also, e.g.*, Chalker Energy Partners III, LLC v. Le Norman Operating LLC, 595 S.W.3d 688 (Tex. 2020) (holding that a No Obligation clause in preliminary agreement functioned to make execution of a definitive agreement a condition precedent to enforcement of any transaction obligations).

emphatic the language of the disclaimer.[144] Nevertheless, there are obvious instances where the use of a TINALEA qualifier does not prevent contract formation.[145] The fundamental limiting factor for TINALEA clauses is that they speak at a specific point in real time and do not preclude subsequent actions by the contracting parties that create a contractual obligation, notwithstanding a preexisting TINALEA clause. In this respect, the efficacy of TINALEA clauses can devolve into a situation analogous to use of a "no oral modifications" clause

144 One highly experienced deal practitioner offered the following model language for an acquisition TINALEA:

> The terms set forth in this letter do not constitute all of the essential terms upon which agreement must be reached by the parties in order to form a binding and enforceable contract, and no binding and enforceable rights or obligations in favor of either party hereto are intended to be created hereby. No correspondence, oral statements or course of conduct between the parties shall alter the non-binding nature of this letter or the parties' dealings, and either party shall be free at any time to terminate discussions or negotiations for any reason or no reason in its sole discretion (and neither party shall have any obligation to initiate or continue negotiations on any basis). A binding and enforceable contract between the parties shall only be created if a definitive written agreement is signed by both parties (and the execution and delivery of such a definitive written agreement by both parties shall be an express condition precedent to the formation of any contract between the parties, and the terms of any such contract shall be limited to the terms specifically set forth in such definitive written agreement.

Glen D. West, *Beware the Type II Preliminary Agreement*, WEIL GLOBAL PRIVATE EQUITY WATCH (Mar. 15, 2022), https://privateequity.weil.com/glenn-west-musings/beware-the-type-ii-preliminary-agreement/ [https://perma.cc/RBU9-FNNR].

145 *See, e.g.*, SIGA Tech., Inc. v. PharmAthene, Inc., 67 A.3d 330, 343 (Del. 2013) (*SIGA I*); (holding that though the attached licensing agreement contained a "not binding" notation, it nevertheless had binding effect as a preliminary agreement to negotiate in good faith); Cambridge Capital LLC v. Ruby Has LLC, 565 F. Supp. 3d 420, 444 (S.D.N.Y. 2021) (holding that a letter of intent containing a section captioned "Non-Binding Agreement" was a binding preliminary agreement to negotiate in good faith stated a cause of action.).

(outside of Section 2 of the U.C.C.), which is generally recognized as unenforceable.[146]

2. Contemplating Memorialization

A second common law principle relates to the significance of prior communications that contemplate memorialization of a definitive executed agreement. In comparison to an explicit disclaimer of intent to contract, contemplated memorialization has never been regarded as having nearly the force of an explicit disclaimer of intent, which itself, as noted, may not itself prove dispositive. The Restatement (Second) affirms the limited significance of a memorialization-contemplated qualifier in formal preliminary agreements where the parties ultimately fail to complete executed definitive agreement.[147] Unlike the disclaimer of intent which "may prevent formation of a contract,"[148] the Restatement rejects a manifestation contemplating memorialization of an agreement as overcoming sufficient manifestations of mutual assent, while noting "the circumstances may show that the agreements are preliminary negotiations."[149] This is illustrated by the ambivalence that courts attach to language that is "subject to" execution of a final agreement.[150] Nevertheless, it is not unreasonable to believe in such circumstances that one of the contracting parties

146 *See infra* notes 156–59 and accompanying text (discussing differing approaches to "no oral modification" clauses under common law and U.C.C.).

147 RESTATEMENT (SECOND) OF CONTRACTS § 27 (AM. L. INST. 1981).

148 RESTATEMENT (SECOND) OF CONTRACTS § 21 (AM. L. INST. 1981).

149 RESTATEMENT (SECOND) OF CONTRACTS § 27 (AM. L. INST. 1981).

150 *See* Glenn D. West, *Contracting Accidentally Through Preliminary Agreement – A Writing "Subject to Contract" May or May Not Be a Contact*, WEIL GLOBAL PRIVATE EQUITY WATCH (Mar. 8, 2017), https://privateequity.weil.com/europe/contracting-accidentally-preliminary-agreements-writing-subject-contract-may-may-not-contract/ [https://perma.cc/KH6V-PVD2] (noting divergent judicial approaches between the U.S. ambivalent approach and England where "subject to contract" language is typically deemed sufficient to preclude formation of a binding agreement.). *See also* Texaco, Inc. v. Pennzoil, Co., 729 S.W.2d 768, 789–90 (Tex. App. 1987) (finding use of "subject to" in press release a part of the surrounding facts and circumstances regarding, but not necessarily conclusive of, the parties' intent not to be bound).

may mistakenly subjectively believe that no binding agreement exists until a final agreement is reduced to writing. The other party (along with courts and contract scholars) may reasonably believe that a binding obligation exists based on the existence of independent manifestations of assent, notwithstanding the fact that parties contemplated reducing any final agreement to writing.

There is alternative contractual argument that adds contractual teeth to preliminary agreement statements that indicate an agreement is subject to execution of a final agreement. Some courts have, in limited circumstances, viewed a statement of this sort as a condition to creation of a final agreement that is binding (i.e., a condition subsequent to the preliminary agreement and precedent to a binding final agreement).[151] While such an approach has the practical effect of limiting the principle set forth in Restatement (Second) §27, the alternative argument will hardly lend itself to a predictable outcome from a business planning perspective. First, this approach has only been rarely embraced by courts. Second, even if adopted, it is subject to the same problems of an express disclaimer to contract discussed above: such a disclaimer can be modified by waiver of the condition or by subsequent oral statement.[152]

[151] *See* Energy Transfer Partners, L.P. v. Enterprise Products Partners, L.P., 593 S.W.3d 732, 740-41 (Tex. 2020) ("An agreement not to be partners unless certain conditions are met [such as, in the case presented, conditions requiring execution of a definitive agreement and receipt of each board's approval] will ordinarily be conclusive on the issue of partnership formation [i.e., a binding agreement forming a partnership] as between the parties," notwithstanding a statutory default in which "the parties' intent with respect to the creation of a partnership is just one factor to be weighed with . . . others."); *see also,* Atlantic Terra Cotta Co. v. Chesapeake Terra Cotta Co., 113 A. 156, 158 (Conn. 1921) (reiterating that offers conditioned on the execution of a final agreement for acceptance create a nonwaivable condition for creation of binding obligation).

[152] *See Energy Transfer Partners*, 593 S.W.3d at 741 (requiring an express waiver of a written final agreement condition). *See infra* note 157 (noting case law discussing oral waivers of no-oral-modification clauses).

3. Statutory Formalities

Statutory formalities are another well-known means of precluding inadvertent contract formation. Statutory defaults are generally more effective than contractual pre-commitment anti-formation strategies, but the existing array of statutory devices are hardly foolproof and operate selectively. Of course, statutory writing formalities are common fodder in the first-year law canon, such as the statute of frauds or the U.C.C.'s enablement of limitations on modification other than by means of writing. Statute of frauds enjoys a checkered reputation as an example of a statutory writing formality that operates in an erratic fashion that rightly causes most commentators to wince.[153] Statute of frauds requirements, strictly speaking, are different from a signed written agreement requirement envisioned by the proposal here. Notably, an agreement satisfies a statute of fraud requirement with a signed writing evidencing the agreement (which may include a signed agreement but also other signed writings),[154] rather than exclusively by means of a signed agreement requirement as proposed below. However, and more importantly, the categories of agreements subject to statute of frauds requirements are commonly viewed as indiscriminately broad (encompassing many circumstances where informal contracting is the norm) and, therefore, the application of the statute's requirement is frequently viewed as arbitrary and unfair.[155] Indeed, this aspect of the statute has fueled judicial skepticism toward liberal enforcement, and encouraged both judicial and legislative exceptions to minimize the perceived shortcoming of statute of fraud requirements. The SAAR+ proposal discussed below is far different from a general statute of fraud

153 *See generally* Joseph M. Perillo, *The Statute of Frauds in the Light of the Functions and Dysfunctions of Form*, 43 FORDHAM. L. REV. 39 (1974); Michael Braunstein, *Remedy, Reason, and the Statute of Frauds: A Critical Economic Analysis*, 1989 UTAH L. REV. 383 (1989).

154 *See, e.g.*, Crabtree v. Elizabeth Arden Sales Corp, 110 N.E.2d 551 (N.Y. 1953).

155 *See, e.g.*, C.R. Klewin, Inc. v. Flagship Properties, Inc., 600 A.2d 772 (Conn. 1991).

requirement in that compliance is both more stringent and more targeted. It is more stringent since the SAAR+ formality actually requires a signed agreement. It is also more targeted in that it would apply only to acquisition agreements (as defined in the model statute). This limitation reflects the judgment that writing requirements of the SAAR+ sort should be used sparingly for well-defined contracting contexts rather than as a general default.

A closer analogy to the type of formal writing requirement envisioned by the SAAR+ proposal below is U.C.C. 2-209(2), a provision that statutorily enables parties to a commercial contract to require that subsequent modifications be amended only in writing.[156] In this respect, the U.C.C. rejects the common law approach which deems "no-oral-modification" clauses ineffective because they can be superseded by subsequent contracting behavior that evidences an intent to override no-oral-modification limitations.[157] In contrast, the U.C.C.'s statutory

[156] *See* U.C.C. § 2-209(2) (AM. L. INST. & UNIF. L. COMM'N 2022) ("A signed agreement which excludes modification or rescission except by a signed writing cannot be otherwise modified or rescinded, but except as between merchants such a requirement on a form supplied by the merchant must be separately signed by the other party."); *see* John E. Murray Jr., *The Modification Mystery: Section 2-209 of the Uniform Commercial Code*, 32 VILL. L. REV. 1, 4 n.15 (1987) (illustrating no-oral-modifications clause in commercial contract: "[t]he parties to this agreement hereby agree and understand that this agreement may not be modified or rescinded except by an agreement evidenced by a writing, signed by these parties or by their duly authorized agents. Any modification that fails to meet this signed writing requirement shall be null and void.").

[157] *See* WILLIAM D. HAWKLAND, LINDA J. RUSCH & LARRY T. GAVIN, HAWKLAND'S UNIFORM COMMERCIAL CODE SERIES § 2-209:2 (1982 updated April 2024) ("Section 2-209(2) explicitly rejects the common law rule that the parties could not bind themselves to making changes to an existing contract only through execution of a signed writing."). For examples of the common law approach, *see, e.g.*, Gaia House Mezz LLC v. State Street Bank and Trust Co., 720 F.3d 84, 90 (2d Cir. 2013) (applying New York law that "any written agreement, even one which provides that it cannot be modified except by a writing signed by the parties, can be effectively modified by a course of actual performance" (quoting Rosen Tr. v. Rosen, 386 N.Y.S.2d 491, 499 (1976), *aff'd sub nom*. Rosen's Tr. v. Rosen, 371 N.E.2d 828 (1977))); U.S. Neurosurgical, Inc. v. City of Chicago, 572 F.3d 325, 332 (7th Cir. 2009) ("[U]nder Illinois law, the terms of a written contract can be modified by a

rule gives maximum protection to freedom from contract considerations where private parties explicitly opt for such an approach.[158] In other words, the U.C.C. provides a means for parties to opt in writing for a robust bright-line pre-commitment device to prevent inadvertent contract modification and any resulting contract surprise.[159]

The key takeaway is that the common law imposes significant obstacles to negotiated strategies that pre-commit to limiting the parties' ability to prevent contract formation in anticipation of a written definitive agreement. As noted above, the common law approach may make sense in many contracting contexts where the business exigencies of a given arrangement cannot necessarily keep up with the demands for an anticipated written agreement. Nevertheless, statutory provisions such as U.C.C. §2-209(2) illustrate situations

subsequent oral agreement notwithstanding contractual language to the contrary.").

158 *See* Murray, *supra* note 1566, at 3 (noting the purpose of U.C.C. Article 2 is to reflect factual bargain notwithstanding common-law technicalities that permit formation on other grounds). Comment 3 to §2-209 specifically identifies the need to protect contracting parties from false allegations of oral modifications, but could have alluded more generally to various issues, including purely benign considerations, that contribute to formation opacity that contracting parties may seek to avoid. What is significant is that the U.C.C. provision allows the parties to opt for heightened formality in formation in certain circumstances in lieu of formation opacity. U.C.C. § 2-209 cmt. 3 (AM. L. INST. & UNIF. L. COMM'N 2022).

159 Of course, U.C.C. §2-209 is not without its own problems as subsection (4) appears to allow non-written "waivers" notwithstanding a no-oral-modification clause. *Compare* Nutrisoya Foods, Inc. v. Sunrich, LLC., 626 F. Supp. 2d 985, 991 (D. Minn. 2009) ("Minnesota courts thus look to party conduct to determine whether it is reasonable for one party to conclude, based on the conduct of the other party, that a provision of the contract has been waived.") *with* Arizona Retail Sys., Inc. v. Software Link, Inc., 831 F. Supp. 759, 764 (D. Ariz. 1993) (holding that assent to modifications of contracts with NOM clauses "must be express and cannot be inferred merely from a party's conduct in continuing with the agreement"). As one commentator has noted: "[t]he choice of the word waiver in subsection[] (4) . . . is unfortunate. Courts and commentators have expended too much discussion on the vagaries of waiver . . . ." Beth A. Eisler, *Oral Modification of Sales Contracts Under the Uniform Commercial Code: The Statute of Frauds Problem*, 58 WASH. U.L.Q. 277, 300 (1980).

where society has recognized that parties should have greater leeway to govern the contract formation process by opting into regimes that give effect to formal contracting requirements requiring a written agreement. Such a result seems appropriate in situations where the benefits of such a requirement will likely exceed the social costs of the unexpected adverse consequences of inadvertent agreements.

4. Developments in Corporate Practice

Wholly apart from contract prevention strategies, corporate practice has evolved in such a way that the risk of inadvertent contract formation is less likely to occur.[160] As noted, corporate lawyers can make use of precautionary contracting devices to prevent informal acquisition agreements and fully binding preliminary acquisitions agreements, even if such efforts may not be foolproof.[161] In addition, however, developments in corporate practice re-enforce inadvertent contract formation devices making, for example, something like a modern day Texaco decidedly less likely. While no attempt is made to compile an exhaustive list of such developments, here are a few to at least illustrate the interaction between corporate practice and contract formation in the acquisitions context.

First, there has been a significant evolution in transactions arising in seller-orchestrated sales processes following the emergence of Delaware's *Revlon* principle.[162] Because such

160 Nothing said here should be confused with the goal of deal certainty and contractual commitment in executed definitive acquisition agreements. *See, e.g.*, Ann M. Lipton & Eric L. Talley, *Twitter v. Musk: The "Trial of the Century" That Wasn't*, 40 DEL. L. 8, 14 (2022) (explaining that, regardless of larger issues of corporate social policy, the case "seems like a resounding victory confirming contractual commitments").

161 *See supra* notes 142–44 and accompanying text (discussing widespread awareness and use of TINALEA qualifiers).

162 *Revlon* is the canonical case with respect to a board's fiduciary duty in selling a company. The court colorfully compared the board to "auctioneers charged with getting the best price for the stockholders at a sale of the company." Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986) . While the "auctioneer" principle has become corporate lore, the Delaware Supreme Court has over the years refined its analysis in many respects to emphasize the flexibility of approaches in market checks

processes are highly orchestrated, the seller controls the dynamics of contract formation.[163] Not only do all phases of a sales transaction offer ample opportunity to disclaim the binding nature of the negotiation and bidding process, but the very notion of a sales process (aside from transaction's negotiation being subject to an exclusivity provision) is powerful circumstantial evidence that no party could reasonably expect that a contract has been formed until a winner has been named.

In addition, two corporate law developments have reinforced the seller's ability to forestall formation of a definitive agreement during negotiations involving a public company, even in the absence of any explicit TINALEA disclaimer. The widespread use of shareholder rights plans (known as "poison pills") gives the target company's board considerable time to impede the ability of a would-be buyer to complete an acquisition requiring a shareholder vote because the poison pill enables the target board to effectively block completion of any

to ensure that the board (and ultimately shareholders) are able to maximize shareholder value. *See* C & J Energy Servs., Inc. v. City of Miami Emps.' Ret. Tr., 107 A.3d 1049, 1053 (Del. 2014). Nevertheless, a competitive sales processes remains a well-established method of maximizing shareholder value. *See, e.g.*, Dell v. Magnetar Glob. Master Fund, 177 A.3d 1 (Del. 2017) (in an appraisal proceeding, describing the transaction's underlying competitive sales process); RBC Cap. Mkts., LLC v. Jervis, 129 A.3d 816 (Del. 2015) (affirming the holding that an advisor aided and abetted in a breach of fiduciary duty in connection with structuring the described competitive sales process).

163 *See* Dean W. Sattler & Christina M. Sonageri, *Bid Process Letters*, THOMSON REUTERS PRACTICAL LAW, https://us.practicallaw.thomsonreuters.com/4-504-5237 [https://perma.cc/X9RA-2JU5] (describing practice of seller using formal bid process letter to control on auction sales process); GUHAN SUBRAMANIAN, NEGOTIAUCTIONS: NEW DEALMAKING STRATEGIES FOR A COMPETITIVE MARKETPLACE 126–27 (2010) (canvassing strategies and design for sale of businesses with respect to negotiated sales, sale by auction, and specifically defining a new term "negotiauction" as "a dealmaking situation in which competitive pressure is coming from both across-the-tale competition and same-side-of the-table competition"). The pervasive emergence of deal strategies is firmly recognized in the world of financial economics. *See generally* Audra L. Boone & J. Harold Mulherin, *Is There One Best Way to Sell a Company? Auctions Versus Negotiations and Controlled Sales*, 21 J. APPLIED CORP. FIN. 28 (2009); Robert G. Hansen, *Auctions of Companies*, 39 ECON. INQUIRY 30 (2001).

unsolicited transaction. The result necessarily removes some of the artificial time pressure in responding to an unsolicited takeover proposal—time pressure that may contribute to a messy contract formation process such as existed in the *Texaco* case.

Another factor that has altered the negotiating dynamic in corporate acquisitions since *Texaco* relates to the significance of fiduciary-outs in corporate acquisitions.[164] Today, fiduciary-outs are commonplace and typically form an explicit condition in formal definitive acquisition agreements.[165] The enforceability of informal agreements or formal preliminary agreements deemed to be final agreements would appear to be subject to the condition that a superior proposal has not intervened (again, a factor that was present in *Texaco*).

Do developments in corporate practice eliminate the contracting problem of formation opacity at issue here? The answer is clearly no, though in some circumstances it probably

164 William T. Allen, *Understanding Fiduciary Outs: The What and the Why of an Anomalous Concept*, 55 BUS. LAW 653, 654 (2000) ("A fiduciary out typically provides that if some triggering event occurs (often the receipt of a defined "Superior Offer" and sometimes the receipt from the corporation's outside lawyers of an opinion to the effect that the board must as a matter of fiduciary duty do an act that the contract forbids or must not do an act the contract requires), then the doing of that act (or the refraining from doing a required act) will not constitute a breach."). At the time of *Texaco*, fiduciary outs were not well understood and were a contested issue in corporate law. *Compare* Jewel Cos., Inc. v. Pay Less Drug Stores Nw., Inc., 741 F.2d 1555 (9th Cir. 1984) (holding merger agreement could be exclusive under California law and foreclose board consideration of superior proposal from another bidder), *with* ConAgra, Inc. v. Cargill, Inc., 382 N.W.2d 576 (Neb. 1986) (holding that the board's fiduciary duties permitted the board to abandon merger agreement with first bidder in favor of a superior proposal from a second bidder).

165 *See* Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914 (Del. 2003) (controversially underscoring the requirement for an effective fiduciary-out and holding that a board "had no authority to execute a merger agreement that subsequently prevented it from effectively discharging its ongoing fiduciary responsibilities"). Of course, *Omnicare* itself (at least as an extreme affirmation of the legal necessity of fiduciary-outs) is not with without its critics. *Compare* Sean Griffith, *The Omnipresent Specter of Omnicare*, 38 J. CORP. L. 753 (2013), *with* Travis Laster, *Omnicare's Silver Lining*, 38 J. CORP. L. 795 (2013).

lessens its frequency of appearance in acquisitions (i.e., it is hard to imagine a *Texaco* situation arising today). Nevertheless, formation opacity and contract surprise will still remain in other situations, such as negotiated transactions involving private companies. In any event, there is a more fundamental contract-theoretic lesson to be had. The proposal discussed below reveals a frequently overlooked flaw in unswerving reliance on common law principles where formalism might provide a superior method for formulating a contracting regime.

III. NORMATIVE THEORIES OF FORMAL PRELIMINARY AGREEMENTS AND THEIR INCOMPLETENESS

Significant scholarship has focused on the so-called Type II preliminary agreements (i.e., agreements subject to a duty to negotiate in good faith or similar obligation) as well as non-binding preliminary agreements.[166] This literature largely ignores binding informal agreements and Type I preliminary agreement (i.e., formal preliminary agreements that are binding final agreements), types that result in inadvertent contract surprise. The scholarship on preliminary agreements implicating Type II issues considers the special character of such formal agreements that serve as an intermediate stage in a process that can culminate in a definitive agreement. While this literature, as described below, is useful in fleshing out the business purpose of such agreements, its theorizing and normative prescriptions are not persuasive in addressing the concerns raised here in two respects. First, normative economic analyses treat the Type II agreement issues in isolation unrelated to the contractual treatment of related preliminary dealings issues. In other words, the literature disregards the affinity between Type II legal issues on the one hand and legal issues relating to Type I preliminary agreements, non-binding formal preliminary agreements, and informal binding agreements on the other. This diverges from the common law's integrated perspective among different types of preliminary dealings. Second, normative prescriptions with respect to

166 *See supra* notes 15–16.

Type II agreements ignore the potential comparative advantages of an alternative legal regime encompassing a fuller range of preliminary dealings in a specific contractual context, such as acquisition agreements. The primary economic analyses seek to explain how courts should incorporate an economic analysis into decisions relating to Type II agreements, but do not address the possibility of using different formal requirements for contracting in the context of preliminary dealings in acquisitions. In this respect, the discussion in this Section lays the groundwork for showing that an alternative legal regime (in particular, the SAAR+ proposal) provides a superior approach to the broader topic of binding preliminary dealings of all sorts, albeit in the narrower context of corporate acquisitions.

A. Functional Theories of Formal Type II Preliminary Agreements

Modern legal scholarship has recognized the doctrinal challenge presented by formal preliminary agreements that serve as an intermediate step toward execution of a definitive agreement. Professor Charles Knapp was one of the earliest commentators to lament the common law's "fail[ure] to deal adequately" with situations involving partial agreement in preliminary dealings.[167] He urged courts to reconsider existing doctrines and show greater receptivity toward enforcement of "contracts to bargain," as he characterized a significant class of preliminary agreements.[168] Within a generation, Professor Farnsworth provided an extensive reconsideration of the topic and concluded that the existing canon of common law principles, if "imaginatively applied," was up to the task of bringing clarity and predictability to the area.[169]

167 Knapp, *supra* note 15, at 673.

168 *Id.* Knapp's exploration of the topic coincided with a related theme, namely precontractual liability (i.e., liability for promises that precede contract formation), that had garnered much attention in the wake of the then-recently decided Hoffman v. Red Owl Stores, Inc., 133 N.W.2d 267 (Wis. 1965).

169 *See* Farnsworth, *supra* note 15, at 220. Farnsworth stands alone from other modern commentators as seeing a grand unity in the common

Leaving aside disagreement on particular issues, Knapp and Farnsworth agree on several overarching points that are worth emphasizing. First, preliminary agreements reflect contractual complexity in some business contexts that requires contract creation as a multi-step process rather than the simple acceptance-and-offer model of contract formation.[170] Second, Knapp and Farnsworth are in a rough consensus that common law doctrinal innovations offer a sufficient means of addressing these legal policy issues.[171] Notably, however, neither explored the possibility that an approach other than the common law might work to redress the contracting issues identified. Third, the reasoning underlying both Knapp's and Farnsworth's analyses are heavily case-laden and fact-specific common law explications of the contracting process.[172]

This early scholarship does not reflect the *TIAA* synthesis described above, though it clearly anticipates it in some respects.[173] Knapp and Farnsworth appear to differ in emphasis regarding the binding nature of what would come to be known as Type II agreements. Specifically, Knapp argued for the binding nature of "contracts to bargain," a core feature of the *TIAA* synthesis with respect to Type II agreements; in

law's approach to preliminary dealings, and thus is not fairly criticized as focusing on one area of preliminary dealings to the exclusion of others.

170 *See* Knapp, *supra* note 15, at 685 (defining contract to bargain as an intermediate stage between contract and non-contract where parties have agreed on some terms but delayed agreement on others); Farnsworth, *supra* note 15, at 219, 257–58 (explaining that where negotiations involve gradual piece-meal process, preliminary agreements serve to memorialize status of intermediate steps features of incomplete negotiations, prevent misunderstanding, and facilitate further negotiation).

171 *See* Knapp, *supra* note 15, at 679 (suggesting that the common law "should attempt to adjust the existing rules to accommodate to the facts of business life" with respect to contracts to bargain); Farnsworth, *supra* note 15, at 220 (arguing that common law doctrines "imaginatively applied" protect parties).

172 *See generally* Knapp, *supra* note 15; Farnsworth, *supra* note 15.

173 See *supra* Section II.B. (describing *TIAA*'s three-part test for preliminary agreements).

contrast, Farnsworth advanced a more guarded position with respect to his term "agreements to negotiate."[174]

Recent legal scholarship provides theoretic frameworks to inform thinking on legal doctrine with respect to binding Type II agreements. An overarching theme in this literature is the need to explain why contracting parties resort to such devices. Having a functional perspective on the purpose of such agreements arguably should shape how society addresses such arrangements as a matter of legal policy. There are two influential articles, one by Alan Schwartz and Robert E. Scott and the other by Albert H. Choi and George G. Triantis, that provide differing economic accounts of preliminary agreements. While their economic focus differs, they agree on a central starting point with respect to binding Type II preliminary agreements—determining that such agreements serve to sequence the process for reaching a final definitive agreement.[175] However, they sharply differ on how Type II agreements should be treated.

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174 *Compare* Knapp, *supra* note 15, at 676, 685 (arguing that contracts to bargain create a robust "duty to go forward with the contemplated transaction"), *with* Farnsworth, *supra* note 15, at 267 n.209 (favoring the term "agreements to negotiate" over "contract to bargain"), 279 n.264, 283 n.279 (expressing reservations regarding Knapp's non-countenance of negotiating with others or "changing one's mind" in the context of agreements to negotiate). Schwartz and Scott rightly recognize *TIAA*'s synthesis of the binding nature of Type II agreements as its novel and pathbreaking contribution. *See* Schwartz & Scott, *supra* note 16, at 664–65, 667 (describing *TIAA*'s approach as a "new rule" which "requires parties to [certain] preliminary agreements to bargain in good faith over open terms" and concluding that the rule is "deficient" and not justifiable).

175 *See* Schwartz & Scott, *supra* note 16, at 665 ("Parties make a preliminary agreement because they cannot write a complete contract at the outset: they function in a complex environment in which a profitable project can take a number of forms, and just which form will work, if any, is unknown at the start."); Choi & Triantis, *supra* note 16, at 456–59 (describing structure of multistage contracting and use of preliminary agreements to memorialize sequenced negotiations). Both of these leading articles also do not dispute that formal preliminary agreements that are fully complete with respect to their essential terms or whose open terms are amendable to gap filling should be fully enforceable. Schwartz & Scott, *supra* note 16, at 664; Choi & Triantis, *supra* note 16, at 445–46. As discussed below, the sequential character of the contracting process also figures prominently in the

For Schwartz and Scott, a primary goal for a common law standard governing such agreements is to protect the reliance interest of each contracting party in making interim investments (simultaneous or sequential) during the pendency of the preliminary contact period (i.e. before execution of a definitive agreement).[176] The preliminary agreement enhances mutual confidence with respect to a counterparty's performance as part of the interim investment sequencing process and with respect to an ultimate transaction, if value enhancing.[177] For Schwartz and Scott, the centrality of reciprocal simultaneous or sequential investments of the contracting parties leads to their criticism of *TIAA*'s use of a duty to negotiate in good faith as the key contractual liability issue in Type II agreements. In their view, the primary goal for courts should be protection of the reliance interest, rather than an open-ended obligation to negotiate in good faith, because, if the reliance interest is protected, parties' self-interest will lead to bargaining that maximizes the parties' joint surplus from any transaction, including in some cases, abandoning transactions that are no longer viable.[178]

The Schwartz and Scott analysis, while rigorous and sophisticated, is not entirely persuasive because the critical concept—investments—is imprecise.[179] The Schwartz and Scott analysis is strongest when the investments at issue directly benefit business operations of a proposed venture, such as

rationale for non-binding preliminary agreements. *See infra* text accompanying notes 1828–183.

176 *See* Schwartz & Scott, *supra* note 16, at 667.

177 *Id.* at 676–80.

178 *Id.* at 667.

179 Schwartz & Scott first introduce the concept of investments seemingly generically, but shift to "reliance investments," a seemingly narrow sense of investments. *See, e.g., id.,* at 667, 668. Reliance investments in turn appear to relate back to so-called "simultaneous investments" and "sequential investments," that is "investments . . . needed to make a project successful." *Id.* at 666 n. 11. Schwartz & Scott at times seem to narrow the scope of their analysis of preliminary agreements to only situations where "early investment accelerates the realization of returns." *Id.* at 666. This narrow consideration does not reflect the broad universe of motivations that may inform preliminary agreements.

providing funding for a counterparty or making a capital contribution to a new venture. However, such scenarios may not be implicated in many preliminary agreements, including corporate acquisition agreements. Legal transaction costs, such as due diligence and negotiating formal documents, are deal process investments that parties expect to incur as part of reaching a final agreement in a complex business transaction. The Schwartz and Scott analysis does not explain the role of such costs in preliminary agreements or how they should figure normatively in a contract analysis of preliminary agreements.

Deal process investment primarily appears to advance each parties' self-interest in acquiring information and controlling risk (i.e., avoiding the risk of unanticipated deal consequences), while perhaps secondarily signaling to the counterparty a desire to conclude a transaction. As information is revealed following a preliminary agreement (such as internal information relating to the counterparty), the two contracting parties' interests and expectations may diverge, causing one or the other party to reassess the transaction and their relative commitment to its completion. Making deal process investments, alone, does not appear to provide a way to ascertain contract intent with respect to a preliminary agreement. Nevertheless, deal process investments are especially important in the context of acquisitions transactions where transaction engineering considerations figure prominently.[180]

Like Schwartz and Scott, Choi and Triantis explore common law standards governing Type II preliminary agreements.[181] While they essentially agree that preliminary agreements serve a sequencing process for negotiation of definitive preliminary agreements,[182] their analysis differs from

[180] *See* Ronald J. Gilson, *Value Creation by Business Lawyers*: *Legal Skills and Asset Pricing*, 94 YALE L.J. 239, 241–42 (1984) (considering lawyers' creation of value, as well as their cost, in corporate acquisitions). For a practical example, bid processes in competitive transactions contemplate that the bidder absorb the costs of their own deal process investments. *See supra* note 16.

[181] *See generally* Choi & Triantis, *supra* note 16.

[182] *Id.* at 440.

Schwartz and Scott in at least two fundamental respects. First, they believe that a duty to negotiate in good faith should be the focal point for liability in a Type II agreement.[183] In their view, protection of reliance interests alone (that is, forms of reliance arising between the signing of a preliminary agreement and execution of a final agreement) is likely to have an incomplete role in explaining preliminary agreements or significantly influencing contract parties' behavior.[184] A good faith standard effectively serves to regulate negotiations during the preliminary agreement period from diverse confounding forms of opportunistic behavior.[185]

Second, Choi and Triantis assert that where the duty to negotiate in good faith is decisive in enforcing Type II agreements, a reliance measure of damages alone may be inadequate and should also include expectation damages when possible.[186] In their view, the appropriate measure of remedy should incentivize the contracting parties to adhere to the standard of liability, which in Type II agreements is the duty to negotiate in good faith (i.e., behavior tied to value enhancing rather than value claiming (opportunistic) behavior), something that implicitly would not occur if the Schwartz and Scott reliance-only duty-neutral approach were adopted. According to Choi and Triantis, common law limitations governing expectation damages, such as foreseeability and reasonable certainty, may be appropriate to guard against excessive contract recovery.[187]

Choi and Triantis ultimately provide a more robust economic account of Type II agreements than Schwartz and Scott. Notably, their analysis emphasizes the importance of

183 *Id.* at 459, 470.

184 *Id.* at 442 ("By focusing on the protection of reliance, legal scholarship leaves unexplained a number of important features in preliminary agreement in practice and the courts."); *Id.* at 455 ("We believe that, while the goals vary across contexts, reliance protection by itself is in fact not usually the driving force.").

185 *Id.* at 442, 482.

186 *Id.* at 479–80.

187 *Id.* at 476–77.

the intrinsic flexibility of the duty to negotiate in good faith.[188] This attribute raises a potential challenge to the SAAR+ proposal that seeks to diminish formation opacity in preliminary dealings in the acquisition context. However, as we will return to later, there is a potential economic difference between strategic vagueness in the meaning of relatively well-defined contract obligation and vagueness (strategic or otherwise) regarding (i) the existence of a binding contract obligation, or (ii) the scope of open-ended incomplete contract obligations.

Choi and Triantis do not argue that expectation damages will always or even typically arise from a breach of a Type II agreement, and they even suggest that it may be more efficient for parties to negotiate around the prospect of expectation damages, if they so choose.[189] Such an approach is consonant with the SAAR+ approach discussed in Part IV.

Economic accounts of binding preliminary agreements do not exclude other behavioral factors that may influence the use of preliminary agreements, whether binding or non-binding.[190] Contract scholars and economists have long recognized that parties sometimes deliberately enter into non-binding

188 The intrinsic flexibility of the standard encourages parties to behave and draws on insights from prior work involving strategic vagueness in acquisition agreements. *See generally* Albert Choi & George Triantis, *Strategic Vagueness in Contract Design: The Case of Corporate Acquisitions*, 119 YALE L.J. 848 (2010).

189 *See* Choi & Triantis, *supra* note 16, at 480.

190 *See id.* at 445 ("Even without legal consequence, however, these agreements play important roles and may rely on forces other than legal enforcement, such as moral, relational, or reputational sanctions"); *see also Faux Contracts*, *supra* note 17, at 1040–42 ("In these situations, parties perform their obligations, at least in part, out of '[a] fear of reputational or relational sanctions.'"). Of course, binding obligations and self-enforcing but non-binding obligations may be used in conjunction with one another. *See id*. at 1042–48. *See generally* Ronald J. Gilson, Charles F. Sabel & Robert E. Scott, *Braiding: The Interaction of Formal and Informal Contracting in Theory, Practice, and Doctrine*, 110 COLUM. L. REV. 1377, 1384 (2010) (the seminal articulation of the relationship between formal and informal contracting whereby "contacting parties can and do agree on formal contracts for exchanging information about the progress and prospects of their joint activities and . . . . thereby support[] the informal enforcement of the parties' substantive performance.").

agreements.[191] In agreements that are non-binding, parties willingly forego recourse to legal enforcement as a means to induce counterparty performance in accordance with their obligations. One reason for entering a non-binding agreement is that the agreement may be amendable to self-enforcing mechanisms, like reputational consequences. The prospect of a tarnished reputation or adverse consequences in future dealings with the same party makes persons amenable to fulfilling their immediate obligations because they view the situation from the perspective of long-term, rather than immediate, self-interest.

Professor Hwang in a series of articles has worked through this type of analysis and gathered data from practitioners as it relates to preliminary agreements in merger negotiations.[192] In her view, non-legal factors account for the widespread use of preliminary agreements in the context of corporate acquisitions. These non-legal factors contribute to deal momentum—progress in the multi-step process intended to lead to a final agreement. Each step of the sequential, multi-step process validates the participants progress toward the goal of a binding agreement. Thus, an interim and preliminary non-binding "faux" agreement serves as a validating step that not merely marks progress, but contributes to the likelihood of progress in succeeding steps toward a final agreement.[193]

Hwang's self-enforcement theory of non-binding preliminary acquisition agreements has many persuasive aspects. It accords with the fact that parties frequently sign agreements which are expressly described as non-binding, evidencing the fact that parties' value and deliberately opt for agreements

191 *See generally* Scott, *supra* note 167. This phenomenon is discussed in the economic literature on deliberately incomplete contracts where parties rationally refrain in some circumstances from conditioning the performance of counterparties on verifiable performances metrics. *See, e.g.*, B. Douglas Bernheim & Michael D. Whinston, *Incomplete Contracts and Strategic Ambiguity*, 88 AM. ECON. REV. 902 (1998).

192 *See generally Faux Contracts*, *supra* note 17; *Deal Momentum*, *supra* note 17.

193 *See Faux Contracts*, *supra* note 17, at 1056, 1060–64.

that will have no legal effect.[194] Accentuating the non-binding nature of many preliminary agreements leaves open the questions of when and why binding preliminary agreements are used. Nevertheless, Hwang is insistent in reminding readers that there is nothing inconsistent with the existence of binding and non-binding preliminary obligations and, of course, the two are commonly used in tandem in real life.[195] Presumably, parties resort to binding forms of preliminary agreements where they seek to make their respective obligations more definite and assured through recourse to legal enforcement.

B. On the Incompleteness of Normative Theories of Preliminary Agreements

The above commentators have focused their analysis within a common law framework, thereby, assuming in some form that a single regime of common law principles is the appropriate approach to address different forms of preliminary dealings in all contracting contexts.[196] By accepting the suitability of common law principles in the context of acquisitions to resolve the binding nature of preliminary dealings, existing scholarship seemingly: (i) accepts a litigation-intensive regime to resolve formation and outcome opacity disputes;[197] (ii)

194 *Id.* at 1056–67.

195 *Id.* at 1065–66 (providing real life examples where binding and non-binding agreements bundled together).

196 *See generally* Schwartz & Scott, *supra* note 16; Choi & Triantis, *supra* note 16. This is not relevant to Hwang's approach because her focus is non-binding agreements in the acquisitions area. *See Faux Contracts*, *supra* note 17 at 1048–56. Her persuasive discussion of non-binding agreements relies heavily on contrasting such agreements with binding agreements. By emphasizing the role of non-binding agreements, Hwang attests to the overriding concern of practitioners in avoiding binding preliminary agreements in a wide variety of acquisitions contexts. Indeed, Hwang herself levels a related incompleteness criticism with respect to Schwartz & Scott and Choi & Triantis. *See Deal Momentum*, *supra* note 17, at 382 ("[N]either explanation addresses why parties often behave as though non-binding agreements are binding.").

197 *See* Schwartz & Scott, *supra* note 16, at 671 (proposing to investigate "how contemporary American courts treat reliance investments made

assumes that the contracting parties reliably (or efficiently) attempt to assess formation and outcome uncertainty with respect to preliminary dealings;[198] and (iii) further assumes that behavioral bias will not affect assessment of these issues.[199]

These are obviously contestable assumptions that mask a serious shortcoming in the analyses. There is no consideration of alternatives outside the bounds of common law principle. Specifically, there is no consideration of solutions built around formal contracting requirements. However, such a criticism may not be entirely fair because there are always many other policy possibilities and it would be unreasonable to expect an earlier commentator to anticipate a particular, yet unformulated, policy alternative. Part IV advances such an alternative proposal. Specifically, it urges a different contracting regime in the context of corporate acquisitions because the risk of contract surprise is readily avoidable. For now, it is worth noting merely that the existing literature above does not specifically address or anticipate such a policy alternative.

Another limitation to the normative economic theories relating to Type II preliminary agreements can be fairly leveled. The Type II normative theories are incomplete in an important respect. They do not purport to explain why the common law invokes loosely related legal doctrines (i.e., analogous

before the parties have written a complete contract" [i.e., at the preliminary agreement stage] through an empirical study of a robust sample of cases decided between 1999-2003).

198 *See* Choi & Triantis, *supra* note 16, at 443 (characterizing the central problem of preliminary agreements as "provid[ing] the means by which the parties can efficiently allocate selected risks of changed circumstances," and accordingly optimal agreement must balance between "goals of promoting efficient specific investment, discouraging value-claiming activity, and efficiently sharing exogenous risks" and the need "to respond to previously unforeseen contingencies").

199 *See, e.g.*, Christine Jolls, Cass R. Sunstein & Richard Thaler, *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471, 1501–05 (1998) (discussing the presence and effect of self-serving bias in understanding failed negotiations); Russell Korobkin, *Behavioral Economics, Contract Formation, and Contract Law*, *in* BEHAVIORAL LAW & ECONOMICS 116 (Cass R. Sunstein ed., 2000) (discussing effect of status quo bias on parties' preference for contract terms and validation in laboratory psychological experiments).

multi-factored tests) to resolve disputes with respect to various types of preliminary dealings within a coherent framework of principles when the economic reliance rationales advanced with respect to Type II agreements and Type I agreements are not also equally applied. Why should a reliance rationale be given exclusive emphasis in the Type II context but not the Type I or inadvertent informal agreement context?[200] While not a source of logical inconsistency per se, it should nevertheless count as an explanatory weakness and argument for some caution before adopting normative prescriptions based on that type of explanation.

The deliberate sequencing characteristic of Type II agreements, as discussed above, reflects various concerns: (i) the desire to conserve and order deal process investments (information search, time, legal costs, etc.) in the negotiation process before concluding a final agreement; and (ii) building mutual assurance regarding a bargaining process consistent with the contracting parties intentions (which admittedly in the Type II context may include assurance with respect to transactional investments (simultaneous and sequential) intended to maximize joint surplus during the preliminary agreement period). These concerns reflect deliberate intentional efforts shared by contracting parties to sequence the negotiation process leading to a final agreement.

In binding Type I agreements and binding informal preliminary dealings, any shared deliberate design to sequence and continue negotiations is judicially foreclosed (i.e., there is a judicial determination that a final agreement objectively came into being notwithstanding the fact that one or both parties subjectively believed that further negotiation would take place). In each case, a binding contract comes into existence before a definitive agreement has actually been executed. In the case of a Type I agreement, the parties' deliberate effort to sequence the negotiations (i.e., by characterizing the agreement as preliminary) is superseded as a matter of law (i.e., a determination imputing a final agreement). In the case of binding informal preliminary dealings, there is a judicial

[200] *See supra* Section III.A. discussion.

determination that negotiations have sufficiently crystallized to warrant finding an agreement.

Accordingly, the overarching rationale for finding that either Type I preliminary agreements or informal preliminary dealings are binding is tied to reaching a consensus as to the parties' shared contracting intent. This rationale may encompass reliance-based investments in the process, but the latter hardly seems a necessary feature for attaining shared contractual intent. Contractual principles represent a pragmatic way to resolve the issue of shared contractual intent. Presumably, the common law favors an objective-oriented approach, because in most circumstances such an approach polices bargaining behavior in contracting, including complex business dealings. Contract formation principles in the context of preliminary dealings appear designed to deter feckless bargaining or bad faith by one party and protect the legitimate contractual expectations of the other party when confronted by such behavior. On an efficiency theory of contracts, society should favor enforcing bargaining conduct that compels parties to adhere to promises reasonably viewed as part of a completed bargain (whether informal dealings deemed binding or formal Type I preliminary agreements) and, indeed, probably especially in complex business dealings where parties exhibit calculative economic behavior.[201]

Under the common law, parties in complex business transactions are allowed to engage in robust non-binding bargaining up to point, marked by a fuzzy line, where such bargaining results in an enforceable agreement.[202] This kind of intent

[201] *See, e.g.*, Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L.J. 541, 549 (2003) (arguing that because "firms are better able . . . to choose efficient terms and strategies," courts in the regulation of business contracts should favor contract law principles that "let the preferences of firms control because firms can better pursue the [welfare maximization] objective that both [society] and firms share").

[202] *See supra* notes 66–71 and accompanying text (describing *Texaco/Pennzoil* litigation spurred by dispute over enforceability of informal preliminary dealings). The facts in *Texaco* illustrate different contractual perspectives on a fluid evolving situation. Similarly, the fact that courts reach different results on the enforceability of unexecuted final agreements

proxy rationale, especially in the case of complex business negotiations, differs from the theoretical reliance rationale for Type II agreements, which gives primacy to parties' reliance interest in sequencing investments as part of the negotiation process. The different categories of preliminary dealing in common law cases stem from how facts should be evaluated, at least at a subjective level, as to the necessity for further bargaining. In this respect, the divergence between Type II agreement cases and Type I preliminary agreements is particularly notable as it is quite possible that classification of an agreement as either Type I or Type II may be a contested issue, but its resolution is not grounded in a rationale tied to the sequencing of investments during the parties' bargaining.[203]

Perhaps the incompleteness argument here against theoretical rationales based exclusively on reliance gives short shrift to a potentially powerful counterargument regarding the virtues of the common law's penchant for multi-factored tests to resolve the kinds of formation and outcome opacity identified in this article across contracting contexts (as opposed to the benefits of formal bright-line contracting requirements in the acquisition context as argued here). Strategic vagueness as to the existence or type of contract and uncertainty regarding the scope of remedial consequences may actually promote the integrity and efficiency of the negotiation process. To be sure, as Choi and Triantis have separately argued, strategic vagueness may serve a beneficial purpose in the multi-step negotiation process characteristic of acquisition agreements where the costs of a negotiated resolution of uncertainty exceed the probability discounted benefits that would be achieved (i.e., "let's just agree to disagree about this

provides yet another example of the fuzzy line between in binding and non-binding agreements in complex agreements. *See also supra* note 6.

[203] *See, e.g.*, Vacold, Inc. v. Cerami, 545 F.3d 114, 132 (2d Cir. 2008) (majority finding a binding Type I agreement whereas dissenting opinion concluding that contractual dispute arose from a Type II preliminary agreement) ("Although there are important analytical differences between Type I and Type II agreements, policing the boundaries between the two is not always a simple task.").

detail and we will re-engage if during the course of performance the detail assumes unusual significance.").[204]

However, resorting to a strategic vagueness argument as a justification for contractual opacity with respect to the status and scope of formal preliminary agreements is a potentially slippery slope that deserves closer scrutiny.[205] Choi and Triantis themselves carefully lay out a variety of applicable conditions in arguing for the potential efficiency of contract vagueness in the case of definitive corporate acquisition agreements.[206] At the very least, such an approach assumes that parties can assign reliable probabilities to known uncertainties and thereby enable contracting parties to achieve probability-adjusted measures of risk to make rational value maximizing decisions. However, this assumption seems doubtful in the case of formation uncertainty or other radical forms of outcome uncertainty, which could as likely be viewed as exhibiting so-called Knightian uncertainty.[207] If these forms of uncertainty are more properly viewed as Knightian in nature, the uncertainty in this context would not appear to conform to a conventional strategic vagueness justification and, indeed,

204 Choi & Triantis, *supra* note 7, at 856 (stating article's thesis that "vague terms made do a better job than precise terms in promoting the goals of contract design" with respect to critical contract provisions in acquisition agreements, especially in the case of provisions "that provide the buyer with options to terminate the agreement").

205 I am not suggesting that the Choi and Triantis article, *supra* note 188, actually makes the strategic vagueness argument regarding contractual opacity with respect to the status and scope of formal preliminary agreements. Rather, the point here is to interrogate the validity of invoking an analogous form of argument as to the general contractual opacity with respect to formal preliminary agreements. As discussed in the text, such an argument would stand on shaky ground.

206 Choi & Triantis, *supra* note 188, at 881–96 (including the seeming innocuous observation at 882 that "[t]he costs of vagueness are relatively well known").

207 Cass R. Sunstein, *Knightian Uncertainty* (forthcoming in BEHAV. PUB. POL'Y) (preliminary draft Dec. 12, 2023 on file with SSRN), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4662711 [https://perma.cc/85F5-TB5V]. Knightian uncertainty occurs when individuals cannot assign probabilities to imaginable outcomes and poses a challenge for decision theory and regulatory practice. *Id.* at 1.

seem undesirable in two respects. First, it is not clear that there is a mutually agreed upon benefit in deliberately avoiding their resolution, whereas a bright-line approach would remove the uncertainty. Second, there is no reason to believe that courts are better suited to decide the issues than the parties in all contexts. As noted in earlier discussion, the contractual status of preliminary agreements is frequently equivocal for courts. A determination of the appropriate remedy for breach of an agreement with an otherwise inherently equivocal status can only be less tractable. In contrast, forcing parties to be clearer about status and scope ex ante is beneficial in at least two respects. It provides courts with a more administrable yardstick in enforcing such agreements and simultaneously provides reliable evidence of parties' intent as to the preliminary agreement.

Admittedly, there is no logical inconsistency in having different economic rationales for different forms of preliminary dealing, each with its own contractual consequences. Nevertheless, the divergent consequences, especially in complex business negotiations characterized by intensive negotiations, at the very least pose a question of whether in some contexts greater ex ante clarity of contractual consequences might be feasible and desirable. This issue is not addressed in current scholarship.[208] Nevertheless, the review of this literature lays the ground for a comparative advantage argument for an alternative contractual regime (the SAAR + regime) in the context of corporate acquisitions. The next part presents such a proposal and makes an affirmative argument for its adoption.

IV. THE CASE FOR FORMALISM IN BINDING PRELIMINARY ACQUISITION DEALINGS: THE SAAR+ PROPOSAL

As the preceding sections have shown, the common law's embrace of the objective theory of contract formation, and its

[208] It is important to note that this Article does not directly challenge current normative scholarship with respect to Type II agreements or take a position with respect to the disagreement between Schwartz & Scott and Choi & Triantis.

simultaneous discounting of subjective intent to contract as an element of formation gives rise to contract surprise problems in preliminary dealings: specifically, (i) formation surprise (in the case of informal agreements); and (ii) a radical form of outcome surprise (in the case of formal preliminary agreements). The common law's approach implicitly rests on a social cost-benefit calculus in which the social benefits of the objective theory of contract formation outweigh the costs of formation doctrines that do not strictly accord with the subjective expectations of both contracting parties. This Part of the Article describes an alternative approach to these problems in the context of acquisition agreements: the SAAR+ proposal. As discussed below, the argument is context specific. Although the problem of contract surprise is pervasive to preliminary dealings, the relative social costs and benefits of introducing greater formality with respect to specific types of agreements can reasonably be expected to increase the costs of contracting while reducing the costs of errors of mistakenly imputed agreements. However, there does not appear to be any reason to believe that these costs vary in fixed proportion to one another or that they are of the same relative magnitude in different transactional contexts. If the costs and magnitudes do in fact vary across contexts, the argument for increased contracting formality narrows considerably. The question is not whether increased formality on average is optimizing with respect to preliminary dealings generally, but rather whether increased formality in specific contexts is appropriate based on the characteristics of that contracting context.

This Part makes the narrower argument for greater formalism in preliminary dealings in the context of corporate acquisition agreements. As reflected in the preceding sections, disputes regarding the enforceability of preliminary dealings in corporate acquisitions (both (i) preliminary dealings that create inadvertent informal agreements, and (ii) formal preliminary agreements whose nature and scope are uncertain) occur not infrequently with outcomes that are difficult to predict. As argued below, the SAAR+ proposal in this context promises to deliver social benefits in terms of clarity of

obligations that outweigh the social costs arising from its contracting requirements.

The Part is in three sections. First, it argues that the contract surprise problem identified is best addressed through a proposal tailored to the corporate acquisition context. Second, it describes the SAAR+ proposal designed to eliminate the problems of formation contract surprise in inadvertent acquisition agreements and to mitigate the problem of outcome contract surprise in formal preliminary agreements. Finally, it addresses practical issues in implementing a SAAR+ proposal.

A. Reassessing the Costs/Benefit Calculus of Opacity in Acquisition Preliminary Dealings

This subsection presents the basic argument for the SAAR+ proposal with respect to acquisition agreements: contract surprise (due either to contractual opacity at formation or to severe forms of outcome uncertainty) is largely avoidable in this context at modest social cost. In short, in this context, the social costs of opacity in formation or outcome (which are a source of contract surprise) are outweighed by the social benefit of clarity achieved through a formal writing requirement embodied in the SAAR+ proposal discussed in Sections IV.B and IV.C.

1. The Challenge of the Common Law's Contract Surprise Problem in Corporate Acquisitions

As discussed in Part II, formation opacity inheres in common law principles and contributes to contract surprise in preliminary dealings. This inherent feature in the common law reflects the laws' effort to resolve the tension between, on the one hand, types of formation and outcome surprise (i.e., surprise arising from circumstances where a contracting party believes no legally enforceable contract exists and seeks freedom from contract) and, on the other, contract frustration (i.e., frustration that would ensue if counterparties could walk away from binding contractual promises). Underlying these concepts are different transactional participant

perspectives—one protecting reasonable contractual expectation at the risk of surprise and the other protecting freedom from contract by preventing inadvertent surprise arising from unintended agreements in negotiation or agreements preliminary to a final agreement. The common law incorporates principles that balance the risk of contract surprise against the risk of contract frustration and that necessarily incorporate some degree of opacity in formation: reasonable inferences from objective manifestations generally trump the subjective intent of the individual participants.[209]

This approach explains why the common law has a well-established orientation that favors contract formation without formal writing requirements.[210] The common law generally is less sympathetic to the harm caused by subjective contract surprise arising from inadvertent contract formation than the harm from contract frustration suffered by a disappointed putative contracting party from reasonable belief that a contract had been concluded.[211] The common law's discounting of inadvertent contract surprise in the absence of a writing requirement rests on a number of factors:

> (i) unnecessarily impeding contract formation with writing formalities increases the costs of contracting both directly (in terms of legal costs involving documentation) and indirectly (in terms of more laborious and time-consuming processes);
>
> (ii) formality requirements may, as a practical matter, be harmful in contracting situations where the

[209] *See supra* notes 26–32 and accompanying text.

[210] *See* RESTATEMENT (SECOND) OF CONTRACTS § 19 (AM. L. INST. 1981) (allowing manifestation of assent by written *or* spoken words, *or* actions); *see also* 1 CORBIN ON CONTRACTS § 3.8 (2023) (explaining acceptance may be construed from words *or* conduct).

[211] *See* RESTATEMENT (SECOND) OF CONTRACTS §19 (3) (AM. L. INST. 1981) ("The conduct of a party may manifest assent even though he does not in fact assent."); *see also* 1 WILLISTON ON CONTRACTS § 4:2 (4th ed.) ("As long as the conduct of a party is volitional and that party knows or reasonably ought to know that the other party might reasonably infer from the conduct an assent to contract, such conduct will amount to a manifestation of assent.").

> commercial or market realities require speed (e.g., recurrent and high-volume transactions that are market-sensitive in the context of commercial practice);[212] and (iii) allowing contract formation absent written agreements imposes greater integrity in negotiation by having the means to credibly commit to one another short of a written agreement and, to some extent, discourage renegotiation of settled matters.[213]

Moreover, other common law doctrines serve to mitigate the harshness of inadvertent formation surprise in terms of formation (such as the requirement of definiteness)[214] or monetary damage limitations (such as requirements of causation and reasonable ascertainment of damages), diminishing concerns about inadvertent contract formation.[215]

These considerations clearly put the burden of persuasion on the proponent of a formal writing requirement, such as the SAAR+ proposal discussed below. At the outset, this creates a challenge for any writing requirement proposal. It must overcome the problem of overbreadth (i.e., namely the suggestion that the common law should embrace writing requirements

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212 These consideration are frequently ascribed to the motivation underlying the drafting of Article 2 of the Uniform Commercial Code. *See, e.g.*, Ingrid Michelsen Hilinger, *The Article 2 Merchant Rules: Karl Llewellyn's Attempt to Achieve the Good, True, The Beautiful in Commercial Law*, 73 GEO. L. J. 1141, 1151 (1985) ("Article 2 merchant rules represented Llewellyn's attempt to create simpler, clearer, and better adjusted rules for commercial transactions.").

213 *See* Craswell, *supra* note 2, at 491–94, 536–39 (discussing how finding contractual commitment promotes efficient reliance and its relevance to preliminary agreements).

214 *Compare id.* (exploring how the concept of reliance colors various contract formation doctrine), *with* Eisenberg, *supra* note 33, at 1179 (criticizing uncritical acceptance of expression rules embodied in common law contract formation doctrines because "little if any attention has been directed to the soundness of most expression rules").

215 *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS §§ 350–52 (AM. L. INST. 1981) (detailing, in order, "avoidability as a limitation on damages," "unforeseeability and related limitations on damages," and "uncertainty as a limitation on damages").

generally). As to the overbreadth challenge, the SAAR+ rests on a simple assertion: acquisition transactions provide a different context that warrants a special writing requirement, if such a requirement can be appropriately fashioned.[216] This kind of argument for a formal writing requirement is not entirely novel, and examples exist in business contexts without doing violence to the common law's general reluctance to embrace writing requirements.[217]

One could imagine other possible challenges to the common law's general willingness to enforce unwritten bargained for promises. For example, in contrast to the common law, courts could give dispositive effect to written contractual language that disclaims an intent to contract or that contemplates memorialization in a fuller final argument. Giving effect to such language would preclude formation of any binding informal agreements inconsistent with such expressions of intent.[218] Such an approach, however, would be more far

[216] Nothing in this Article should be construed as seeking to undermine the common law's well-established general tradition of enforcing non-written agreements.

[217] *See supra* note 156 (discussing U.C.C §2-209(2) "no-oral-modification" (which allows parties to a sales contract to pre-commit to a requirement that any modification be by signed writing)); *see also* DEL. CODE ANN. tit. 8, § 251(b) (West 2020) (as in most jurisdictions for long-form domestic and foreign mergers, requiring that a merger agreement be pursuant to a "executed" agreement); *see also* N.Y. LTD. LIAB. CO. LAW § 102(u) (McKinney) (unlike the majority of jurisdictions, requiring that operating agreements for LLCs (including all terms) be in a writing); 15 U.S.C. § 80a–15 (requiring that an investment management agreement between an investment adviser and a registered investment company be in writing, a requirement motivated by regulatory policies). These types of requirements reflect the intuition expressed in the quotation opening this Article that in complex business dealing, use of written documents accord with norms of legal practice. Finally, the common law's parol evidence rule (which adopts a doctrinal assumption that privileges fully integrated written agreements over prior extrinsic evidence or contemporaneous oral statements) evidences the common law's own recognition that written agreements are sometimes useful in ascertaining the parties' contracting intent. *See generally* Steven J. Burton, ELEMENTS OF CONTRACT INTERPRETATION 69–71 (2009).

[218] This appears to be the tack taken by one commentator in asserting without further development. *See* Crump, *supra* note 787, at 7 ("If a document expressly says that it is not a contract, or that it requires a definitive

reaching than what is proposed here. Indeed, such an approach would imply the wholesale rethinking of the premises underlying Sections 21 and 27 of the Restatement (Second) of Contracts,[219] an undertaking not suggested here.

Instead, the threshold consideration for the SAAR+ writing requirement lies in showing that contracting in the corporate acquisition context is different and warrants a distinct approach, even if such an approach in other contexts is not preferred. It is that task to which the article now turns.

2. Corporate Acquisitions Represent a Distinctive Contracting Context

At a practical business level, corporate acquisitions exhibit a distinctive character not shared by many other contracting contexts. These factors include: (i) definitive acquisition agreements are complex and frequently entail a multi-step negotiation process in which the parties' expectations may be overly optimistic relative to the actual progress in resolving unresolved issues; (ii) parties are customarily represented by experienced sophisticated deal counsel both because of the high stakes and complexity in acquisition transactions; (iii) the duration of the process until closing makes them susceptible to the unanticipated external developments on the parties' respective bargaining positions and, thus, parties are cognizant of the special importance of deal certainty throughout the process.[220]

written agreement before anything within it binding, it ought not to become a contract.")

[219] *See* RESTATEMENT (SECOND) OF CONTRACTS §21 (AM. L. INST.1981) ("Neither real nor apparent intention that a promise be legally binding is essential to the formation of a contract, but a manifestation of intention that a promise shall not affect legal relations may prevent the formation of a contract."); RESTATEMENT (SECOND) OF CONTRACTS §27 (AM. L. INST. 1981) ("Manifestations of assent that are in themselves sufficient to conclude a contract will not be prevented from so operating by the fact that the parties also manifest an intention to prepare and adopt a written memorial thereof; but the circumstances may show that the agreements are preliminary negotiations.").

[220] These three propositions are routinely affirmed by commentators. *See, e.g.*, Stephen J. Choi, Mitu Gulati, Matthew Jennejohn & Robert E.

The contract formation process leading to a definitive acquisition agreement is a multi-step process that addresses many fact-specific issues shaped by the bargaining dynamics between buyer and seller.[221] The process of contract creation is multi-stepped, not only because of the number of issues in play, but also because the interdependence of issues may itself strongly argue for a sequenced process for resolution. Some issues must be resolved before it is meaningful to address others (e.g., it would not make much sense to negotiate a material adverse event clause until there is a rough agreement on price and deal structure).[222] Moreover, as in all acquisitions, there are informational asymmetries that favor the seller.[223] In a negotiated transaction, the negotiations provide an opportunity, beyond due diligence by itself, to elicit counterparty information either directly or inferentially in the negotiation process, thereby resulting in the revelation of relevant

Scott, *Contract Production in M&A Markets*, 171 U. PENN. L. REV. 1881, 1885 (2023) ("The M&A market often involves large, sophisticated parties with the resources and, on occasion, the motivation to craft bespoke contracts."); Choi & Triantis, *supra* note 188, at 853, 857 ("[T]hese contracts involve sophisticated parties and large financial stakes" and "contract design is complicated by uncertainty in exogenous conditions: market forces, political developments, consumer tastes, and so on."); Jeffrey Manns & Robert Anderson IV, *The Merger Agreement Myth*, 98 CORNELL L. REV. 1143, 1151 (2013) ("Lawyers are at the forefront of drafting the acquisition agreement" which is "the product of extensive negotiations tailored to the particulars of the transaction.").

221 *See Faux Contracts*, *supra* note 17, at 1056, 1063 ("M&A deals are always completed in stages" and reporting the importance of building reliable counterparty reputation at the "earlier stages of a multi-stage transaction"); *see also* Choi & Triantis, *supra* note 16, at 456–61 (in discussing the structure of multistage contracting, using repeated use of deal transactions as quintessential illustration).

222 *See Deal Momentum*, *supra* note 17, at 17, 25 (describing that the use of preliminary agreements in dealmaking practice lends itself to two alternative theories: use to "resolve complexity and uncertainty" and use, even where non-binding, to "resolve enough uncertainty" to create deal momentum "push[] the deal forward").

223 *See* Sean J. Griffith, *Deal Insurance: Representation & Warranty Insurance in Mergers & Acquisitions*, 104 U. MINN. L. REV. 1839, 1840 (2020) (in explaining the function of reps and warranties in acquisition agreements, noting the seller's informational advantage relative to the buyer).

business information (i.e., buyers will be able to whittle away at the informational asymmetry in the course of negotiations).[224]

Corporate acquisitions for contract purposes requires considerable specialization and representation by sophisticated deal counsel. It is apparent that corporate acquisition contracting is regarded by legal academics as a specialized field entailing unique contracting considerations.[225] Moreover, M&A practitioners routinely raise cautionary warnings regarding the unintended consequences in terms of inadvertent informal agreements or formal preliminary agreements arising from common law contract principles.[226] Widespread academic and professional recognition of the specialized nature of corporate acquisitions validates the intuition that contracting

[224] *See id.* at 1842 ("[R]eps impose liability to induce efficient disclosure. The liability risk generated by the reps is the engine driving the exchange of information in the deal.").

[225] Scholarship in the area is legion. *See* Choi et al., *supra* note 220 (discussing issues of contract production relating to trade-off between use of customized and standardized terms in merger and acquisition contracting context); Guhan Subramanian & Annie Zhao, *Go Shops Revisited*, 133 HARV. L. REV. 1215, 1220 (2020) (canvassing the proliferation of go-shop provisions in merger agreements and noting the origins of the practice); Griffith, *supra* note 223, at 1842–43 (discussing use of deal insurance in connection with acquisition agreement's representations and warranties to overcome inherent information problem between buyer and seller); Fernán Restrepo & Guhan Subramanian, *New Look of Deal Protection*, 69 STAN. L. REV. 1013, 1016 (2017) (noting thirty-year evolution in deal practice relating to termination fees and other forms of deal protection features such as match rights, new generation intangible asset lock-ups, and side agreements); Manns & Anderson, *supra* note 220, at 1143 (2013) (empirical study casting doubt on whether financial markets "respond in an economically significant way to the deal-specific legal terms of M&A agreements"); Choi & Triantis, *supra* note 188, 856-81 (describing contract design issues in acquisition agreement provisions protecting buyer's deal optionality); John C. Coates IV & Guhan Subramanian, *A Buy-Side Model of M&A Lockups: Theory and Evidence*, 53 STAN. L. REV. 307, 310 n.2 (2000) (giving contractual definition of lock-up provisions in acquisition agreements).

[226] *See, e.g.*, *Faux Contracts*, *supra* note 17, at 1052–56 (describing interviews of deal lawyers evidencing well-established practice with respect to ensuring preliminary agreement are non-binding rather than binding); *see also supra* notes 144, 150 (discussing articles from M&A practitioners).

in the context of corporate acquisitions differs from run-of-the-mill contracting contexts. Moreover, in acquisitions, the contracting parties routinely are represented by sophisticated counsel who are well-suited to signal the onset of binding commitments. The transaction costs of formality in contracting will not be significantly affected by a formality requirement since attorneys are quite capable of memorializing an agreement when an agreement in fact exists and the memorialization reflects a fraction of the total legal costs incurred in such a transaction.

Finally, the widely recognized importance of deal certainty (or deal finality) at the final stages of an acquisition suggests (by its contrast to preliminary dealings) why formation clarity at a preliminary stage is of unusual importance in the acquisition context.[227] Deal certainty is important in a final agreement because each party recognizes that counterparties may encounter strong incentives to abandon the transaction in the interim before closing, leaving the abandoned party out of luck. Sellers undoubtedly worry about buyer's remorse (i.e., the buyer desire to walk away from the deal after signing because in hindsight it may appear that the buyer overpaid in the acquisition).[228] On the other hand, the buyer will seek to guard against seller wanderlust (i.e., the tendency of sellers to want to nix the current deal if a better one is available).[229] Preliminary agreements likely lack this close scrutiny on preserving deal certainty because the participants assume there is not a final transaction. In the presence of formation opacity, however, there is an unstated risk that the deal participants will view their respective commitments to a deal differently, especially without clear terms governing termination, increasing the costs of mistakenly-attributed finality in preliminary dealings.

Developments in corporate practice all point toward participant desire for clarity and precision in the formation process. As previously noted, modified competitive auction

227 *See* Restrepo & Subramanian, *supra* note 225, at 1017–19 (discussing the importance of deal protection as a means of securing deal certainty).

228 *See id.*

229 *See id.*

processes have proliferated in the wake of *Revlon* and market practices that recognize the benefit of competition in the sale of companies.[230] As part of this trend, market norms favoring greater formality in contracting have arisen. Written bid process letters routinely preclude formation contract surprise. The seller controls each stage of the process, including the documentation, and the participating bidders understand that they are engaged in a winnowing process where inadvertent agreements by the seller are not reasonably inferred.[231] The prevailing market norm in acquisition sales processes provides an informal indication of participant preference for formality in contracting in this context. Notice that this preference is not altered by the fact that some contracting parties, specifically bidders, may ultimately be disappointed by the outcome of the process. The bidder's disappointment does not stem from formation surprise in contracting, but rather on the failure to secure the proposed transaction on the bidder's terms (a result that is entirely consistent with the social benefits of contracting).

Another way of thinking about differences between corporate acquisitions and other contracting contexts is the absence of features that may favor a regime that tolerates opacity in formation. Informal contracting seems appropriate in contexts where the trade-offs in terms of costs and benefits are non-obvious with respect to contract formation surprise through inadvertence and offsetting contract surprise caused by formalities that obstruct contract formation. Agreements among friends and neighbors, modification to contractor arrangements, or at-will arrangements all appear to be situations where the cost-benefit trade-offs based on the formality or

230 *See supra* Section II.C (discussing modern practices used to prevent risk associated with contract formation opacity in corporate acquisitions).

231 A prospective buyer is aware that preliminary dealings are part of a carefully delimited sales process and the success of any participant will depend on providing superior value to the seller relative to other prospective buyers. In such a setting, a competing buyer must largely acquiesce to seller's form of agreement and requirements relating to ancillary agreements, such as financing commitments, as a condition for successful participation in the sales process.

informality of agreements seems to favor informality to save on the transaction costs of contract formation. Similarly, many contracting situations, such as commercial transactions, may involve significant routinization and frequency.[232] Others may involve contracting terms (such as spot prices or interest rates) that are market-sensitive.[233] These situations create a need for reliable informal contracting, even though there will be instances of contract surprise due to inadvertence.

In contrast, acquisition agreements involve inherently complex context-specific issues and will turn on non-transitory long-term valuations based on an estimate of the acquisition's ability to generate or contribute to future going concern value of the acquiror. Such determinations rest on business judgment about long-term factors and embedded costs. Unlike the business need in ordinary commercial transactions to lock in the parties' position in real-time so that the counterparty can enter transactions rapidly in response to fluctuating market conditions, the business need to lock-in the parties' positions does not stem from the practicalities of such transactions; parties may want to lock in the deal for reasons of self-interest, but the transaction itself does not require heavy reliance on informal contracting.

3. The Cost of Opacity Outweigh Its Benefits in Preliminary Acquisition Dealings

While the factors above suggest that contracting in the corporate acquisition context is distinctive in nature from many other contracting contexts, it is necessary to consider whether those differences on balance warrant a different approach to a formal writing requirement, and specifically whether such factors likely affect the social costs and benefits of contracting requirements that require increased formality. Thus, the case for a SAAR+ depends on showing in the acquisition context that the costs of avoiding contract surprise are relatively low

232 *See supra* note 3.

233 *See, e.g.*, Tchrs. Ins. & Annuity Ass'n of Am. v. Trib. Co., 670 F. Supp. 491 (S.D.N.Y. 1987) (involving a commitment letter in financing).

while the benefits of clarity through enhanced formal requirements are correspondingly significant.

As to the first factor, the inherent contracting complexity of acquisitions suggests that the risk of contracting surprise and the costs of mistakenly inferring a binding final agreement are likely high. As previously noted, negotiations in the acquisition context are typically viewed as a multi-stage process in an informationally complex environment. Core issues relating to pricing and financing typically must be resolved before subsidiary issues such as representations and warranties, termination conditions and fees, and covenants even begin to make sense. Indeed, this understanding of the negotiation process is borne out by what is observed in such processes. The back and forth suggests a recognition that parties do not share a common understanding of when the multi-stage negotiations have reached a stage of a binding commitment, except when the deal is signed. In such circumstances, parties frequently explicitly insist on reciting the non-binding character of any negotiations to achieve clarity between participants' psychological commitment to a deal and the onset of participants' joint legal commitment. The inherently multi-stage process makes it more difficult to discern when the line between contract formation and mere negotiations in acquisitions has been crossed relative to other contracting contexts, and, consequently, the expectations of the contracting parties are more likely to diverge regarding when the line has been crossed. In other words, the likelihood of legitimate contract surprise seems relatively high absent a bright-line relating to formation or outcome.

The costs of the contract surprise seem to exceed contract frustration concerns because, notwithstanding the need for multiple steps in the negotiating process, there are obvious self-interested reasons that both parties will seek deal certainty and press to complete written agreements when a bargain has been struck. From the buyer's perspective, knowledge of negotiations can excite the interests of competing buyers, raising the prospect of a bidding contest and a result contrary to the buyer's interest. On the other side, sellers typically are anxious to resolve the status of acquisition

transactions because the possibility of a transaction may be unsettling for employees and customers. In the case of a public company, where share price is a function of market-sensitive material information, the imperative for speed is all the greater, as prices fluctuate depending on rumors and the risk of insider trading liability increases with material developments in the dynamic process leading to a final agreement. Similarly, once a seller has made a decision to sell, or at least explore a sale, there is an obvious incentive to move on from a business which does not figure in the seller's long-term plans.

Unlike recurring commercial transactions that may warrant streamlining the legal process to avoid unnecessary delays in formation, cumbersome formality requirements, and the advice of lawyers, acquisition transactions invariably will involve lawyers. Where lawyers will be involved routinely, the incremental costs of formal requirements are likely to be small. The parties have sought to include counsel in contemplation of working toward a final written agreement. The failure to attain such an agreement does not arise from a formality requirement so much as an inability of the parties to strike a mutual agreeable bargain. Moreover, because acquisition transactions will involve sophisticated counsel on both sides of the transaction, typical concerns in consumer contracts relating to contracts of adhesion are simply not implicated by the formality requirements proposed here.

In addition, parties have adequate incentives in the acquisition context to negotiate a binding formal agreement where a contract is genuinely sought by both parties.[234] Bright-line formal requirements to formation bring about socially beneficial clarity while parties are otherwise well-situated to protect their interests through private ordering. In other words, the risk of mistaken contract surprise likely far exceeds the risk of mistaken contract frustration. Formality in contracting prioritizes eliminating contract formation surprise due to inadvertence, reflecting a judgment that such surprise does not serve a useful purpose (i.e., one that from a policy perspective

[234] The significance that deal certainty has assumed in such transactions evidences the strong incentives of parties to conclude a transaction.

should not be protected) in the acquisition transaction context.

Under the existing common law regime, in contrast, even very sophisticated contracting parties in corporate acquisitions cannot necessarily prevent contract formation, merely by formally disclaiming an intent to reach a final agreement (since any such disclaimer is always subject to fluid oral modification), or by explicitly stating that a final agreement is contemplated (since the requisite mutual assent for a binding agreement may be found to have occurred before completion of the contemplated final agreement).[235] The common law approach unnecessarily discounts protection from contract in corporate acquisitions where risk of mistakenly imputed contracts is fairly high and adequate means of protection from contracting abuses would otherwise exist, making formality requirements a reliable mechanism for ascertaining true contractual intent.

Admittedly, a formality requirement arguably makes it more difficult for one party to lock in a beneficial deal, as a matter of stealthy bargaining tactics, but this kind of cost as a matter of social policy is not worthy of protection. As noted above, requiring a formal written agreement will generally not increase the underlying transaction costs at the margin of a genuine intended agreement (i.e., materially increase the costs of an agreement where a bargain has been struck). Even assuming that a formality requirement may lead to gamesmanship about signing up a deal (thereby, allowing one or the other party to evade obligation while considering alternative opportunities), it is hard to see how opting for a fact-based determination regarding formation serves as an efficient or effective means of policing would-be unfaithful counterparties.[236]

Finally, formal contracting requirements have a judicial administrative benefit. They shift the burden of resolving contract formation issues from courts to the contracting parties.

[235] *See supra* Section II.C.

[236] *See Faux Contracts*, *supra* note 17, at 1060–64 (discussing practitioner perception of reputation of negotiating parties as repeat players as well as within the context of a single deal).

In many contexts, it makes sense to impose this burden on courts, where the need for informal contracting is high and courts offer a relatively efficient mechanism for resolving disputes. Nevertheless, in the acquisition context, application of a facts-and-circumstances approach to preliminary dealings adds to litigation costs and likely produces more defensive negotiations strategies rather than fostering unambiguously constructive negotiations at an earlier stage. Because contracting parties are well-equipped in the acquisition context to both signal and recognize the onset of binding commitments, courts are relieved of this obligation, significantly reducing the risk of needless and high-stakes judicial errors.

* * *

The preceding discussion makes the case for rethinking common law principles that contribute to opacity in preliminary dealings in the context of corporate acquisitions. A formal writing requirement in the case of preliminary dealings essentially provides clarity as to intent to contract and such clarity has the tangible benefit of diminishing contract surprise, especially in circumstances characterized by multi-step negotiations that contribute to contract opacity, both in formation and outcome. In the context of corporate acquisitions, the benefits of a formal writing requirement likely exceed the costs arising from its imposition, assuming a feasible formal requirement can be formulated. The following subsections provides a concrete illustration of such a requirement for corporate acquisitions—the SAAR+—that both eliminates contract surprise with respect to informal acquisition agreements and substantially mitigates outcome surprise in formal preliminary agreements, all without significant altering the relative costs of contracting in the acquisition context.

B. The SAAR+ Proposal

The SAAR+ proposal narrowly addresses the problem of contractual opacity in preliminary dealings in the context of corporate acquisitions. The requirement has two distinct features: (1) a writing requirement as to the transaction, and (2)

a default remedies requirement that parties can contract around in writing. The first feature addresses the issue of inadvertent contract formation in informal agreements and the latter feature, when supplemented by the basic writing requirement, brings clarity to formal preliminary agreements.

1. Eliminating Formation Surprise in Informal Acquisition Agreements

The SAAR+ proposal's core requirement would impose an executed written agreement requirement as a condition to enforcement of any acquisition agreement. In other words, enforcement of acquisition agreements would require the parties to explicitly and formally express an intent to contract in the context of acquisitions. As shown above, formation opacity serves little material benefit in the context of corporate acquisitions. Unlike other contracting contexts, a bright-line formal writing requirement does not have the disadvantage it could in other contexts. As a useful illustration of the effects of such a requirement, the outcomes in cases like *Texaco* and *Turner Broadcasting* would be reversed. In *Texaco*, there never was an integrated signed agreement of either a definitive or preliminary agreement.[237] Similarly, in *Turner Broadcasting*, the draft definitive agreement was never executed.[238]

The SAAR+ proposal described here would need legislative action to effectuate.[239] The principal technical challenge posed by such a requirement lies in formulating a workable proposal for implementation. As noted in the appendix, there are two issues that stand out. First, there would be a need to define an acquisition agreement in a way that segregates such agreements from other agreements. As explained, the article borrows from the Hart-Scott-Rodino Act's definition of an acquisition used for purposes of antitrust clearance. Although serving a very different purpose in the contracting context, the definition serves an analogous function to the concept's function in the antitrust context.

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[237] *See supra* text accompanying notes 56–65.

[238] *See supra* note 46.

[239] Draft text for the proposal is appended in the appendix.

Second, the definition must be distinguishable from other ancillary agreements that may separately accompany an acquisition or be embedded in its terms. This becomes especially important with respect to the second feature of the SAAR+ proposal, namely the remedy limitation in the acquisition agreement with respect to acquisitions, absent a written opt-out. The SAAR+ would treat ancillary undertaking as severable from the acquisition agreement and not subject to any explicit remedy limitation.

2. Mitigating Outcome Surprise in Formal Preliminary Agreements

The source of formation surprise in informal agreements is apparent. The absence of formality creates the potential for divergent expectations regarding the formation of a contract between the transaction participants. Formal preliminary acquisition agreements eliminate the problem of informality as a source of contract formation surprise precisely because only executed formal written agreements will be binding. Nevertheless, as has been discussed, an analogous opacity problem lurks in binding formal preliminary acquisition agreements (which in some cases may include letters of intent, memoranda of understanding, or even term sheets). Here, the avoidable contract "surprise" or uncertainty does not arise so much from the inadvertent consequences of negotiations, but rather the effect of a preliminary agreement in binding the participants to a definitive agreement.

As noted above, formal preliminary agreements are a form of deliberately incomplete agreement.[240] They are incomplete in several respects. First, they are incomplete in stating what will be the outcome of future negotiations (i.e., they are deliberately incomplete due to the many unstated terms of a contemplated definitive agreement that will necessarily follow). Second, they are potentially incomplete or opaque in explicitly informing the court of what type of preliminary agreement is contemplated—a binding Type I agreement, a binding Type II agreement, or merely a non-binding agreement to agree.

[240] *See supra* note 191. *See also* text accompanying notes 79-80.

The SAAR+ proposal does not afford the same easy fix to the problem of contract surprise in formal preliminary agreements that its formality requirement achieves in the case of inadvertent informal acquisition agreements. Indeed, the SAAR+'s formality requirement serves little purpose in the case of formal preliminary acquisition agreements, other than foreclosing oral modifications of the formal preliminary agreement, since by definition such agreements are signed written agreements. As noted, formal preliminary agreements are deliberately incomplete and the deliberate incompleteness gives rise to a different type of contract surprise relating to outcome and scope uncertainty rather than formation uncertainty. Nevertheless, the common element in the two scenarios is contract surprise occasioned by the equivocal intent of the contracting parties.

The second feature of the SAAR+ addresses the outcome and scope uncertainty problem inherent in formal preliminary agreements. Specifically, the SAAR+ would supplement the agreement formality requirement with a second provision, a default remedy limitation (making reliance damages the default remedy for breach of a formal preliminary acquisition agreement), unless the parties have provided otherwise in their formal agreement. On first blush, the SAAR+'s second feature may seem unrelated to outcome uncertainty occasioned by formal preliminary agreements, as it does not appear to resolve the nettlesome issue of intent presented by such agreements.[241] However, this feature incentivizes parties to clarify the scope and termination consequences in the formal preliminary acquisition agreement itself.[242] The

241 *See supra* Section II.B.

242 *See* Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 92 (1989) (seeking to provide "a more complete explanation of the current diversity of defaults"). The proposed open-ended default rule is certainly not a majoritarian default rule in the sense that it merely incorporates "what [contracting parties] would have contracted for." *Id.* at 91. Nor does it appear to be majoritarian in the sense of an approximation of the "what the majority of contracting parties would want" in the acquisition context. *Id.* Indeed, a scholar like Hwang would likely assert that a majority of contracting parties would probably favor a no-damages default rule as many such agreements

default rule essentially requires an objective statement of intent in order to deviate from the default.[243]

An expressed intent to override the default rule as to measure of damages would mitigate the lurking problem of intent in acquisition agreements (i.e., how and in what ways is the preliminary agreement binding?). Under SAAR+, parties can agree that the preliminary agreement protects more than a mere reliance interest, such as protecting an expectational interest (or alternatively provide a liquidated amount approximating that value). Similarly, a preliminary acquisition agreement can provide an alternative measure of damages less than the actual reliance measure of damages either by precluding monetary damages or simply stating that the agreement is non-binding.[244] While there is no requirement to

may be no more than agreements to agree. *See Faux Contracts, supra* note 17. Accordingly, the default rule here probably should be viewed as a mild form of penalty default rule that ultimately rests on the rationale that "it is cheaper for the parties to negotiate a term ex ante than for courts to estimate ex post what the parties would have wanted." *Id.* at 93. The penalty default does not reflect asymmetry in bargaining power among, or even unique informational advantages of, contracting parties in the acquisition context. Rather, it is an information-forcing default, much as the example invoked by Ayres and Gertner of the U.C.C.'s zero-quantity rule. The penalty default is structured, as discussed in the text below, to "give both contracting parties incentives to reveal information" ex ante by explicitly inviting parties to contract around the rule's default. *Id.* at 97. Information regarding whether a preliminary agreement is intended to be binding or non-binding, and if binding, in what sense, is difficult to discern ex post and is invariably clouded by the contracting parties' hindsight bias and opportunism in response to changing deal realities. *See generally* Ian Ayres & Robert Gertner, *Majoritarian v. Minoritarian Defaults*, 51 STAN. L. REV. 1591 (1999).

243 *See cf.* Robert E. Scott, *A Relational Theory of Default Rules for Commercial Contracts*, 19 J. LEGAL STUD. 597, 598 (1990) ("The principal task of the law of commercial contracts is to set default rules for commercial actors and other repeat players who presumably, are quite capable of bargaining for customized alternatives. The conventional assumption, therefore, is that in such commercial environments it is more important for the law to be certain than to be right.").

244 To the extent that some jurisdictions give effect to non-binding clauses, it would not alter the status quo. However, jurisdictions are not entirely uniform in this approach and so it would bring greater certainty of

spell out remedies under the preliminary acquisition agreement, to the extent that the remedy is expanded or eliminated, parties must express that intent with clarity and precision. This expressed intent will shed light on the nature of the bargain that the parties have struck. Even where parties do not bargain around the default, courts at the very least would continue to focus on the equitable factors that they do in analyzing damages in breach of a Type II agreement: what did the parties reasonably expect in good faith and the actual degree of reliance by either party with respect to the agreement.

The structure of the default rule substantially erodes the importance of the distinction between classification of preliminary agreements as Type I or II agreements.[245] The parties' expressed intent as to damages provides strong evidence regarding which type of binding preliminary agreement is contemplated at the time of contracting —Type I or Type II. The parties' acceptance of reliance damages as the appropriate measure of damages clearly counsels against classifying the agreement as a Type I agreement and even suggests that superfluous nature of such an exercise. In other words, rather than relying on courts to discern the contracting intent of the parties as to the creation of a Type I or II agreement, the SAAR+ proposal forces the party to provide objective evidence of the parties' contracting intent with respect to the preliminary agreement. Moreover, parties will not merely signal what type of preliminary agreement is intended (i.e., Type I, II, or non-binding), but will likely clarify the circumstances when damages are warranted and/or specify limits on damages.[246]

outcome. THE RESTATEMENT (SECOND) OF CONTRACTS § 21 is characteristic of this equivocation as a general rule. The default rule would shift the controlling principle to a bright-line standard in the case of preliminary acquisition agreements.

245 Thus, the SAAR+ approach to formal preliminary agreements introduces simplifying analytical benefits. It also sharply reduces the stakes in judicial determinations of whether preliminary agreements are binding or not binding. *See also supra* note 130.

246 Ex ante negotiation around a damages default does not appear to be infeasible in practice. Admittedly, there may be circumstances where sophisticated parties do not negotiate around a default. *See, e.g.,* Julian

A notable design feature of the SAAR+'s default rule is its fixing the appropriate damages default. As proposed, the default is reliance damages rather than either a no-damages default or a default permitting expectation damages. As to the no-damages alternative, there already exists well-developed practice in the acquisitions context that preliminary agreements are generally non-binding (i.e., do not trigger contractual liability).[247] Accordingly, as noted above, a no-damages default would probably better approximate a majoritarian default either in terms of what most parties would bargain for or what would be optimal in most situations.[248]

Reliance damages, however, seems preferable as a default to a no-damages default in two respects. As to one type of preliminary agreement, namely Type II preliminary agreements, reliance damages are actually the general common law measure to ensure an enforceable obligation to negotiate in good faith.[249] Language in an agreement suggesting an obligation to negotiate in good faith arguably sounds as if it is creating an enforceable obligation, consistent with some form of

Nyarko, *Stickiness and Incomplete Contracts*, 88 U. CHI. L. REV. 1, 71-72 (2021) (exhaustive empirical study showing that parties fail to negotiate around dispute resolution clauses selected from drafting templates and noting its cautionary significance for default terms in contracts). However, damage limitations represent a price (rather than a non-price) term, precisely the kind of default to which sophisticated parties are typically attentive. For example, termination fees in definitive acquisition agreements have become an accepted feature of practice. *See generally* Frank C. Butler & Peter Sauska, *Mergers and Acquisitions: Termination Fees and Acquisition Deal Completion*, 26 J. MANAG. ISSUES 44 (2014) (documenting use and trends in termination fees); *see also* Restrepo & Subramanian, *supra* note 225, at 1016.

247 *See Deal Momentum*, *supra* note 17, at 282("[P]arties commonly use non-binding preliminary agreements.") (emphasis in the original). In such situations, parties are relying on the reputation of the counterparty to ensure good faith in negotiation. *See Faux Contracts*, supra note 17, at 1064–65. How then does the SAAR+ proposal significantly enhance the effectiveness of TINALEA (or non-binding) clauses in formal preliminary agreements? The simple SAAR feature effectively forecloses modification of the TINALEA in the formal preliminary agreement by means of oral agreement.

248 *See supra* note 241.

249 *See supra* notes 126-28.

remedy in damages. The reliance damages default forces the party seeking to prevent an enforceable obligation as an equitable matter to objectively signal their intent to the counterparty that the preliminary agreement is non-binding.[250] A second, less obvious reason, is to create greater symmetry between the SAAR+ approach (which views the issue from a contract formation perspective) and potential claims based on promissory estoppel.[251] The SAAR+ proposal effectively eliminates promissory estoppel claims, but in doing so, uses an explicit default that treats closely related claims the same. Such an approach essentially discourages artful pleading by litigants that multiply causes of action arising out of the same set of facts.

A reliance damages default is also preferable to a default that permits expectation damages. As previously noted, reliance damages are more common in the case of preliminary agreements, while expectation damages should generally apply in cases of a breach of Type I agreements.[252] The SAAR+ proposal opts for the less generous damage measure and imposes the burden on the party seeking a more generous recovery to provide indisputable objective evidence of the parties' intent in that regard. This seems appropriate where the core problem that the default rule seeks to overcome is the inherent ambiguity regarding the nature of a preliminary agreement. Moreover, an indeterminate recovery for agreements that do not result in a definitive agreement likely fuels high-

250 As noted above, parties could easily overcome the default and provide for no damages if they chose in which case, a TINALEA clause may be provided in lieu of the reliance default. *See supra* note 142. In such a case, the parties are relying on the reputation of the counterparty to ensure good faith in negotiation. In addition, the SAAR+ proposal will make a TINALEA (or non-binding) clause more effective since it forecloses modification of the TINALEA by means of oral agreement.

251 *See supra* note 5, where the potential of the two types of claims to overlap was noted. Structuring the default around reliance damages would make promissory estoppel claims redundant.

252 This follows largely because in the case of Type II agreements there is seldom a reliable means of calculating expectation damages where material features of the final agreement remain unresolved. *See supra* notes 123–26 and accompanying text.

stakes litigation among transaction participants. Given the inherent indeterminacy of recovery, it is reasonable to opt for a default where courts are likely to be more accurate in calculating reliance damages rather than expectation damages (i.e., out-of-pocket costs are more tangible than the prospects of expectation).

The relative costs and benefits of a default damages rule for formal preliminary acquisition agreements argue in favor of the default rule. As in the case of the formal writing requirement, the default rule will not materially increase the marginal transaction costs of a preliminary agreement where there is genuine agreement between the parties. At that point, the parties have already incurred deal expenses relating to investigating a transaction and preparing a preliminary agreement. The main practical benefit of SAAR+ is to impose a firm bright-line understanding of the interests negotiated and protected by the preliminary acquisition agreement if breached. As noted above, where parties mutually do not intend to be governed by the default rule, it incentivizes parties to resolve their respective understandings with respect to damages at a much earlier stage of the multi-step sequence of negotiations and specifically before concluding a preliminary agreement. In other words, it incentivizes clarity as to remedy where the preliminary agreement does not culminate in a final definitive agreement. The default is not an impediment to a formal preliminary agreement, as the parties can accede to the default. The default rule structure is an impediment to a preliminary agreement only if we imagine that parties seek to agree to disagree about future remedies of their agreement. Of course, in that case, parties probably should not proceed and courts should not be drawn into the role of mediator for a fundamental divergence in the parties' respective views on remedies. In short, an inability to conclude an agreement under a SAAR+ regime would more likely stem from the lack of a genuine agreement about the proposed acquisition rather than the costs of the formalities themselves.

C. Implementation of the SAAR+ Proposal and Its

Limits

If there is one unifying theme of the SAAR+ proposal as applied to acquisitions, it lies in limiting the scope of judicial discretion in the context of preliminary dealings. Correspondingly, such an approach makes contracting parties much more responsible for explicitly documenting and necessarily clarifying their contract rights in such contexts.

The approach advocated here prioritizes in the acquisition context the elimination of surprise in contract formation due to inadvertence relative to potential contract frustration arising from any obstacles to formation created by greater formalism.[253] By tilting the playing field toward formalism in the case of acquisitions, the SAAR+ balances the risk of surprise (the risk of being blindsided by obligations not deliberately undertaken) and frustration (the unexpected disappointment from the inability to enforce promises that lack the requisite degree of formality) differently than the balance struck at common law. Implicitly, the SAAR+ proposal rests on a judgment with respect to informal agreements that the benefits of avoiding costs arising from acquisition obligations not deliberately undertaken exceed the potential costs in terms of possible contract frustration. Moreover, as to formal preliminary acquisition agreements, a default rule as to remedies will force parties to clarify their respective actual intent rather than imposing a burden on courts to discern intent from facts and circumstances that frequently provide an imperfect rendering of the agreement.

Even if one is persuaded that the SAAR+ proposal is better than the common law framework for dealing with preliminary dealings in the context of corporate acquisitions, the manner of implementing such a regime is not obvious. Contract law is jurisdiction-centric, meaning it varies in the United States across jurisdictions. Moreover, the SAAR+ proposal explicitly

253 *Cf.* Robert E. Scott, *The Case for Formalism in Relational Contract*, 94 NW. U. L. REV. 847 (2000) (assessing arguments for and against formalism in different types of contracts). *See generally* Frederick Schauer, *Formalism*, 97 YALE L. J. 509 (1988) (presenting argument intended to "rescue formalism from conceptual banishment").

takes the form of a positive law proposal. It must be imposed by statute which would require action by a state legislature. One more hurdle exists: corporate acquisitions are likely to be cross-jurisdictional in dimension, especially where the applicable law is not fixed by jurisdiction of incorporation. That is, the locus of any acquisition will seldom be confined to one state jurisdiction.

In short, effective implementation of a SAAR+ regime to preliminary dealings could founder on the intractability of choice of law issues. And yet, the problem of intractability is not quite so difficult to overcome as it may appear on its face. There is a clear distinction between the problems of implementing SAAR+ in the case of formal preliminary agreements and informal agreements. Formal preliminary agreements offer the ability to use a choice of law clause, which would allow parties to opt into jurisdictions hospitable to a SAAR+ regime.[254] The attraction of such a regime in well-known contract jurisdictions for corporate acquisitions, such as Delaware or New York, might spur adoption of such a regime in those states.

The challenge is much greater with respect to informal acquisition agreements; informal acquisitions lack the formalities of governing law clauses and are likely to be governed by the situs of contracting. Today, especially with the prevalence of electronic forms of communication, the situs of any informal agreement is less subject to mutual control or to offer unilateral assurance protecting both contracting parties. Obviously to the extent that a SAAR+ were adopted pervasively, such as a uniform law proposal, the concern would disappear. But the prospect of a uniform law movement around the SAAR+ should be regarded as fanciful.

Taking a more realistic approach, the clearest problem to displacing the common law as to informal acquisition

[254] For a general discussion of interpretation of choice of law clauses, see Tanya J. Monestier, *The Scope of Generic Choice of Law Clauses*, 56 U.C. DAVIS L. REV. 959, 972-82 (2023) (noting that while courts across jurisdictions readily give effect to choice of law clauses in subsequent contractual disputes, judicial practice differs regarding whether choice of law clauses should also govern the assertion of non-contractual claims).

agreements would be presented by isolated adoption of the SAAR+ proposal by a few states. There are several possibilities how limited adoption of the SAAR+ proposal might nevertheless have a significant effect, even though no one possibility is entirely satisfactory. One approach might be to effect a choice of law selection through an ancillary preliminary agreement, such as a confidentiality agreement. Another possibility for the SAAR+ proposal's efficacy would be to link its implementation to jurisdiction of incorporation by making the contracting formality a requirement of agreements to merge involving entities incorporated in a particular jurisdiction, or even with respect to sales involving a controlling share of stock or of all or substantially all of a company's assets. Such an approach, if linked to Delaware, would have far reaching application. This approach would essentially convert the acquisition contracting issues into an issue of corporate law.

The proposal also poses a separate issue: Why limit SAAR+ only to preliminary dealings with respect to acquisition agreements? There are two responses. First, much of the argument for the proposal is that it is contextually appropriate in the context of acquisition agreements, whereas ordinary common law formation principles are certainly appropriate in other contexts. Those other contexts are exemplified by contracting situations where informal contracting is the norm. One has to think only of employer-employee or residential contractor-customer situations (among many, many such situations) to realize why a wholesale rejection of common law principles would not make a whole lot of sense. Similarly, use of the SAAR+ default seems unjustified without regard to context. Formal preliminary agreements involving sophisticated counsel is not well-established uniformly across the myriad of business contexts where such agreements may be used. For example, preliminary agreements, letters of intent, and term sheets negotiated by business persons alone may make perfect sense in many commercial contexts.

Second, and this reverses the focus of the question, this article takes no position on whether there might be contexts that are more analogous to acquisition agreements in the way that they are structured. For example, complex financing tied to

real estate projects might be similar (leaving aside existing statute of frauds requirements that may already apply). The issue, however, is ultimately beside the point. The applicability of a SAAR+ regime to other contract contexts in no way suggests not proceeding with a SAAR+ proposal in the context of acquisition agreements.

V. CONCLUSION

The legal status of preliminary dealings, including preliminary agreements, present challenges under existing common law standards. However, these challenges stem not from any fundamental misformulation in common law standards. In many contexts, these principles appropriately balance the costs and benefits of contractual uncertainty regarding formation and scope. Rather, the problem stems from whether the same common law standards are necessarily equally suitable in all contracting contexts. This article shows that an alternative contracting regime with respect to preliminary dealings in acquisitions imposing greater formal requirements is likely to produce better legal outcomes where the costs of the added formality are dwarfed by the benefits of ensuring closer alignment between the parties' actual contracting intent and the legal consequences of their bargaining behavior.

APPENDIX A - MODEL STATUTORY LANGUAGE FOR SAAR + PROPOSAL

a. No action shall be brought upon an acquisition agreement, unless the promise, contract or agreement upon which such action is brought, is in writing and signed by the party to be charged therewith.

b. No action shall be brought upon a preliminary acquisition agreement, unless the promise, contract or agreement upon which such action is brought, is in writing and signed by the party to be charged therewith.

c. In an action for breach of a preliminary acquisition agreement, a party shall only be entitled to recovery of

reliance damages or restitution, unless another measure is expressly provided for in the preliminary writing (including liquidated damages), not to exceed a reasonable approximation an expectation measure of damages.

d. In an action for breach of a preliminary acquisition agreement, the court shall give conclusive effect to language in the agreement that it is not binding.

e. As used in this section, unless the context otherwise requires—

1. Acquisition agreement
The term "acquisition agreement" shall be construed to mean and include all writings that fully and finally contemplate the specification of rights and obligations of parties where a company is to acquire, directly or indirectly, ownership or control of another company, where the minimum transaction value is equal to or greater than $5 million, through
i. an acquisition of shares;
ii. an acquisition of assets or assumption of liabilities;
iii. a merger or consolidation; or
iv. any similar transaction.

2. Preliminary acquisition agreement
The term "preliminary acquisition agreement" shall be construed to mean and include all agreements between parties that intend to subsequently contemplate an acquisition, as described in SPAA § (d)(1), subject to the final negotiation of material terms.

Comments:

1. **Preliminary writing requirement**: Subsections (a) and (b) deal with the requirement that any final agreement, complete or incomplete as to its terms, between corporations in the context of an

acquisition must be signed by the party whom enforcement is being sought against. The language of these subsections stems from an existing Massachusetts statute of frauds provision, which emulates the standard statute of frauds language across jurisdictions. See M.G.L. ch. 259, § 1. However, unlike the statute of frauds, the SPAA requires both that the writing be signed and also evidence the terms of the agreement. This requirement is limited to causes of action for breach of contract and should not preclude tort actions.

2. **Remedies**: Upon a finding that a preliminary acquisition agreement has been breached, a court should employ a reliance measure of damages as a default in the absence of any enforceable remedy provision in the written agreement. If the preliminary agreement includes a provision providing that the remedy for a breach is a liquidated measure of damages, it will be limited to the expectation measure of damages for the proposed transaction.

3. **Definitions**: The definition of "acquisitions" is modeled on statutory language found in federal securities law, the Hart-Scott-Rodino Antitrust Improvements Act of 1976 ("HSR"). Additionally, the HSR contains a minimum transaction threshold. See 15 U.S.C. § 18a. The minimum transaction threshold of the SAAR is significantly lower than the threshold of the HSR as it better serves the statute's purpose of conforming to business realities and fulfilling the intent of the parties to the acquisition.