ARTICLE

UNBUNDLED BARGAINS: MULTI-AGREEMENT DEALMAKING IN COMPLEX MERGERS AND ACQUISITIONS

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Why are some bargains memorialized in dozens of related agreements, rather than one definitive agreement? This Article uses mergers and acquisitions (M&A) deals as a lens through which to understand why some bargains are governed by arrangements that this Article calls "unbundled bargains." In an unbundled bargain, elements of a complex deal are broken out and memorialized in separate, but related, agreements. Unbundled bargains are common in M&A deals—these deals are governed by a definitive acquisition agreement, and also by employment agreements, transition services agreements, intellectual property assignment agreements, and many other ancillary agreements that shape the deal's terms.

This Article shows that the boundaries of a deal extend beyond the acquisition agreement and into the manifold parts of an unbundled bargain. In the process, this Article makes three contributions to the literature. First, it provides a comprehensive account of why ancillary agreements exist, and shows that M&A deals are, invariably, governed by unbundled bargains. Second, it shows that unbundled bargains reduce

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dealmaking costs ex ante and deal enforcement costs ex post by making deals more modular and improving the quality of each modular part. Third, it shows that reframing many related agreements as one unbundled bargain has significant implications for contract theory and transactional practice.

INTRODUCTION

In 2012, Delaware courts enjoined a $5.5 billion hostile takeover bid based on their interpretation of the word "between" in a confidentiality agreement.[1]

1 Martin Marietta Materials, Inc. v. Vulcan Materials Co. (*Martin Marietta I*), 56 A.3d 1072, 1076 (Del. Ch. 2012) (enjoining for four months Martin Marietta's hostile bid for Vulcan), *aff'd*, 68 A.3d 1208 (Del. 2012).

The courts' decisions in *Martin Marietta* highlighted the important role that ancillary agreements can play in shaping major business transactions.

Most mergers and acquisitions (M&A) scholarship has focused on the acquisition agreement—the heavily negotiated central agreement in any M&A deal. But all M&A deals are also governed by dozens of ancillary agreements—smaller agreements entered in conjunction with or around the time of the acquisition agreement—without which deals cannot go forward. This Article investigates why deals are memorialized with constellations of agreements, rather than with just one. Through a study of complex M&A deals, this Article begins to probe why these "unbundled bargains" exist, how they add value in business transactions, and what they imply for contract interpretation and deal design.

The facts of *Martin Marietta* are typical of the early stages of any friendly M&A deal. In 2010, the country's two largest construction aggregates companies, Martin Marietta Materials and Vulcan Materials, entered into two routine confidentiality agreements while discussing a potential deal.[2] Confidentiality agreements are among the most common ancillary agreements in M&A transactions: parties enter into these short, simple agreements to protect nonpublic information exchanged during initial evaluation and negotiation.[3] Because deal lawyers often consider confidentiality agreements straightforward and boilerplate, junior attorneys or in-house counsel usually draft them.

Martin Marietta's general counsel drafted the agreements, using a confidentiality agreement template that the parties had used before.[4] In the agreements, the parties agreed not to use information shared in confidence for any purpose other than "a possible business combination transaction . . . *between* [the parties]."[5] This meant, for instance, that they would not use proprietary information learned during due diligence to compete against each other. This is a common provision when the deal parties are competitors. Martin Marietta and Vulcan negotiated on and off over the next year and a half, exchanging nonpublic information in the process.[6] Friendly talks fizzled around the time changes in Vulcan's stock price made the deal particularly attractive to Martin Marietta.[7]

2 *Id.* at 1075.

3 *See* ABA, MERGERS & ACQUISITIONS COMM., MODEL MERGER AGREEMENT FOR THE ACQUISITION OF A PUBLIC COMPANY 341 (2011) ("A confidentiality agreement . . . is usually the first agreement entered into between the parties to a potential transaction . . . . [T]he discussions are frequently at an early stage, with neither party being committed to pursuing a transaction.").

4 *Martin Marietta I*, 56 A.3d at 1082.

5 *Id.* at 1083 (emphasis added).

6 *Id.* at 1085-89.

7 In early 2011, the companies' chief financial officers met and exchanged nonpublic information. After that meeting, because Martin Marietta's stock price had surged compared to Vulcan's, Martin Marietta revised its estimated deal synergies upward by $100 million a year—a big jump that made the deal more attractive to Martin Marietta. *Id.* at 1090-91.

On December 12, 2011, Martin Marietta launched an unsolicited exchange offer for Vulcan's shares, preparing the offer using nonpublic information Vulcan had shared with Martin Marietta.[8] In its unsolicited exchange offer—a type of hostile takeover—Martin Marietta publicly offered to acquire Vulcan shares from any and all of Vulcan's stockholders.[9] Vulcan stockholders could exchange each Vulcan share for half a share of Martin Marietta's more valuable stock.[10] That same day, Martin Marietta filed suit in the Delaware Chancery Court, seeking a declaration that nothing in the confidentiality agreements barred Martin Marietta's hostile takeover.[11] Vulcan countersued, seeking to enjoin Martin Marietta's exchange offer.[12]

Ultimately, both the Delaware Chancery Court and the Delaware Supreme Court agreed with Vulcan, granting a four-month injunction against Martin Marietta's hostile takeover.[13] The opinions turned in part on the courts' interpretations of the word "between" in one of the confidentiality agreements. The parties had disputed the meaning of the provision that barred the parties from using information for purposes other than "a possible business combination transaction . . . *between* [the parties]."[14] The courts found that the parties meant to limit use of the information to pursuit of a transaction *between* the two parties—Martin Marietta and Vulcan.[15] Because the hostile takeover was an attempt by Martin Marietta to buy shares from Vulcan's stockholders on the public market, rather than from Vulcan, it was not a transaction between the two parties.[16] Therefore, Martin Marietta violated the provision when it used nonpublic information in the hostile transaction.[17]

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8 *Id.* at 1072; *see also id.* at 1096 ("But scarce as the record is, the evidence reveals that Martin Marietta did use [confidential] Evaluation Material in forming its hostile bid.").

9 *Id.* at 1076.

10 *Id.* In an unsolicited exchange offer, a buyer makes an offer directly to the target's shareholders, "usually at a premium to the target's stock price to put pressure on the target's board." Frank Aquila & Melissa Sawyer, *Unsolicited Takeover Offers*, EMERGING ISSUES, Jan. 2009, at 7, https://www.sullcrom.com/siteFiles/Publications/Lexis_Unsolicited_Bids.pdf [https://perma.cc/LE2R-2KU4]. The offer can be for shares of the buyer's stock (as in Martin Marietta's bid for Vulcan), for cash, or for some combination of cash and stock. Along with its unsolicited exchange offer, Martin Marietta also launched a proxy contest (an attempt to replace members of Vulcan's board of directors) and sent a public "bear hug letter" to Vulcan announcing the terms of the exchange offer. *Martin Marietta I*, 56 A.3d at 1099. For a detailed account of Martin Marietta's offer to Vulcan, see Martin Marietta Materials, Inc. v. Vulcan Materials Co. (*Martin Marietta II*), 68 A.3d 1208, 1215-16 (Del. 2012). For an overview of types of unsolicited takeovers, see generally Aquila & Sawyer, *supra*.

11 *Martin Marietta I*, 56 A.3d at 1101.

12 *Id.* at 1076-77.

13 *Martin Marietta II*, 68 A.3d at 1228; *Martin Marietta I*, 56 A.3d at 1147.

14 *Martin Marietta I*, 56 A.3d at 1083 (emphasis added).

15 *Id.* at 1121.

16 *Id.*

17 *See id.* at 1121-22.

The *Martin Marietta* decisions caused a stir among deal lawyers. Companies seeking to sell themselves often require potential buyers to sign confidentiality agreements that have explicit "standstill provisions."[18] These provisions prevent potential buyers from announcing a bid (including a hostile bid) for the target for a period of a year or two from the conclusion of the sale process.[19] The *Martin Marietta* confidentiality agreements did not contain explicit standstill provisions, but the courts nonetheless enjoined Martin Marietta's bid as though the agreements contained standstill provisions.[20]

Many deal lawyers lambasted the decisions for finding an "implied standstill provision."[21] One law firm noted that "the court . . . gave very little, if any, weight to . . . [the fact] that two sophisticated parties (with sophisticated counsel) did not discuss or include a standstill provision in [the agreement]."[22] Others called the decisions "a wakeup call . . . that confidentiality agreements negotiated in the early stages of a deal can have significant consequences down the road."[23] A year after the decisions, one lawyer wrote that "[*Martin Marietta*] reminded people that these are real agreements. These are not boilerplate, and they're

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18 *See* Christina M. Sautter, *Promises Made to Be Broken? Standstill Agreements in Change of Control Transactions*, 37 DEL. J. CORP. L. 929, 931 (2013) ("When a publicly traded company explores a sale and allows potential buyers access to its confidential information, that company, the target, customarily requires each potential buyer to execute a confidentiality agreement containing a standstill provision.").

19 *Id.* at 931-32.

20 *See, e.g.*, *Martin Marietta I*, 56 A.3d at 1134 ("[W]here a confidentiality agreement includes language limiting the kinds of legal requirements that will permit disclosure . . . [,] disclosure of confidential information in the context of a hostile bid will not be allowed, even in the absence of a standstill.").

21 *See, e.g.*, SIMPSON THACHER & BARTLETT LLP, DELAWARE CHANCERY COURT DELAYS MARTIN MARIETTA'S TAKEOVER ATTEMPT OF VULCAN MATERIALS DUE TO CONFIDENTIALITY AGREEMENT BREACHES 4 (May 15, 2012), http://www.stblaw.com/docs/default-source/cold-fusion-existing-content/publications/pub1418.pdf [https://perma.cc/EJ9A-UZFM] (noting that in light of the Chancery Court's *Martin Marietta* decision, "[p]articular consideration needs to be given to whether the terms of a confidentiality agreement create an implied standstill provision"); Steven H. Goldberg & Henry C. Bodenheimer, *Silence Is Not Necessarily Golden on Standstill Provisions*, BAKERHOSTETLER (June 13, 2012), http://www.bakerlaw.com/alerts/silence-is-not-necessarily-golden-on-standstill-provisions-6-13-2012 [https://perma.cc/N7P3-CRFF] ("[I]n this case, the Court's strict enforcement resulted in an implied standstill provision being read into the Confidentiality Agreements . . . ."); David K. Robbins & Janice A. Liu, *Why Draft a Standstill Provision When "Between" Is Enough?*, MORGAN LEWIS (May 11, 2012), http://www.morganlewis.com/pubs/why-draft-a-standstill-provision-when-between-is-enough [https://perma.cc/W5RG-WU6J] ("[T]he Chancery Court's opinion provides a clear roadmap for lawyers that will result in an implied standstill provision even though the confidentiality agreement does not have an express standstill. Although the Court repeatedly emphasized the fact-specific nature of the case, the detailed parsing of the contractual languages leaves little doubt on how these provisions would be construed in future situations.").

22 Bryan E. Davis et al., *Delaware Update: The Implied Standstill*, JONES DAY (May 2012), http://www.jonesday.com/delaware-update--the-implied-standstill-05-18-2012 [https://perma.cc/DUU5-7HUG].

23 Abbe L. Dienstag et al., *Reconsidering NDAs in Light of* Martin Marietta Materials, Inc., v. Vulcan Materials Co., LEXOLOGY (May 21, 2012), http://www.lexology.com/library/detail.aspx?g=e23a4a91-fb4a-4321-9f3e-acc4ee81ab4b [https://perma.cc/2QZY-ZW3E].

not something you just sign to move on . . . . People are spending a lot more time and being much more careful in constructing and negotiating them."[24]

For deal lawyers, *Martin Marietta* reveals the importance of small agreements in major deals. It shows that ancillary agreements like confidentiality agreements—drafted quickly by busy in-house lawyers or inexperienced first-year associates at law firms—must be taken seriously, and can significantly affect major deals. In *Martin Marietta*, a confidentiality agreement—an agreement so peripheral to the heart of the deal that it barely qualifies as part of the deal at all[25]—nonetheless determined the most important part of the deal: whether it could go forward at all.

If deal lawyers are just beginning to appreciate the importance of ancillary agreements in practice, legal scholars have an even more rudimentary understanding of the role these agreements play in shaping deals. To date, there has been no comprehensive account of why ancillary agreements exist.[26] Specifically, legal scholars have not tackled the issue of why M&A deals are governed by a constellation of agreements—the much-studied acquisition agreement and dozens of under-studied ancillary agreements—rather than by a single comprehensive

24 Liz Hoffman, *A Year After* Martin Marietta*, Deal Drafters Still Skittish*, LAW360 (May 16, 2013, 7:27 PM), http://www.law360.com/articles/424138/a-year-after-martin-marietta-deal-drafters-still-skittish [https://perma.cc/7QGX-SBY3] (quoting Frank Aquila, an M&A partner at Sullivan & Cromwell); *see also id.* (describing how the *Martin Marietta I* decision has transformed confidentiality agreement drafting and negotiations from a routine task for junior associates to a task requiring serious negotiation and partner review).

25 This Article will demonstrate that confidentiality agreements, which share characteristics with ancillary and preliminary agreements, lie at the outermost boundaries of deals. An ancillary agreement at the deal's outermost boundaries can have the greatest possible effect on a deal's substance—that is, a confidentiality agreement can affect whether a deal exists or not. *See infra* subsection II.A.2.c.

26 Much of the existing M&A scholarship focuses on the definitive acquisition agreement. For example, some scholarship focuses on how provisions of the acquisition agreement allocate risk and surplus between the parties. *See generally, e.g.*, Afra Afsharipour, *Transforming the Allocation of Deal Risk Through Reverse Termination Fees*, 63 VAND. L. REV. 1161 (2010) (discussing the use of reverse termination fees in definitive M&A agreements to change the allocation of deal risk); Albert Choi & George Triantis, *Strategic Vagueness in Contract Design: The Case of Corporate Acquisitions*, 119 YALE L.J. 848 (2010) [hereinafter Choi & Triantis, *Strategic Vagueness*] (demonstrating that vague provisions may work better to preserve certain goals of material adverse change clauses in definitive M&A agreements than precise and costly proxies); Steven M. Davidoff & Christina M. Sautter, *Lock-Up Creep*, 38 J. CORP. L. 681 (2013) (describing the prevalence of lock-up provisions in definitive M&A agreements); Jeffrey Manns & Robert Anderson IV, *The Merger Agreement Myth*, 98 CORNELL L. REV. 1143 (2013) (examining empirically how financial markets value the terms of public company acquisition agreements). Other scholarship focuses on how deal lawyers help to grow the deal surplus, but that scholarship also focuses on the acquisition agreement. *See generally, e.g.*, George W. Dent, Jr., *Business Lawyers as Enterprise Architects*, 64 BUS. LAW. 279 (2009) (describing transactional lawyers as "enterprise architects" that wear a variety of hats, including that of enterprise design); Victor Fleischer, *Regulatory Arbitrage*, 89 TEX. L. REV. 227 (2010) (examining the role of deal lawyers in creating deal value through regulatory arbitrage); Ronald J. Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 94 YALE L.J. 239 (1984) (describing the work of deal lawyers in M&A transactions through an examination of provisions of definitive M&A agreements); Steven L. Schwarcz, *Explaining the Value of Transactional Lawyering*, 12 STAN. J.L. BUS. & FIN. 486 (2007) (discussing the role of deal lawyers in reducing regulatory costs in transactions).

deal document. This Article provides a comprehensive account of the dynamic interactions between ancillary agreements and acquisition agreements in M&A dealmaking. In doing so, it begins to develop a new theory of the deal and posits that a deal's boundaries extend beyond the acquisition agreement and into the corners of unbundled bargains. Reframing complex deals as unbundled bargains has important implications for contract theory and transactional practice: it suggests new ways for courts to interpret complex deal disputes and for parties to design better deals.

Both courts and parties routinely underestimate the boundaries of deals. This underestimation affects both the way that courts interpret deal disputes and whether parties choose to unbundle their deals into separate contracts. For example, although deal lawyers were aghast at the courts' decisions in *Martin Marietta*, reframing the *Martin Marietta* deal as an unbundled bargain sheds new light on the courts' decisions. The decisions actually suggest that those courts understood unbundling—they interpreted a confidentiality agreement as part of the M&A deal, allowing it to determine whether the deal could go forward at all. If courts regularly view M&A deals as unbundled bargains, parties should, in the future, feel more comfortable unbundling their bargains into multiple contracts, because no matter how many agreements memorialize a deal, those parts will be interpreted together should a dispute arise. There is another benefit to courts understanding unbundled bargains, and interpreting the parts of unbundled bargains together: because parties know that deal parts will be interpreted together in a dispute, they have less incentive to obfuscate parts of the deal by burying them in undisclosed or less-scrutinized ancillary agreements.

This Article proceeds in three Parts. Part I introduces the concept of unbundled bargains. It illustrates the dynamic relationship between ancillary agreements and acquisition agreements in M&A deals. Part II introduces a new theory of the deal, and shows how and why M&A deals are unbundled bargains. Unbundled bargains add value to M&A deals by increasing modularity and precision, which increases dealmaking efficiency ex ante and reduces deal enforcement costs ex post. Part III considers the implications of unbundled bargains for contract interpretation and deal design.

The principles developed in this Article can be applied beyond M&A to help illuminate when and why bargaining parties strike bargains through single contracts and when and why they use many interconnected agreements.

I. COMPLEX M&A AS UNBUNDLED BARGAINS

Put simply, an unbundled bargain is one that is governed by many agreements rather than by a single comprehensive agreement.[27] Unbundled bargains cohere around a central agreement, but are also governed by many side agreements that, together with the central agreement, form a whole deal.

Unbundled bargains appear in many contexts. They are common in contexts where parties enter into a default bargain that has a preset bundle of rights and obligations, and contract at the margins to change that bundle. A couple entering into a legal marriage (a default bargain) may choose, for example, to give their healthcare proxies to their daughter rather than to each other. In doing so, the couple unbundles their default marriage bargain and changes their marriage bargain from one governed by a single agreement (a marriage) to an unbundled bargain governed by two agreements (a marriage and a separate healthcare proxy). Similarly, in a deal to buy a new car, the manufacturer may provide a standard purchase agreement for buyers to sign. The dealership, however, may sweeten the bargain by tossing in free premium floor mats, but can only practicably do so through an ancillary (and perhaps oral) agreement.

Unlike in other contexts, however, M&A parties do not unbundle as a way to contract around defaults. Rather, sophisticated commercial parties represented by competent advisors choose how to allocate deal provisions between an acquisition agreement and ancillary agreements, largely unhampered by legal and regulatory requirements. Yet, against this backdrop of freedom in deal design, unbundled bargains are nonetheless ubiquitous. In fact, every complex M&A deal is governed by an unbundled bargain. This Article begins to unwind why M&A parties choose to unbundle their bargains, and provides insights that can be applied to other areas of the law where unbundling occurs.[28]

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27 This Article uses the terms "deal" and "bargain" in the way a transactional lawyer would: to describe, loosely, an arrangement or understanding between parties. Deals and bargains may be memorialized or not, enforceable or not. "Agreement" is also used the way a deal lawyer would: to describe a written bargain that might be a contract. In contrast, a "contract" has a specific legal meaning: it describes a written or oral understanding between parties that is meant to create a binding, enforceable obligation under the law. Enforceable contracts serve two functions. First, if they are written down, they are a record for the contract parties. Second, they convey information to a third party (like a court) in the event of a dispute. *See* 1 SAMUEL WILLISTON & RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS § 1:1 (4th ed. 2007) ("The traditional definition of the term 'contract' is 'a promise or set of promises for breach of which the law gives a remedy, or the performance of which the law in some way recognizes as a duty.' . . . [T]he word 'contract' . . . may, to one in business or a lay person, mean the writing that evidences a bargain or agreement.").

28 Other scholars have discussed contract or regulatory unbundling in other transactional contexts. *See* Matthew Jennejohn, *The Private Order of Innovation Networks*, 68 STAN. L. REV. 281 (2016) (discussing complex, multifaceted contractual arrangements between firms that resemble, but fall short of, an acquisition); Eric L. Talley, *Corporate Inversions and the Unbundling of Regulatory Competition*, 101 VA. L. REV. 1649 (2015) (discussing tax inversions as a result of federal law's unbundling of U.S. tax law from corporate governance regulation).

The remainder of this Part shows how M&A deals are unbundled bargains and proceeds as follows. Section A provides a brief overview of the acquisition agreement and its functions. Section B shows that M&A deals include many ancillary agreements that, together with the acquisition agreement, make an M&A deal unbundled.

A. *The Acquisition Agreement*

The term "acquisition agreement" can refer to an asset purchase agreement, stock purchase agreement, merger agreement, or other central, definitive contract that forms the backbone of an M&A deal.[29] Acquisition agreements memorialize important deal terms (e.g., what is being sold and at what price) and govern parties' behavior through covenants (promises) and closing conditions (which, if not met or waived, may cause a deal not to close).[30]

Acquisition agreement terms allocate risks and costs, and divide deal surplus between parties.[31] Representations and warranties, for example, allocate the cost of obtaining information about the target company to the lowest-cost information provider,[32] and covenants, closing conditions, and other terms help to allocate risk or mitigate moral hazard.[33] The acquisition agreement's terms can

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29 *See* Choi & Triantis, *Strategic Vagueness*, *supra* note 26, at 855 (describing "corporate acquisition agreements" as agreements that govern transactions such as "asset purchases, stock purchases, and mergers").

30 *See* Manns & Anderson, *supra* note 26, at 1151-52 (describing common parts of an acquisition agreement).

31 *See, e.g.*, *id.* at 1153 ("The key purpose of the acquisition agreement is to mitigate and allocate risks between the parties . . . ."). *See generally* Afsharipour, *supra* note 26 (discussing how reverse termination fees change the allocation of deal risk).

32 The seller knows more about the business being sold, so it is the lowest-cost acquirer of information about the business. Instead of having the buyer perform extensive due diligence on the state of the business before signing, it is more efficient for the seller to make representations and warranties about the state of the business—and be on the hook if those representations and warranties are untrue. *See* Gilson, *supra* note 26, at 271-73 (discussing how representations and warranties facilitate efficient production of information). Representations and warranties are usually "brought down" at closing—that is, a common condition to closing is that the representations and warranties true at signing are still true at the moment before closing. This means that if any representations and warranties are untrue at closing (except as qualified by materiality or the definition of material adverse change, as applicable), the buyer may be able to terminate the transaction at little or no cost. *See* Afsharipour, *supra* note 26, at 1170-80 (discussing how deal terms in an acquisition agreement help allocate risk between buyers and sellers).

33 Other common acquisition agreement terms that help to allocate risk include covenants and closing conditions. There is usually a gap in time between signing and closing because parties may need the interim period to secure, for example, outside financing or regulatory approval. Covenants govern the actions that parties can take during the interim period, and closing conditions give parties a right to walk away by detailing what happens when covenants and closing conditions are breached. For a more thorough discussion of the risk-mitigating terms in acquisition agreements, see Gilson, *supra* note 26, at 260 ("[M]any portions of a typical acquisition agreement result from the fact that many acquisition transactions contemplate a significant gap between the date on which the acquisition agreement is signed and the date on which the transaction is closed."); Lou R. Kling et al., *Summary of Acquisition Agreements*, 51 U. MIAMI L. REV. 779, 781 (1997) (identifying the need to secure financing as a reason for a delay between signing and closing); *id.* at 795-99 (describing covenants in typical

also grow the deal surplus. In his seminal article on deal lawyering, Ron Gilson argued that provisions in the acquisition agreement bridge parties' information gaps, risk appetites, and temporal differences, thereby making it possible for parties to agree on a deal at all.[34] Terms also reduce overall deal costs by, for instance, strategically reducing upfront costs if the probability of costly back-end litigation is very low.[35]

Other scholars have done much work in discussing the functions and value of acquisition agreements.[36] The existing literature, however, largely ignores the many ancillary agreements that invariably buttress the acquisition agreement.

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acquisition agreements); Manns & Anderson, *supra* note 26, at 1152 (describing common closing conditions and their functions). *See also* Choi & Triantis, *Strategic Vagueness*, *supra* note 26, at 871-72 (discussing deal financing). *See generally* Afsharipour, *supra* note 26 (demonstrating empirically the increased use of reverse breakup fees in M&A deals).

For example, under the Premerger Notification Program of the Hart–Scott–Rodino Antitrust Improvements Act of 1976 (HSR Act), 15 U.S.C. § 18a (2012), parties to large mergers and acquisitions may be required to notify the Federal Trade Commission (FTC) and the Department of Justice (DOJ) of the transaction. Technically, the FTC and DOJ do not approve the deal. Rather, once parties have made the relevant filings to the FTC and DOJ, a statutory waiting period begins, during which the parties cannot close the deal. Once the waiting period expires or is terminated without agency action, the parties can close the deal. *See* FTC, WHAT IS THE PREMERGER NOTIFICATION PROGRAM? AN OVERVIEW 1 (Mar. 2009), https://www.ftc.gov/sites/default/files/attachments/premerger-introductory-guides/guide1.pdf [https://perma.cc/7F4G-CWH9]. Parties may condition the closing of a deal on the expiration or termination of the HSR Act waiting period, so the length of the waiting period—and the length of time it takes to obtain other similar approvals—may account for some or all of the time between signing and closing. *See, e.g.*, Comcast Corp., Registration Statement (Form S-4) 27 (Mar. 20, 2014), http://www.sec.gov/Archives/edgar/data/1166691/000119312514107315/d681637ds4.htm [https://perma.cc/AW4Z-E78X] [hereinafter Comcast–Time Warner Agreement] (conditioning the Comcast–Time Warner merger's closing on the expiration or termination of the HSR Act waiting period).

34 Gilson, *supra* note 26, at 256-94. A pricing structure like an earnout, for example, bridges parties' differing expectations about a target company's expected performance postclosing. *Id.* at 262-64. Deals with earnouts are structured so that part of the consideration is paid at closing, and the rest is paid contingent on the target company meeting certain earnings goals in a specified period postclosing. *Id.* Without an earnout provision, the buyer and seller would be at an impasse, and the deal would die. The insertion of an earnout, however, adds value by saving deals. In Gilson's example, a buyer expects the target company to generate $7.5 million in revenue in the first year postclosing, but the seller believes the target will generate $9.25 million. *Id.* An earnout allows the parties to bridge this expectation gap: the buyer pays the seller $7.5 million at deal closing, and a year after the deal closing, the parties return to the table, at which time the buyer pays the seller $1 for each dollar of revenue the target generates over $7.5 million. *Id*. at 264. Victor Fleischer, Steven Schwarcz, and others have also examined the role of specific acquisition agreement terms in expanding the size of the deal surplus, within the context of examining the role of deal lawyers. *See* Fleischer, *supra* note 26, at 229, 241 (discussing how deal lawyers "[q]uarterback[] the deal" and may create value by engaging in regulatory arbitrage, which "exploits the gap between the economic substance of a transaction and its legal or regulatory treatment"). *See generally* Dent, *supra* note 26 (arguing that transactional lawyers are "enterprise architects" who engage in enterprise design); Schwarcz, *supra* note 26 (arguing that deal lawyers add value to a deal primarily by reducing regulatory costs).

35 *See* Choi & Triantis, *Strategic Vagueness*, *supra* note 26, at 883 ("The ex ante cost of drafting more precise contract language may be greater than the expected litigation cost entailed in enforcing the standard.").

36 *See supra* note 26.

The acquisition agreement and its ancillary agreements together create an unbundled bargain that forms the entirety of an M&A deal.

B. *Ancillary Agreements*

One of a junior M&A attorney's most important jobs is to "keep the deal checklist." An M&A deal checklist is a technicolored monstrosity—a detailed grid that keeps track of all deal documents and action items. The checklist is dozens of pages long. While the acquisition agreement is the central contract in a complex M&A deal, it takes up only one line in the deal checklist. All of the other agreements listed are "ancillary," but are nonetheless important and necessary to the deal.

M&A ancillary agreements are many and varied, and can be entered into at various stages in the deal timeline. The lifecycle of an M&A deal is defined by two major events: "signing" (the execution of the acquisition agreement) and "closing" (the performance of the acquisition agreement).[37] Before signing, parties may enter into a preliminary agreement—such as a memorandum of understanding, a letter of intent, or a term sheet—that is essentially a stripped-down version of the eventual definitive acquisition agreement.[38] At signing, "parties negotiate, draft, and execute a package of final agreements"[39]—one of which will be a definitive acquisition agreement—and, at that point, "parties

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37 *See* Jonathan M. Barnett, *Hollywood Deals: Soft Contracts for Hard Markets*, 64 DUKE L.J. 605, 618 (2015) (describing the timeline of conventional contractual negotiations).

38 There is an expansive literature that discusses when these preliminary agreements become binding, when parties can begin to rely on preliminary agreements, and the extent of damages a relying party can claim when deals fall through after only a preliminary agreement has been signed. This Article puts aside these kinds of preliminary agreements and negotiations and focuses largely on ancillary agreements that are entered into contemporaneously with the acquisition agreement's signing or closing. The exception here is the confidentiality agreement, which is signed before the acquisition agreement (and so in that sense is "preliminary" to the acquisition agreement), but which, this Article argues, more closely resembles an ancillary agreement. For a discussion of preliminary agreements, see generally Gregory Klass, *Intent to Contract*, 95 VA. L. REV. 1437 (2009) (analyzing various rules for interpreting parties' intent to be bound); Juliet P. Kostritsky, *Uncertainty, Reliance, Preliminary Negotiations and the Holdup Problem*, 61 SMU L. REV. 1377 (2008) (suggesting that courts grant recovery for reliance expenditures even in cases where parties are engaged in precontractual preliminary negotiations, rather than only when parties have a binding preliminary agreement that regulates a holdup in investment); Alan Schwartz & Robert E. Scott, *Precontractual Liability and Preliminary Agreements*, 120 HARV. L. REV. 661 (2007) [hereinafter Schwartz & Scott, *Precontractual Liability*] (arguing that contract law should encourage relationship-specific investments in preliminary agreements in certain instances); Robert E. Scott, Hoffman v. Red Owl Stores *and the Myth of Precontractual Reliance*, 68 OHIO ST. L.J. 71 (2007) (discussing at what point in preliminary negotiations parties have an obligation to negotiate in good faith); Albert Choi & George Triantis, Multi-stage Contracting in Complex Transactions (Jan. 7, 2014) (unpublished manuscript), http://www.law.uchicago.edu/files/files/choi_paper.pdf [https://perma.cc/78G7-FEU9] [hereinafter Choi & Triantis, *Multi-stage Contracting*] (discussing how preliminary agreements in complex commercial cases differ from cases where joint investment and reliance are key). *See also* Klass, *supra*, at 1441 (suggesting that in the preliminary agreement context there should be "a requirement that parties who want such agreements to be legally binding say so").

39 *See* Barnett, *supra* note 37, at 618 (describing the package of agreements signed in typical deals).

become legally obligated to effect the transaction."[40] At closing, the deal is performed—the buyer pays, and the seller hands over what is being sold.[41]

Most ancillary agreements are entered into at or after signing, but an important one is signed early. Confidentiality agreements, like those in *Martin Marietta*, are often the first ancillary agreements signed during negotiations.[42] Confidentiality agreements share characteristics with both preliminary agreements and ancillary agreements. Like preliminary agreements, they are signed early in the deal's lifecycle. They do not, however, set out the acquisition agreement's material terms in a bare-bones way. Instead, they are more like ancillary agreements, in that they shape the terms of the deal. In *Martin Marietta*, the confidentiality agreement shaped the deal's most important part—that is, it determined whether a deal could go forward at all, and, if so, when and how. Confidentiality agreements are, uniquely, preliminary-agreement-like ancillary agreements. If an unbundled bargain is the sum of an acquisition agreement and its ancillary agreements, a confidentiality agreement barely makes the cut as part of the unbundled bargain. Its unique position at the edge of the deal, however, makes a confidentiality agreement a particularly interesting way to figure out how far a deal's boundaries reach. When this Article discusses how ancillary agreements could be used for interpretive context in contract disputes, confidentiality agreements are a way to test how far away from the center of the deal a contract interpreter should reach for interpretive context—that is, should the interpreter reach all the way to the edge of the deal, to the confidentiality agreement?

Most other ancillary agreements are easier to identify than confidentiality agreements. They are entered into at signing or between signing and closing (especially if the deal's closing is contingent upon the signing of certain ancillary agreements).[43] Ancillary agreements buttress the acquisition agreement's bargain and help precisely draw the contours of the whole deal.

M&A deals have dozens of ancillary agreements—too many to catalog—but most serve a few similar functions. Some facilitate deal execution: the exchange of assets or shares for consideration. Acquisition agreements, unlike deeds or assignments of rights, do not actually transfer assets or money—rather, "separate filings or recordings may be necessary to effect the transfer [of assets]."[44] These documents and filings are ancillary agreements. In a real estate deal, for example,

40 Kling et al., *supra* note 33, at 781.

41 *See id.* (describing the moment of closing as "when the acquisition actually occurs").

42 *See* Sasha S. Hahn, Note, *"Between" a Rock and a Hard Place:* Martin Marietta v. Vulcan *and the Rise of the Backdoor Standstill*, 65 HASTINGS L.J. 1393, 1396 (2014) ("In the context of merger discussions, a confidentiality agreement is generally the very first agreement signed.").

43 *See* Manns & Anderson, *supra* note 26, at 1152 ("Closing conditions delineate circumstances that give the bidder or target company the right to walk away from the agreement during the pre-closing period.").

44 Byron F. Egan, *Asset Acquisitions: Assuming and Avoiding Liabilities*, 116 PENN ST. L. REV. 913, 917 (2012); *see also id.* (noting that asset purchases are a cumbersome way to do an M&A deal because the act of the asset transfer requires separate filings and agreements).

a deed effects the transfer.[45] In intellectual property deals, intellectual property assignments effect the transfer. In private company deals, part of the consideration may also be transferred via an escrow agent—a third party that holds part of the consideration until the parties settle postclosing matters.[46] That escrow is governed by an ancillary agreement: the escrow agreement.[47]

Other ancillary agreements govern rights and obligations that survive postclosing. Most of the acquisition agreement's rights and obligations end at closing,[48] but parties can carve out a continuing relationship, often through an ancillary agreement. A buyer may decide that, but for transitional support from the seller or ongoing employment of key employees, the deal is not worth doing. In those cases, the transition services or employment agreements that govern the parties' ongoing relationship are essential.[49] Ongoing lease agreements, which are essential to continuing operations after Real Estate Investment Trust (REIT) separation transactions, are particularly salient recent examples. In a REIT separation deal, a company with substantial real estate assets separates its real estate assets and either sells those assets to an existing REIT or spins them off into a newly formed REIT.[50] The REIT leases the same property back

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45 *See* Craig Circosta & Sandra Wintner, *Ancillary Agreements*, LEXOLOGY (Oct. 4, 2012), http://www.lexology.com/library/detail.aspx?g=7fae6b8a-6b93-4c19-8908-efa3e0e2822c [https://perma.cc/4B9W-ZZUM] (providing an overview of ancillary agreements executed and delivered at the closing of an M&A transaction, including documents of transfer such as real estate deeds).

46 *See Negotiating and Drafting M&A Escrow Agreements*, PRAC. L. (Nov. 21, 2013), http://us.practicallaw.com/1-549-7438 [https://perma.cc/CHD3-8TC8] ("In private M&A transactions, the buyer often requires that a portion of the purchase price be held back until a later date to satisfy the seller's post-closing obligations."); *id.* ("[S]ellers typically prefer that . . . amounts [to meet such obligations] be placed into escrow with a third-party escrow agent, rather than being retained by the buyer.").

47 *See* Sanjai Bhagat et al., The Use of Escrow Contracts in Acquisition Agreements 6-8 (Oct. 2015) (unpublished manuscript), http://ssrn.com/abstract=2271394 [https://perma.cc/8QG3-RNGY] (describing the parties and common terms of escrow agreements in M&A deals).

48 Of course, parties may look to the acquisition agreement for guidance on how to deal with postclosing price adjustments such as earnout calculations or indemnifications. They may also look to the acquisition agreement if a dispute arises with respect to, for example, a fraudulent representation. For the most part, however, postclosing, the acquisition agreement is a record of a deal that is signed, sealed, and completed; the acquisition agreement stops being a live document that governs any postclosing actions.

49 *See* Paul A. Chandler & Lindsay Blohm, *Transition Services Agreements in Acquisitions and Divestitures: An Introduction*, MAYER BROWN BUS. & TECH. SOURCING REV., Fall 2010, at 7, http://www.mayerbrown.com/files/Publication/8f250357-3487-4d7c-8a0a-23deddc90e93/Presentation/PublicationAttachment/4df434ff-1035-43bc-b0b1-49320a2095fd/BTS-Review_Fall2010_Issue15.pdf [https://perma.cc/54DM-WZ46] (discussing types and features of transition services agreements and when they should be entered into).

50 *See* WACHTELL, LIPTON, ROSEN & KATZ, SPIN-OFF GUIDE 8-9 (2014), http://www.wlrk.com/files/2014/SpinOffGuide.pdf [https://perma.cc/K95C-LDSX] (discussing the kinds of companies that engage in REIT spinoffs). REITs, like partnerships, are "conduit entities" that are not taxed at the corporate level. Instead, the taxable income of a REIT is distributed to its shareholders, and taxed at the shareholder level only. In contrast, corporations are taxed at the corporate level, and distributions to shareholders are taxed again at the shareholder level. *See generally* Bradley T. Borden, *Rethinking the Tax-Revenue Effect of REIT Taxation*, 17 FLA. TAX REV. 527 (2015) (discussing tax treatment of REITs, the recent trend in REIT spinoffs, and the effect of these transactions on erosion of the corporate tax base).

to the legacy operating company.[51] In 2011, for instance, assisted living company HCR ManorCare sold its real estate assets to HCP, a REIT, for $6.1 billion.[52] At the same time, HCP and ManorCare entered into a long-term lease, leasing the properties back to ManorCare.[53] The lease was an essential ancillary agreement, without which the deal would not have been worth doing.

Still other ancillary agreements provide deal protection or other assurance to the parties. Voting agreements, for example, are common contracts between the buyer and a group of the target's stockholders, in which the stockholders agree to vote their shares in favor of the transaction.[54] Voting agreements function as deal protection because they "ensure[] that the transaction will be consummated if put to a stockholder vote."[55] Opinion letters—short letters in which the company's investment bankers or lawyers opine on the fairness or anticipated regulatory treatment of a transaction—also protect the deal by shifting some deal risk from parties to deal advisors.[56] In the AT&T–DIRECTV merger, for example, the parties' obligations to close the deal were subject to receipt from their respective counsel of tax opinions stating that the merger would qualify as a tax-free reorganization under § 368 of the Internal Revenue Code.[57] In tax-driven M&A deals like tax inversions or recent REIT deals, tax opinions are very important because they reassure deal parties that the deal will receive the desired tax benefits.[58]

51 *See* Borden, *supra* note 50, at 547-52 (discussing the structure of REIT-related leasebacks).

52 News Release, HCP, Inc., HCP Closes $6.1 Billion Acquisition of HCR ManorCare's Real Estate Assets (Apr. 8, 2011), http://ir.hcpi.com/phoenix.zhtml?c=67541&p=irol-newsArticle&ID=1548205 [https://perma.cc/B2UC-5HG2].

53 *Id.*

54 *See* Thanos Panagopoulos, *Thinking Inside the Box: Analyzing Judicial Scrutiny of Deal Protection Devices in Delaware*, 3 BERKELEY BUS. L.J. 437, 447 (2006) (describing stockholder voting agreements and how they function as deal protection).

55 *Id.*

56 *See* Lucian Arye Bebchuk & Marcel Kahan, *Fairness Opinions: How Fair Are They and What Can Be Done About It?*, 1989 DUKE L.J. 27, 28-29 (discussing how much judges should rely on fairness opinions and "warn[ing] against excessive reliance on fairness opinions"); Gilson, *supra* note 26, at 275 (describing the content of opinions of counsel).

57 *See* AT&T Inc., Amendment No. 3 to Registration Statement (Form S-4) 18 (Aug. 19, 2014) [hereinafter AT&T Amendment] (disclosing that, as a condition to closing, AT&T's lawyers at Sullivan & Cromwell would deliver to AT&T an opinion stating that "the merger will qualify as a reorganization within the meaning of Section 368 of the Internal Revenue Code").

58 *See* Cathy Hwang, *The New Corporate Migration: Tax Diversion Through Inversion*, 90 BROOK. L. REV. 807, 808 (2015) ("In a corporate inversion, a corporate group with a common parent incorporated in a domestic jurisdiction reshuffles its corporate structure or acquires a foreign company in order to end up with a common parent incorporated in a lower-tax foreign jurisdiction." (footnote omitted)); David Polster et al., *Unlocking Value Through REIT Spin-Offs*, SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP & AFFILIATES (Jan. 2015), https://www.skadden.com/insights/unlocking-value-through-reit-spin-offs [https://perma.cc/V7DE-2A76] (discussing the mechanics of REIT spinoff transactions and how favorable tax treatment of the resulting REIT can "provide a means for companies to unlock the value of their real estate"). *See generally* Austan Goolsbee & Edward Maydew, *Taxes and Organizational Form: The Case of REIT Spin-Offs*, 55 NAT'L TAX J. 441 (2002).

II. A New Theory of the Deal: Unbundled Bargains

In M&A deals, parties begin their bargains from relatively blank slates—they can allocate deal provisions between the acquisition agreement and ancillary agreements freely or keep most provisions in one agreement.[59] Acquisition agreements are long, complicated, and cover broad subject matter. What work is being done by ancillary agreements that is not being done—or cannot be done—by acquisition agreements? The existence of ancillary agreements in M&A deals is particularly puzzling because the easiest explanation for unbundling in other contexts—to contract around defaults—is not particularly applicable to M&A.

While most M&A scholars focus on the acquisition agreement, this Part shows that complex M&A deals are unbundled bargains and shows how ancillary agreements can make deals more modular and precise, thereby reducing dealmaking costs ex ante and deal enforcement costs ex post.

If M&A deals are actually unbundled bargains, the boundaries of the deal must also expand beyond the four corners of the acquisition agreement to encompass those unbundled pieces. Thus, this Part ultimately suggests a new way to think about what constitutes a deal: specifically, the accurate boundaries of the deal are larger than they appear, and encompass an acquisition agreement and many ancillary agreements. Reframing M&A deals as unbundled bargains has important implications for how deal disputes are interpreted and how parties should be motivated to design deals going forward, which will be explored in Part III.

A. *The Efficiency of Unbundled Bargains*

Ancillary agreements allow parties to unbundle their bargains and form deals that are more modular and precise. Unbundling decreases deal costs ex ante (in the deal design and contract drafting stage) and ex post (when contracts are litigated and enforced). This Section examines how unbundled bargains increase dealmaking efficiency.

1. Deal Modularity

Unbundled bargains make deals more modular. Modularity—a concept oft-discussed in computer software creation and adopted in private law literature—"is a device to deal with complexity by decomposing a complex system into pieces (modules), in which communications (or other interdependencies) are

59 To be sure, laws and regulations do provide a framework in which M&A deals can be struck. *See, e.g.*, Fleischer, *supra* note 26, at 237 ("The complexity of the modern administrative state provides more opportunities for regulatory arbitrage—another form of value creation for the client—than ever before."). The existence of a framework within which a deal must operate, however, is not the same as having to enter into a default bargain.

intense within the module but sparse and standardized across modules."[60] In other words, a highly modular component of a machine is one that can be manipulated without significantly affecting other parts of the machine (and the other parts of the machine, too, can be modified without much affecting the module). Ancillary agreements are like modular machine parts—they can be changed without triggering cascading changes to other deal documents. Adding ancillary agreements to a deal allows a deal to take on some of the benefits of modularity.

In M&A deals, ancillary agreements are generally used to govern both the most complex pieces of the deal and the simplest. For ease, this Article calls those pieces complex modules and simple modules. Each in their own ways, complex modules and simple modules make deals better and make dealmaking more efficient. Complex modules increase precision without significantly increasing costs. Simple modules reduce deal costs without losing much quality. Each is discussed in turn here.[61]

a. *Complex Modules*

M&A parties are almost invariably advised by a handful of elite law firms that staff M&A deals in similar ways.[62] A group of M&A lawyers responsible for deal design and primary contract drafting forms the center of any M&A deal team. When a particular provision needs to be included in a deal, an M&A lawyer can work on that provision herself or assign that provision to an attorney who specializes in the issue. In complex M&A deals, specialist input is often needed when deals interact with regulation.[63] In practice, firms that advise in these deals often employ attorneys who specialize in regulatory areas, and M&A lawyers regularly assign regulatory deal pieces to specialist attorneys.

When complex deal pieces are assigned to specialist lawyers, those pieces will not necessarily be modules—that is, although they might be assigned to specialists, they may be so connected to the rest of the deal that they are not modular. For

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60 Henry E. Smith, *Modularity in Contracts: Boilerplate and Information Flow*, 104 MICH. L. REV. 1175, 1176 (2006).

61 Although some literature has discussed contract modularity, *see generally, e.g.*, Margaret Jane Radin, Commentary, *Boilerplate Today: The Rise of Modularity and the Waning of Consent*, 104 MICH. L. REV. 1123 (2006) (analyzing interaction between standardization and customization in contract drafting); Smith, *supra* note 60; George G. Triantis, *Improving Contract Quality: Modularity, Technology, and Innovation in Contract Design*, 18 STAN. J.L. BUS. & FIN. 177 (2013) (describing how modular contracts improve collaboration in creating standardized contract provisions), modularity has yet to be discussed in the context of deals.

62 *See* Davidoff & Sautter, *supra* note 26, at 709 ("The takeover [M&A] market is a concentrated one where a few law firms dominate."); Fleischer, *supra* note 26, at 230 ("Large companies that can afford elite law firms employ more aggressive deal structures that push the regulatory frontier.").

63 *See* Fleischer, *supra* note 26, at 237 ("In the twenty-five years since Gilson wrote his article, the administrative state has increased substantially, and the amount of time lawyers devote to regulatory matters has grown apace.").

example, an intellectual property representation and warranty may be drafted with specialist input, but it interacts with other parts of the acquisition agreement extensively: it may refer to the acquisition agreement's definitions of materiality or material adverse change, which are defined or explained in another part of the agreement.[64] As a result, that part of the deal is specialist-driven, but nonmodular.

Many complex, technical, or regulatory pieces of an M&A deal, however, are both modular and assigned to specialists—these are complex modules. An employment agreement is one example. An employment agreement ensures that a key target-company employee is employed by the buyer postclosing, and is often signed as a condition to closing. An employment lawyer almost always takes the lead on an M&A-related employment agreement, because employment law is usually outside an M&A lawyer's expertise. And, while employment agreements may *refer* to the acquisition agreement, they are also very modular—they are self-contained enough that changes to the details of the employment agreement generally do not need to affect other deal documents. Likewise, even big changes in the acquisition agreement—for example, a modification in the deal's tax structure—may not affect the employment agreement at all. Ancillary agreements related to tax, antirust, or intellectual property matters are other ready examples of complex modules within unbundled M&A bargains.

Contracts literature identifies a tension between front-end contract drafting costs and back-end litigation costs.[65] Increasing drafting costs tends to decrease the expected back-end enforcement and litigation costs because more front-end attention decreases the probability of a later dispute.[66] By the same token, some scholars have noted that parties may rationally reduce contract specificity (and thereby reduce front-end costs) if the probability of litigation is remote (and

64 For example, a target might represent and warrant that it has provided a list of "all material registered Intellectual Property" or represent that it has a right or title to all intellectual property "[e]xcept as would not reasonably be likely to have . . . a . . . Material Adverse Effect." *See* AT&T Amendment, *supra* note 57, at A-22 to -23 (providing the target's representation and warranty on its material registered intellectual property). The terms "material" and "Material Adverse Effect" are likely defined or elaborated upon in other parts of the acquisition agreement, so changes to other parts of the agreement would likely affect that representation. Likewise, if that representation advanced a new definition of the materiality thresholds, those definitions could also have an effect on the other parts of the acquisition agreement.

65 *See, e.g.*, Choi & Triantis, *Strategic Vagueness*, *supra* note 26, at 852 ("[D]rawing on the line of scholarship that analyzes the rules-standards dichotomy in the design of legal rules, recent work frames the choice between vague and precise contract terms as a tradeoff in information costs: precise contract provisions raise contracting costs on the front end, but reduce enforcement costs at the back end."); Richard A. Posner, *The Law and Economics of Contract Interpretation*, 83 TEX. L. REV. 1581, 1583 (2005) [hereinafter R. Posner, *Contract Interpretation*] (defining the cost of a contract as the ex ante negotiating and drafting costs, plus the probability of litigation multiplied by the sum of the parties' litigation costs, the judiciary's litigation costs, and judicial error costs).

66 Choi & Triantis, *Strategic Vagueness*, *supra* note 26, at 852.

therefore the expected costs of enforcement are low).[67] For instance, parties may use vague material adverse change clauses, especially if material adverse change clauses are very rarely litigated to judgment.[68]

Like contract designers, the M&A lawyers who design deals must consider the tradeoff between front-end costs and back-end costs. One manifestation of this tradeoff arises in how complex regulatory tasks are assigned within the deal team: when a complex regulatory issue arises, an M&A lawyer can choose to advise a client on that issue based on her own research or assign that issue to a specialist who frequently deals with similar matters.[69] If the M&A lawyer chooses to advise a client on that issue herself, she has two choices: she can invest a large amount of time on the front end to become an area expert, or she can provide nonexpert advice, increasing back-end costs because she has increased the probability of a negative outcome in litigation.

Assigning pieces of a deal to specialists, however, provides a third way to increase dealmaking efficiency: an M&A lawyer can choose to assign a complex module to a specialist who is already an expert. Because a specialist lawyer does not need to spend time learning a complex area of regulation, the client receives expert advice on a technical issue without needing to pay the M&A lawyer to become an expert in that area. Even if engaging a specialist lawyer entails some start-up costs—namely, the cost of a specialist learning the background of the M&A deal at hand—those costs are likely less than the cost of the M&A lawyer learning the specialist's area of expertise.[70]

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67 *See id.* ("If a provision matters only in remote contingencies, for instance, then the back-end costs should be discounted by that remote probability, and it may be correspondingly efficient to save front-end costs by using a standard (or a vague term) rather than a rule.").

68 *Id.* at 896.

69 This decision bears some resemblance to the Coasean theory of the firm. Ronald Coase argued that firms grow larger if it is cheaper to produce a particular component internally, and do not grow if it is cheaper to purchase that component from outside the organization. The choice to "make or buy" is also affected by the transaction costs of each production method. *See* R. H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386, 387-89 (1937). This theory has been used to explain why some firms are highly integrated, and others are more specialized (and rely on outside suppliers to produce most components). *See generally* Peter G. Klein, *The Make-or-Buy Decision: Lessons from Empirical Studies* (surveying the empirical literature on firms' vertical integration, and providing a summary of Coase's theory of the firm), *in* HANDBOOK OF NEW INSTITUTIONAL ECONOMICS 435 (Claude Ménard & Mary M. Shirley eds., 2008). Like the firm in Coase's theory, an M&A lawyer can choose to "vertically integrate" provisions of the deal into the acquisition agreement, or parcel out provisions for specialists. However, unlike the firm in Coase's theory, where the boundaries are defined by the decision to vertically integrate or not, the boundaries of an M&A deal are not defined by an M&A lawyer's decision to integrate a particular provision or not. Rather, that decision merely defines the *boundaries of the acquisition agreement*, which are separate from the boundaries of the deal. The boundaries of the deal are larger than those of the acquisition agreement, because they must be large enough to encompass the provisions that are not vertically integrated into the acquisition agreement but are nonetheless crucial to the deal. *See infra* Section II.C.

70 This argument assumes that the specialist lawyer's hourly rate is approximately that of an M&A lawyer's. This assumption is supported by hourly billing statements that major firms have filed in connection with bankruptcy representations, in which the billing rates of specialist lawyers

Assigning deal pieces to specialists can also make front-end dealmaking more efficient in a handful of smaller ways. Assigning matters to specialists, for example, might generate benefits if the specialist is a repeat player with certain government agencies. An antitrust attorney may make dozens of filings a year under the HSR Act's Premerger Notification Program. As a result, an antitrust attorney becomes a repeat player with the relevant departments and individual regulators at the FTC and DOJ, with all of the usual benefits that accrue to reputable repeat players. For example, regulators may come to expect that a particular antitrust attorney's work is excellent, and thus be more inclined to approve her filings. An antitrust attorney may also be able to call a regulator she knows to ask for an informal status check on a pending filing. Regulatory attorneys may also spend their careers alternating between working in regulatory agencies and working in private practice. As a result, regulatory attorneys may know how certain client issues are evaluated within a regulatory agency, and can provide more nuanced and accurate advice to a client.

Making those complex pieces *modular* by moving them into separate ancillary agreements is key to reducing front-end costs. Nonmodular pieces have many points of connection with the rest of the deal,[71] so when they change, they are more likely to cause ripple effects throughout other parts of the deal. Thus, an M&A lawyer will carefully review nonmodular complex pieces to ensure that the ripple effects they cause through the rest of the deal are addressed. This erodes some of the efficiency gained when a complex piece is assigned to a specialist. In contrast, the more modular a complex piece, the less time an M&A lawyer has to spend reviewing it. Because modular pieces are relatively self-contained, the complex module can be substantially modified within itself with less likelihood of causing ripple effects in the rest of the deal. As a result, an M&A lawyer spends less time reviewing the specialist's work, which is a front-end cost savings.

But even when complex modules do not *reduce* front-end costs, they can still make front-end contract design more efficient. In particular, they can help parties increase marginal contract quality by less than the marginal cost of increasing

are revealed to be approximately the same as comparably experienced M&A lawyers. *Compare* Fifth and Final Application of Skadden, Arps, Slate, Meagher & Flom LLP, Counsel to the Official Committee of Unsecured Creditors, Seeking Allowance and Payment of Compensation and Reimbursement of Expenses Under 11 U.S.C. §§ 330 and 331 at 4, *In re* AMR Corp., No. 11-15463 (Bankr. S.D.N.Y. Feb. 7, 2014), http://amrcaseinfo.com/pdflib/11662_15463.pdf [https://perma.cc/62V3-SYPT] (M&A attorneys' fees), *with* Summary Sheet Pursuant to the United States Trustee Guidelines for Reviewing Applications for Compensation and Reimbursement of Expenses Filed Under 11 U.S.C. § 330 at 2-3, *In re* AMR Corp., No. 11-15463 (Bankr. S.D.N.Y. Jan. 31, 2013), http://www.amrcaseinfo.com/pdflib/6492_15463.pdf [https://perma.cc/S2VZ-7YUG] (specialist attorneys' fees).

71 *See* Smith, *supra* note 60, at 1176 ("Two elements are more likely to be in the same module if they are part of a dense web of connections, whereas they are more likely to be part of separate modules if they are weakly connected in this sense.").

quality. Modularity is a way to promote teamwork: when teams of programmers work on the same body of computer code, for example, "it is important that individual pieces be well separated. Otherwise, the need for communication between programmers with the purpose of coordinating their individual tasks quickly gets out of hand."[72] Because M&A is a team-based practice, modularizing the deal is a useful way to promote dealmaking efficiency. Suppose an M&A lawyer has 600 hours left to work before a deal signing, and she saves 50 hours of work by assigning a complex module to a specialist (who needs to spend only 10 hours to achieve the same result). In practice, an M&A lawyer is not likely to work only 550 hours because she saved 50. Instead, she will work for her full 600 hours, filling those "saved" 50 hours by improving parts of the deal that are within her expertise. The client, of course, then pays for 610 hours of work: 600 hours of the M&A lawyer's work, and 10 hours for the specialist's work. The deal's front-end deal costs actually increase, but the marginal cost is less than the marginal benefit: for the marginal cost of 10 hours of work, both the specialist's part and the M&A lawyer's part of the deal are improved. Although the client pays for 10 more hours of work, she actually receives the benefit of 50 more hours of work, because paying for 10 hours of the specialist's work freed up 50 hours of the M&A lawyer's time.

Complex modules can also reduce back-end enforcement costs. Contract theory suggests that parties prefer easily verifiable contract terms (and contracts) because litigation and contractual enforcement on the back end are costly.[73] This is one of the reasons parties appear to prefer specific contract terms over vague ones.[74] Like vague terms, complex, highly technical deal terms are also more expensive to litigate than simple terms because complex commercial terms, when litigated, introduce high levels of judicial uncertainty.[75]

One way to reduce the uncertainty of judicial interpretation is to make complex terms simpler—a seemingly impossible task. Making complex terms more *modular*, however, may make them easier to understand. Modularity appears to "allow[] complexity to become manageable by interrupting information flow within the system."[76] Breaking complex projects into smaller, self-contained

72 Matthias Blume & Andrew W. Appel, *Hierarchical Modularity*, 21 ACM TRANSACTIONS ON PROGRAMMING LANGUAGES & SYSTEMS 813, 817 (1999); *see also id.* (discussing the need for modularity in code writing in order to allow teams to "divide and conquer").

73 *See* Choi & Triantis, *Strategic Vagueness*, *supra* note 26, at 852 ("Contract theorists focus on the cost of verifying facts and typically posit that parties avoid terms that are costly to verify.").

74 *Id.*

75 Because judicial accuracy is uncertain in complex commercial disputes, many practicing litigators prefer to litigate complex commercial cases in federal court. For a discussion of litigators' and parties' preference for federal courts over state courts, see Cathy Hwang & Benjamin P. Edwards, *The Value of Uncertainty*, 110 NW. U. L. REV. 283, 291-92 (2015); 101 NW. U. L. REV. ONLINE 19, 26 (2015), http://scholarly commons.law.northwestern.edu/cgi/viewcontent.cgi?article=1227&context=nulr_online [https://perma.cc/L8P7-PALP].

76 Smith, *supra* note 60, at 1180.

modules enhances human understanding of the entire complex M&A system.[77] Thus, all else being equal, using a complex module increases the likelihood that a court will understand the information contained in that module. As a result, uncertainty of judicial interpretation and back-end enforcement costs are reduced.

Modularity's ability to break down complex systems is one reason that specialists work on complex *modules*, rather than on complex pieces of the deal that are then plugged back into the deal in a nonmodular way. Another reason is that modularity can reduce the back-end costs of performing parts of the deal, because modules are separated out into easily executable pieces. The actual sale of a company is performed by lawyers: an M&A deal closes and its acquisition agreement is performed when, for instance, consideration is wired to the seller and stock certificates are delivered to the buyer. Lawyers, however, may not perform other parts of the unbundled bargain. For example, the individual divisions within a target company may execute a transition services agreement, in which the seller agrees to provide some ongoing services to the buyer postclosing.

Few are the employees who are accustomed to dealing with the types of complex commercial contracts that govern M&A deals. At the same time, these employees may also have very specialized knowledge of their fields, and contractual terms concerning their fields may need to be spelled out in a very particularized and technical way. Putting the terms of ongoing transitional services into a complex module helps address this tension: employees can consult a self-contained transition services agreement that describes the services they need to provide (without needing to cross-reference a complex commercial contract), and specialists can provide expert input into that particular contract. Note that in transition services agreements, as in some other ancillary agreements, the relevant specialists need not be specialist attorneys. For example, a transition services agreement that deals with ongoing mailroom support may benefit from the expert advice of the person who manages the target company's mailroom. A transition services agreement that is a complex module both enhances contract performers' ability to understand the terms of the contract and increases the quality of the contract through relevant expert advice.

b. *Simple Modules*

One common feature of modules is that, because they are relatively self-contained, they can be excised from or incorporated into different contexts with ease.[78]

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77 *Id.* at 1180-81; *see also* Kathrin Figl & Ralf Laue, *Cognitive Complexity in Business Process Modeling*, 23 ADVANCED INFO. SYSTEMS ENGINEERING 452, 465 (2011) ("Research on . . . [business process models] suggests that decomposing complex models into smaller submodels can improve model comprehensibility.").

78 *See* Triantis, *supra* note 61, at 191 (describing how software can be used to assemble modular, standard contract provisions by "adding, adjusting, swapping, and removing modules according to the client's responses to a series of questions about the subject transaction," and how this process lowers the costs of agreement production).

Not surprisingly, there is significant overlap between contractual provisions that are modular and those that are boilerplate. A counterparts provision—a short provision that specifies that parties to an agreement may sign different copies of the agreement—is one example of a contractual component that is both modular and boilerplate: across different types of commercial contracts and different contractual parties, counterparts provisions are nearly identical.[79] By their nature, boilerplate provisions are standardized provisions that do not rely on other parts of the contract to function—so they are also modular, and can easily be used in a variety of different contracts.

Complex M&A deals similarly contain many boilerplate provisions. An M&A lawyer running a deal can either find and draft boilerplate provisions herself or assign the drafting of boilerplate provisions to another person. Complex modules are often assigned to subject-matter specialists. Perhaps surprisingly, M&A lawyers are assisted not just by subject-matter specialists, but also by specialists whose practices focus on *simplicity*—that is, junior associates.

Junior associates are entry-level attorneys who have relatively little experience with contract drafting and deal design. In practice, boilerplate parts of the deal are often assigned to junior associates, for at least three reasons: their work is billed to a client at a lower hourly rate, they have enough experience to accomplish simple tasks well, and simple tasks allow them to gain lawyering skills. Assigning a boilerplate provision to a junior associate happens in one of two ways: a junior associate is assigned to work on a discrete, fairly boilerplate section of the acquisition agreement (like representations and warranties), or she is assigned to work on a discrete, boilerplate contract. In both cases, a junior associate is working on a simple module, although only in the latter case is a junior associate working on a simple module that is part of an unbundled bargain.

Assigning a simple module to a junior associate can reduce front-end deal design costs. Because a client pays less for a junior associate's work than for a senior associate's work, it is cost-efficient to assign tasks to junior associates when possible. This is especially true in the case of simple modules, where there is relatively little room to inject lawyers' judgment or expertise, and where changes

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79 In the Actavis–Allergan deal, for example, the counterparts provision reads,

> This Agreement may be executed manually or by facsimile by the Parties, in any number of counterparts, each of which shall be considered one and the same agreement and shall become effective when a counterpart hereof shall have been signed by each of the Parties and delivered to the other Parties. Delivery of an executed counterpart of a signature page to this Agreement by facsimile transmission or by e-mail of a .pdf attachment shall be effective as delivery of a manually executed counterpart of this Agreement.

Actavis plc, Amendment No. 1 to Registration Statement (Form S-4), at A-106 (Jan. 26, 2015). An earlier deal between Actavis and Forest Labs contained a nearly identical counterparts provision, as did the contract governing the completely unrelated AT&T–DIRECTV merger. *See* AT&T Amendment, *supra* note 57, at A-49; Actavis plc, Amendment No. 1 to Registration Statement (Form S-4), at A-74 (May 2, 2014).

to the simple module will cause few, if any, ripple effects throughout the deal. Moreover, as with complex modules, assigning simple modules to others allows senior M&A lawyers to spend more time improving parts of the deal that would benefit from their expertise.

But whereas assigning a complex module to a specialist can increase deal design quality *and* reduce enforcement costs, assigning a simple module to a junior associate may improve only front-end efficiency. Complex modules reduce enforcement costs because specialists' input decreases the probability of error within those complex modules. In contrast, simple modules are relatively hard to botch. Some simple modules, like officers' certificates, escrow agreements, and intellectual property assignments, are extremely straightforward—they are little more than exercises in copy/paste and fill-in-the-blank. Thus, no matter who works on a simple module, the likelihood of error is exceedingly small. Assigning a simple module to a junior associate, then, is simply a matter of front-end cost reduction and workflow efficiency: junior associates are no better than senior associates at simple modules, but they are cheaper, and assigning work to them frees up senior associate time for more complex tasks. This more efficiently allocates work between attorneys of differing levels of expertise.

One important puzzle about simple modules remains: Why are some boilerplate pieces of the deal (like escrow agreements) broken out into ancillary agreements, while other boilerplate pieces (like representations and warranties) remain part of the acquisition agreement? There are at least two possible explanations. The simplest is that making a particular boilerplate provision *X* part of an acquisition agreement requires more senior attorney review of *X* than if *X* were part of a separate agreement. For example, consider an M&A deal team that is composed of a partner, a senior associate, and a junior associate. Almost as a rule, a partner will read the acquisition agreement carefully—including boilerplate provision *X* if *X* is included. In contrast, a partner will probably not review *X* if it is drafted as an ancillary agreement by the junior associate or specialist. Rather, a senior associate reviews those documents.[80] If it is more cost-efficient to minimize senior attorneys' time spent on a deal—and it is—making *X* part of a simple module rather than part of an acquisition agreement advances that goal.

There is another, less intuitive reason for boilerplate to exist in a simple module rather than in the acquisition agreement. So far, this Article has used the term "simple module" to describe, for the most part, boilerplate agreements that are part of an unbundled bargain—that is, "boilerplate" and "simple" have been used

80 In practice, M&A attorneys often assume that simple modules are boilerplate and require less partner attention. As a result, extracting a boilerplate piece of the deal from the acquisition agreement should have little effect on the simple module's quality. Similarly, complex modules are reviewed by partners in specialist groups before being passed back to the M&A team, so a senior M&A associate's review to ensure that the complex module fits with the rest of the deal should suffice to ensure quality. Adding the M&A partner's review would probably add more marginal cost than marginal deal quality.

somewhat interchangeably. But even the simplest boilerplate is, by the standards of those not regularly steeped in complex commercial contracts, technical and complex. Modularity, however, enhances human understanding of complexity, so putting boilerplate into an ancillary module may, in fact, serve two purposes. First, because it is boilerplate, that piece of the deal is simpler to *draft*. And second, because that boilerplate (which, while simple to draft, is still hard to comprehend) is broken out into a distinct ancillary module, it also becomes easier to comprehend.[81]

c. *Modularity and Hierarchy*

A growing literature applies modularity to the drafting of individual contracts. This literature identifies a modular contract provision as one that can be drafted in a way that does not affect other parts of the contract.[82] Modular provisions are self-contained, and can be ported from contract to contract, or manipulated within a contract, without affecting the rest of the contract.[83]

This Article takes a step beyond that literature and argues that, like *contracts*, *deals* can be modular. The many contracts that govern a deal are modular parts of that deal, and each contract may also contain its own modules. This "hierarchical modular structure"[84] is observed in other contexts, such as writing computer software, where modules within modules are used to address multiple layers of system complexity.[85]

Hierarchical modularity also helps explain why M&A deals are not just governed by one modular contract. Rather, they are modular *deals* composed of multiple modular *contracts*, because multiple layers of modularity help capture and process an M&A deal's complexity. Good modular systems contain few modules, each of which should not be too complex.[86] But M&A deals are inherently complicated, so it seems impossible to satisfy the competing demands of both (1) not having too many modules, and (2) ensuring each module is not too complex. For example, a modular but bundled deal could have simple modules, but contain far too many of them in one agreement. Conversely, a deal could have very few modules, yet each module could be so complex—perhaps because each encompasses

81 *See* Smith, *supra* note 60, at 1180 ("Crucially, human understanding of any system is enhanced by breaking it up . . . into modules.").

82 For a discussion on modularity in contracts, see generally sources cited *supra* note 61.

83 *See* Triantis, *supra* note 61, at 191 ("Contracts are modular to the degree that their parts can be drafted and read without adjustment or reference to other parts of the contract.").

84 Blume and Appel, *supra* note 72, at 813.

85 *See id.* at 818 ("To cope with complexity, large projects are routinely divided into parts."); Smith, *supra* note 60, at 1180 ("Modularity is a key device for dealing with complexity . . . .").

86 *See* Blume and Appel, *supra* note 72, at 818 ("In a good modularization, no module should be overly complex, and there should not be too many modules. This can only be accomplished with a hierarchal structure, with each module constructed from submodules.").

too many substantive areas of the law—that it fails to truly confer the benefits of modularity.

Hierarchical modules relieve the tension between the total number of modules and the complexity of each: each M&A deal can be carved up into a *relatively* small number of modular ancillary agreements, each of which can then be modularized within itself to reap further benefits. For example, a relatively long and detailed employment agreement can be a deal module. That agreement, however, can be further modularized within itself: complex issues of substantive law can be assigned to more senior employment lawyers, while more boilerplate provisions can be assigned to junior employment lawyers. In that way, hierarchical modularity explains the prevalence of unbundled and modular dealmaking over bundled and modular dealmaking.

2. Deal Precision

In addition to increasing deal modularity, unbundled bargains can also increase deal precision. An acquisition agreement is somewhat monolithic: a half dozen or fewer parties sign and agree to more or less the same terms and on the same timeframe. Parties use ancillary agreements to contract around some of the acquisition's more monolithic features by, for example, involving only a subset of the deal parties, dealing with only a small and specific slice of risk, or expanding or contracting the acquisition agreement's timeframe. This subsection discusses each of these in turn, and analyzes how increasing deal precision through ancillary agreements improves dealmaking efficiency. Like modularity, ancillary agreements that are used to increase deal precision appear to lower dealmaking costs on the front end and reduce enforcement costs on the back end.

a. *Party Specificity*

Parties to acquisition agreements usually include the buyer, the seller, the target (which may be a division or subsidiary of the seller), and a small number of other parties that may be essential to the transaction—like a majority stockholder, or a nonoperating corporation that will be included in the structure for regulatory reasons.[87] Ancillary agreements usually do not include the same slate of parties as acquisition agreements. Rather, ancillary agreements generally include some subset of the acquisition agreement's parties, or bring in others who are not party to the acquisition agreement at all. When an ancillary agreement functions to bind parties *other than* the exact slate of parties that sign the acquisition agreement, it is increasing the party specificity of the deal—it is identifying some part of

87 *See, e.g.*, Comcast–Time Warner Agreement, *supra* note 33, at A-1 (listing the parties to the acquisition agreement as only Time Warner, Comcast, and a merger subsidiary).

the deal that pertains only to a certain subset of parties, and crafting a separate agreement that pertains only to that subset.

Dealmakers need not, as a contractual matter, use ancillary agreements to increase party specificity. For example, suppose that Adam, Beth, Carla, and David are all parties to the acquisition agreement, but there is a specific provision *X* that pertains only to Carla and David. The acquisition agreement could be drafted so that all parties agree to the acquisition agreement, except that Adam and Beth specify that they do not agree to provision *X*, and Carla and David specify that they do. This arrangement, however, rarely occurs in complex M&A deals. Instead, a separate ancillary agreement containing only *X* is drafted, and only Carla and David are party to that agreement.

Parties may prefer using separate ancillary agreements for party-specific issues to reduce both front- and back-end deal costs. On the front end, carving out separate agreements can reduce contract drafting costs. In general, parties to complex M&A deals are represented by a parade of expensive advisors, each of whom is paid to comb through and negotiate, in detail, every document to which his client is a party. If a particular provision pertains only to Carla and David, there is no reason for Adam and Beth (and their advisors) to spend time reviewing it—it is cheaper for Adam and Beth if that provision is in a separate document that only Carla and David review. This arrangement may also be cheaper for Carla and David, because it means fewer parties at the negotiating table, which reduces negotiation and drafting time. On the back end, if ancillary agreement *X* is litigated, only Carla and David need participate, reducing enforcement costs.

Ancillary agreements may also be the *only* way to add party precision when deal parties are trying to bring in, for certain provisions, parties who are not otherwise part of the acquisition agreement. Sometimes, parties are added into the deal via ancillary agreements for fairly innocuous administrative reasons. This is especially true in deals that involve the assignment of globally registered intellectual property. Consider the recent decision by Kentucky company Hillerich & Bradsby to sell its Louisville Slugger brand to Wilson Sporting Goods, a division of Finnish sports equipment maker Amer Sports Corp.[88] A significant part of the performance of these kinds of deals, where a brand is sold, is accomplished by the seller assigning its global intellectual property rights to the buyer. It is not particularly likely, however, that either of the parent companies of the seller or the buyer—the parties most likely to have signed the acquisition agreement—owns the relevant rights directly. Instead, each may hold its rights via a subsidiary or series of subsidiaries. Rather than include those subsidiaries in

88 Bruce Schreiner, *Louisville Slugger Maker Selling Brand to Rival Wilson*, CINNCINATI.COM (Mar. 23, 2015, 12:51 PM), http://www.cincinnati.com/story/sports/2015/03/23/louisville-slugger-maker-selling-brand-to-wilson-sporting-goods/70325620/ [https://perma.cc/97TH-YT23].

the acquisition agreement, a series of assignment agreements are used to assign the rights. For example, one agreement may assign the Louisville Slugger trademark (registered in Spain) from Hillerich's European subsidiary to Wilson's Spanish operating company, another may assign the Hong Kong registered trademark from Hillerich's Hong Kong company to Wilson's Hong Kong company, and so on. Through a series of individual ancillary agreements, each of the seller's and buyer's relevant subsidiaries are brought into the deal, but only for the small portion of the deal that touches on their interests.

At times, however, parties add ancillary agreements to pull in deal parties for less innocuous reasons. Delaware's merger statute provides that the target's minority shareholders do not need to approve a private company merger.[89] Instead, once the target's majority shareholders and the buyer have agreed to a deal and closed it, the minority shareholders receive an ancillary agreement—a letter of transmittal—that facilitates the exchange of the minority's shares for consideration.[90] The letter of transmittal itself is a fairly innocuous deal precision device: it only pulls minority shareholders into the deal for the part of the deal that concerns them (the exchange of shares and money).[91] In recent years, however, parties have slipped extra provisions into the letter of transmittal. For example, through letters of transmittal, minority shareholders have given general releases of liability to the buyer, or indemnified the buyer postclosing.[92] In a recent Delaware case, *Cigna Health and Life Insurance Co. v. Audax Health Solutions, Inc.*, the court found those extra provisions unenforceable.[93] But before *Cigna*, extra provisions in letters of transmittal were a common way to rope minority shareholders into parts of the deal that were against their interests.[94]

In most cases, however, no matter the rationale, using party-specific ancillary agreements reduces litigation and enforcement costs. When a particular intellectual property assignment is litigated, for example, only the two subsidiaries that actually transfer and receive the assignment need to be involved, which reduces litigation costs. Even in cases like *Cigna*, where an inappropriately small subset of interested parties are separated out into an ancillary agreement, party specificity

89 DEL. CODE ANN. tit. 8, § 251(h) (2015).

90 *See id.* § 251(b).

91 Sharon Reier, *What to Do with Stock Certificates After a Merger: Cleaning up the Paperwork*, N.Y. TIMES (May 29, 1999), http://www.nytimes.com/1999/05/29/your-money/29iht-mside.2.t.html [https://perma.cc/ZKD5-NZS2].

92 *See* CLEARY GOTTLIEB STEEN & HAMILTON LLP, WAKE UP CALL FOR PRIVATE M&A DEAL STRUCTURING 2 (2014), http://www.cgsh.com/files/News/d4fe3f29-2901-4a64-9d2d-83c78447565e/Presentation/NewsAttachment/120369ef-badb-4667-9611-855a27e6b0dd/Wake%20Up%20Call%20for%20Private%20M%M%26A%20Deal%20Structuring.pdf [https://perma.cc/7UF7-L7T3] [hereinafter CLEARY, WAKE UP CALL] (explaining how dealmakers leveraged the customary letter of transmittal to obtain "a panoply of agreements and obligations to [their] benefit").

93 107 A.3d 1082, 1099 (Del. Ch. 2014).

94 *See* CLEARY, WAKE UP CALL, *supra* note 92, at 1 (describing the practice as "ubiquitous" and the "structure of choice" for dealmakers before *Cigna*).

can reduce litigation costs: the smaller subset can join additional interested parties to the litigation as necessary.[95] In contrast, in cases where litigation commences with too many parties (including some who have little stake in it), it is harder (and more expensive) for those uninterested parties to extract themselves from the litigation.

b. *Risk Specificity*

The *Cigna* case is also a good example of how ancillary agreements can carve out small portions of risk from acquisition agreements and increase deal precision. Under Delaware's merger statute, private company mergers like the *Cigna* merger require the approval of the target company's board and majority shareholders.[96] The majority shareholders also sign the acquisition agreement, and, through that, take on a certain portion of postclosing risk.[97] The minority shareholders, however, do not sign the acquisition agreement and therefore do not assume that postclosing risk. The improper letter of transmittal in *Cigna* was an ancillary agreement by which some postclosing risk was carved out of the acquisition agreement and passed specifically to the minority shareholders.[98] To be sure, acquisition agreements are full of risk-shifting provisions. *Cigna*'s letter of transmittal carved out and shifted just two small slivers of postclosing risk, leaving much of the risk still to be borne by the majority shareholders.[99] Other ancillary agreements also can shift small portions of risk in complex M&A deals. Opinion letters—letters in which a banker or lawyer certifies that the deal is a good one for shareholders, or that the deal will be treated as a tax-free reorganization—shift risk from the parties to the advisors.

As with improvements to other types of specificity, improving risk specificity can make the dealmaking process more efficient and reduce litigation and enforcement costs down the road. Moreso with risk specificity than with other types of specificity, though, there is a tradeoff between (1) deal efficiency and cost reduction, and (2) the policy of protecting nonconsenting parties in deals. Returning to the *Cigna* example helps clarify this tension. In *Cigna*, indemnification appeared in the acquisition agreement and the supporting documents (both signed by consenting stockholders), and in the letter of transmittal (signed by nonconsenting stockholders).[100] As such, all shareholders, consenting or not, agreed

95 To the extent that multiple parties share similar claims and there is a fear that multiple party-specific litigations may yield inconsistent adjudications, existing joinder rules mitigate these fears. *See, e.g.*, FED. R. CIV. P. 19 (setting forth when joinder of additional parties to a dispute is required).

96 DEL. CODE ANN. tit. 8, § 251(h) (2015).

97 *See generally* CLEARY, WAKE UP CALL, *supra* note 92 (analyzing the rise of letters of transmittal in private mergers and the effect of *Cigna* on private mergers going forward).

98 *Cigna*, 107 A.3d at 1085-86.

99 *See id.* at 1086-87 (detailing the provisions of the transmittal letter, which included general release and indemnification clauses).

100 *Id*. at 1085-86.

to indemnify the buyer.[101] This broad indemnification creates a level of protection for the buyer that cannot be achieved when an indemnification is in the acquisition agreement alone. Anthony Casey argued recently that firms use asset partitions with an overlay of cross-guarantees and cross-defaults so that, should one financed project fail, a creditor can selectively enforce its right against either the whole firm or just a portion of it.[102] The complex "corporate web" created by partitions and cross-liabilities creates a more precise risk relationship between creditors and borrowing firms, which creates value by lowering both the creditors' monitoring and enforcement costs and the borrowing firm's cost of capital.[103]

In *Cigna*, ancillary agreements reduced the buyer's deal risk, and, by extension, the buyer's deal costs. Often in deals, the buyer and seller have different valuations of the target—for example, the seller thinks the target is worth *X*, while the buyer thinks the target is worth *X*-5.[104] A mechanism that can bring the two parties' valuations closer together saves deals that would otherwise be lost, thereby creating value.[105] While Gilson uses an earnout provision as an example of a provision that brings parties' values closer together, an ancillary agreement that lowers the buyer's deal costs also achieves the same goal—more deals happen when parties are able to be closer in valuation of the target. The indemnification in *Cigna* served the same purpose—it lowered the buyer's risk and costs, making it more likely that the parties would agree on a deal.

General releases, like those used in *Cigna*, can also serve a similar function. Unlike the indemnification, which appeared in both the acquisition agreement and an ancillary agreement, the general release in *Cigna* appeared only in the ancillary agreement.[106] At first blush, this provision-allocation decision is somewhat puzzling. Why exclude the general release from the acquisition agreement, which the majority signs? One possibility is that isolating the risk associated with the general release reduces back-end litigation and enforcement costs. The purpose of a general release is to release the buyer, broadly, from postclosing claims. If a shareholder who has signed the release sues the buyer postclosing, the buyer will point to the release to have the case dismissed. If

101 *Id.* at 1085.

102 *See* Anthony J. Casey, *The New Corporate Web: Tailored Entity Partitions and Creditors' Selective Enforcement*, 124 YALE L.J. 2680, 2685 (2015) (arguing that firms partition assets across multiple dimensions to allow selective enforcement in the case of a default, thereby reducing monitoring and enforcement costs and ultimately the cost of capital).

103 *See id.* ("The availability of these enforcement options lowers the firm's cost of capital because creditors can more effectively monitor risk and respond to defaults.").

104 *See* Gilson, *supra* note 26, at 262-63 (discussing differences in the valuation of a business by a buyer versus that of a seller and how these differences can result in "inaccurate pricing" or even "no transaction").

105 *See id.* at 263 ("The lawyer can increase the value of the transaction if he can devise a transactional structure that creates homogeneous expectations.").

106 *Cigna*, 107 A.3d at 1085-86.

the general release is part of the acquisition agreement, however, the buyer may need to point to the general release provision *within* the acquisition agreement—which is full of sensitive information. Separating out the general release, which is likely to be useful in many future litigations, makes the general release a nimble, usable document in later litigation. This makes future litigation easier and cheaper.

While *Cigna* is a good example of how ancillary agreements lower costs by adding deal specificity, it also shows how ancillary agreements can disadvantage parties that are not signatories to the acquisition agreement. In *Cigna*, the acquisition agreement's signatories took some of the deal's risk and attempted to offload it to a nonsignatory group—the minority shareholders. Although the court found that risk allocation improper under Delaware's merger statute, parties had been offloading that risk onto minority shareholders through an ancillary agreement for years before *Cigna* went to court. Furthermore, even outside the letter of transmittal context, ancillary parties may be disadvantaged. For example, an employee who is not a majority shareholder may sign an employment agreement without knowing the full details of the acquisition agreement. She may not have as much bargaining power in her negotiations as a majority shareholder who also signs a separate employment agreement.

c. *Time Specificity*

An acquisition agreement comes into effect when it is signed, and generally loses its potency at closing.[107] But parties interact before signing, and often continue interacting postclosing. Ancillary agreements that deal with parts of the bargain that exist before or after the acquisition agreement can also add value to deals by governing those earlier or later timeframes.

Some agreements that parties sign before the acquisition agreement, like letters of intent or memoranda of understanding, are preliminary agreements—they contain the bare-bones, material terms of the eventual acquisition agreement.[108] There is a rich literature on how preliminary agreements add value to deals—namely, that they help parties deal with early-stage uncertainty and deal complexity.[109] This Article sets aside the discussion of preliminary agreements, and, of the agreements entered into before the acquisition agreement is signed, focuses only on the confidentiality agreement.

107 *See* Kling et al., *supra* note 33, at 804-05 (noting that most representations and warranties do not survive closing).

108 *See* Schwartz & Scott, *Precontractual Liability*, *supra* note 38, at 664 (describing preliminary agreements as written memorializations of the parties' intent where certain material terms are decided, but others are open).

109 *See* Choi & Triantis, *Multi-stage Contracting*, *supra* note 38, at 1 (arguing that commercial agreements are entered into in stages because "uncertainty and transaction costs make it infeasible for the parties to settle on core issues of their contract" and also because "some agreements are simply too complex or time-consuming to be completed in a single stage").

Unlike preliminary agreements, confidentiality agreements are not bare-bones versions of acquisition agreements. Instead, confidentiality agreements govern party behavior during deal negotiation. They straddle the line between ancillary and preliminary agreements—they govern a specific sliver of party interaction (like ancillary agreements) but are signed before the acquisition agreement (like preliminary agreements).[110] Because confidentiality agreements are generally the first agreements signed in potential deals, they play a critical role in creating space for parties to consider deals.[111] In the preliminary negotiation stage, parties want to share information to evaluate the deal's potential, but also hesitate to share information for fear of its misuse (e.g., to poach each others' employees, or to reverse engineer proprietary technologies). Confidentiality agreements help to resolve that tension because parties agree to use confidential information only for deal evaluation.[112] In much the same way as the techniques Gilson describes,[113] confidentiality agreements create economic value by bridging parties' differences and making deals possible in the first place.

Parties similarly use ancillary agreements, such as transition services agreements, leases of real property, and employment agreements, to govern postclosing party interactions.[114] These agreements cover parts of the deal that are essential to making the deal worthwhile, but that exist outside the acquisition agreement's timeframe. Without an ancillary agreement to unbundle that timing mismatch from the acquisition agreement, the deal may not be possible, because those essential ongoing interactions may not be able to occur. Like confidentiality agreements, these ancillary agreements can be understood as deal technologies that save deals that would die in their absence.

While ancillary agreements that improve time specificity can be primarily thought of as a way to design deals efficiently on the front end, they can also reduce execution costs after a deal is done.[115] As previously discussed, separating out postclosing obligations through an agreement like a transition services agreement cabins the postclosing obligation to its own module, which makes it easier for individuals to execute those obligations.

The need for time specificity also helps explain why the same parties may enter into several agreements instead of one. Consider, for example, the unbundled, time-specific nature of long-term procurement contracts between suppliers and

110 *See* Hahn, *supra* note 42, at 1396.

111 *Id.*

112 *See id.* ("A confidentiality agreement represents the dual interests of the parties in protecting confidential information shared in order to evaluate whether to proceed with a merger."); *see also* IGOR KIRMAN, M&A & PRIVATE EQUITY CONFIDENTIALITY AGREEMENTS LINE BY LINE (2008).

113 *See* Gilson, *supra* note 26, at 271-73 (discussing the benefits to both the buyer and seller in a deal from cooperating and reducing the information asymmetry).

114 *See supra* Section I.B.

115 *See supra* Section I.B.

original equipment manufacturers.[116] Parties enter into an initial contract—a lengthy master supply agreement that "cover[s] many of the core legal aspects of a supply contract."[117] At a later time of sale, these *same* parties enter into an additional contract—a purchase order—that specifies additional terms, like quantity.[118] In these long-term procurement contracts, parties strike one deal to buy and sell. But they use multiple contracts entered into at different times—an unbundled bargain—to give their one deal more time specificity.[119]

B. *Alternative Explanations for Unbundling: Anticipated Critiques and Responses*

This Article has argued that unbundled bargains are an efficient way to design deals. This Section addresses some anticipated alternative explanations for unbundled bargains' existence. One important caveat, however, should be addressed upfront. Suppose that one of these alternative explanations is true: unbundled bargains are not the result of considered contracting innovation, but rather are (1) an accident of path dependency, (2) the result of a principal–agent problem, or (3) a way to dodge disclosure. These explanations still do not negate the fact that unbundled bargains appear to make deals easier to execute, cheaper to enforce, and less likely to be litigated—all efficiency-enhancing benefits. In reality, the question of why unbundled bargains arose is not nearly as interesting as the question of what unbundled bargains actually do.

1. Precedent and Path Dependency

One set of critiques may suggest that unbundled bargains are not the result of considered contracting decisions, but rather the result of a slow-changing transactional practice's attachment to forms and precedent, and a sense of path dependency once those precedents are established.[120] An attachment to precedent acquisition agreements makes it hard for a deal lawyer to add new terms into the deal without using a new ancillary agreement. Thus, once that ancillary agreement

116 *See* Lisa Bernstein, *Beyond Relational Contracts: Social Capital and Network Governance in Procurement Contracts*, 7 J. LEGAL ANALYSIS 561, 566 (2015).

117 *Id.*

118 *Id.*

119 Bernstein describes in detail the many parts that make up an unbundled procurement bargain. These parts include not just the master agreement and additional purchase orders, but also "the lengthy sets of terms contained in buyer-drafted Supplier Quality Manuals, Supplier Codes of Conduct (or Ethics), and Environmental Handbooks. Among other things, these handbooks contain detailed manufacturing process specifications, ethical sourcing requirements, environmental responsibility guidelines, and a description of the roles the buyer's employees are entitled to play in the supplier's production process. Any conflicts between the provisions of these writings are resolved by reference to the agreement's stated hierarchy of authority." *Id.* at 567-68 (footnotes omitted).

120 *See, e.g.*, Marcel Kahan & Michael Klausner, *Path Dependence in Corporate Contracting: Increasing Returns, Herd Behavior and Cognitive Biases*, 74 WASH. U. L.Q. 347, 359-65 (1996) (arguing that behavioral biases, rather than increasing returns, may lead to industry standardization of contracts).

becomes part of a deal and that deal becomes the precedent for another deal, that ancillary agreement is there to stay.[121]

While this explanation for the rise of unbundled bargains may hold some truth, it should not undermine the fact that unbundled bargains appear to have efficiency benefits. It is no secret that deal lawyers rely on precedent for almost every aspect of a deal. When starting work on a new deal structure, one lawyer will likely call another and ask for a precedent checklist, which will provide a roadmap for the types of documents needed for that deal. More experienced lawyers will often have precedent agreements that they prefer to use as templates for future deals, and will modify those templates with provisions from other templates that they like. A partner may have whole precedent transactions that she particularly likes to use as a template, and even a first-year associate will begin to build her personal library of corporate profiles, confidentiality agreements, and opinion letters that she has used in the past.

But adherence to precedent is not necessarily inefficient. Victor Fleischer, for example, notes that "[f]orms and precedent are undoubtedly the backbone of corporate practice and there is often no reason to start from scratch."[122] Blank-page drafting is, at a minimum, time-consuming—even taking the time to type hundreds of pages from scratch consumes many hours. Moreover, precedent can improve dealmaking in four ways, three that reduce front-end design costs and one that reduces back-end litigation costs. First, because deal terms are often complex and convoluted, precedent documents have the benefit of containing ironed-out language. This saves the lawyer from spending time drafting new terms. Second, in negotiations, deal lawyers often discuss whether or not a particular deal term is "market"—that is, whether it falls within the current market norms. A lawyer who uses a precedent deal can often name her precedent and, in negotiations, support her position by noting that a previous deal used the term she is proposing. This cuts down on negotiation time. Third, because of widespread precedent use, many deal documents are now remarkably similar. Similarity in deal document organization makes it easier to find a particular term, and easier to spot terms that are off market, or at least different from other deals' terms. This reduces dealmaking time, because lawyers do not have to spend time learning a new document organizational structure with each new deal. Marcel Kahan and Michael Klausner identify this phenomenon as a "network benefit[]," and discuss the fact that contractual network benefits can mirror the learning benefits of network products like standardized

121 *See* Davidoff & Sautter, *supra* note 26, at 709-10 (quoting one lawyer who stated that once a particular term—in this case, a lock-up—gets into a deal, "pressure builds on lawyers to ask for the same in their next deal . . . . [A]s soon as there are a handful of examples, the precedent-based argument becomes the downhill snowball").

122 Victor Fleischer, *Deals: Bringing Corporate Transactions into the Law School Classroom*, 2002 COLUM. BUS. L. REV. 475, 483.

hardware.[123] This standardization increases contract quality, lowers drafting and enforcement costs, and makes it easier for investors to price terms.[124] Fourth, and perhaps most important, many precedents have the benefit of having been tested in litigation: if a lawyer uses a precedent that has come out of litigation decided in her favor, she can be more confident that a lawsuit involving her deal will also be decided in her favor.

One final thought on path dependency: the market for legal deal advice is competitive. Price competition is fierce, and lawyers who invent legal technologies that save clients money are handsomely rewarded with more clients and more deals.[125] Against this backdrop, it is expected that inefficient practices would be winnowed out, and that, if unbundled bargains are inefficient, one law firm would have noticed this inefficiency and been handsomely rewarded for their innovative contracting practices.

2. Lawyers as Agents

Another set of critiques suggests that unbundled bargains are not evidence of efficient transactional practice, but rather the result of concerted efforts by lawyers to extract more fees from clients. These critiques piggyback on the principal–agent problem in the client–lawyer relationship. A deal lawyer's relationship to her client bears strong resemblance to the agent–principal relationship, and thus, has the potential to be fraught with the classic problems of any agency relationship. In the context of M&A, one might argue that unbundling a bargain means more hours can be billed, which maximizes a deal lawyer's interest in collecting more fees rather than a client's cost reduction interest. To take this critique one step further, the tension between the lawyer's and client's goals is exacerbated by two assumptions about transactional practice: deal lawyers get paid only for front-end deal design, and deal lawyers always bill for work by the hour. If these assumptions are true, then unbundled bargains may have arisen simply to boost deal lawyers' profits.

This argument, however, has several flaws. First, it relies on an overly simplistic characterization of deal lawyers as agents. The relationship between clients and lawyers is only somewhat similar to a typical principal–agent relationship. Features of the legal industry mitigate problems inherent in many agency

123 *See* Kahan & Klausner, *supra* note 120, at 351-52 (discussing the benefits of network-benefit contractual provisions over time).

124 *Id.*

125 *See, e.g.*, Shayndi Raice, *How Tax Inversions Became the Hottest Trend in M&A*, WALL ST. J.: L. BLOG (Aug. 5, 2014, 11:21 AM), http://blogs.wsj.com/law/2014/08/05/how-tax-inversions-became-the-hottest-trend-in-ma [https://perma.cc/CAW6-NT68] (reporting on how lawyers on a law firm retreat "figured out a [tax inversion] plan that could persuade clients to take the brakes off M&A," and were able to benefit handsomely from the deal innovation).

relationships. Deborah DeMott calls lawyers "[d]istinctive [a]gents,"[126] and argues that a lawyer's good behavior is monitored not just by clients, but also by courts (which can sanction lawyers for bad behavior) and peers (who can self-regulate).[127] As a result, although lawyers *are* agents, the fact that that lawyers are answerable to nonclients who help monitor their behavior mitigates the bad behavior one would expect from a more typical agency relationship.[128]

Moreover, assumptions about the legal industry that may exacerbate the agency problem are not necessarily present. For example, it is easy to assume that because a deal lawyer is only involved in front-end deal design, a deal lawyer's goal is to maximize billing on the front end, without considering back-end enforcement costs. If this were true, then deal lawyers, regardless of whether they are acting as good or bad agents, would always try to increase front-end billing. A good agent might argue that more front-end billing makes deals better and ignore the fact that, at some point, the cost of adding precision on the front end is more expensive than rolling the dice on the low probability of back-end enforcement costs. A bad agent might not care if front-end billing makes a deal better, and care only that front-end billing is a way to extract more rent from the client.

In reality, however, neither a good nor a bad lawyer focuses only on the front end of deal design. The market for providing deal advice is competitive, so even front-end focused lawyers cannot unnecessarily drive up the client's bill, for fear of the client taking her business elsewhere. Additionally, clients and lawyers are repeat players. A deal lawyer is highly incentivized to provide good counsel, good service, and reasonable prices to a client. If a lawyer routinely turns out a bad product that ends up being litigated, a client is likely to take her future business elsewhere. Finally, law firms that provide elite front-end advice often also provide elite back-end advice. Deal lawyers stand to gain from driving up front-end costs, but *also* gain when the client returns to the same firm for litigation advice.[129]

The second and related assumption that could exacerbate the agency problem is that deal lawyers generally bill by the hour. The assumption is that hourly

126 Deborah A. DeMott, *The Lawyer as Agent*, 67 FORDHAM L. REV. 301, 311 (1998).

127 *Id.* at 305-06.

128 *See id.* ("[T]he lawyer's membership in a self-regulating profession limits the reach of the lawyer's agency relationship with the client as the source of the client's rights and the lawyer's obligations.").

129 A client returning to the same firm that provided him front-end advice for back-end advice is not as farfetched as it seems. Sophisticated clients understand that most major deals are litigated—regardless of the quality of front-end deal advice—so a deal being litigated is not necessarily due to the error of deal lawyers. Moreover, a client may have an ongoing relationship with a certain firm that makes it beneficial for the client to return to the same firm for litigation advice. For example, a client may have a firm on retainer, receive a discount for services from a particular firm, or believe that having its original deal lawyers available to advise on the litigation is cost-efficient. *See* CORNERSTONE RESEARCH, SHAREHOLDER LITIGATION INVOLVING MERGERS AND ACQUISITIONS: REVIEW OF 2013 M&A LITIGATION 1 (2014), https://www.cornerstone.com/GetAttachment/73882c85-ea7b-4b3c-a75f-40830eab34b6/-Shareholder-Litigation-Involving-M-and-A-2013-Filings.pdf [https://perma.cc/7S9G-7VCK] (reporting that in 2013, 94% of M&A deals valued over $100 million were litigated).

billing incentivizes all lawyers to drive up front-end deal costs, which misaligns with the client's interest in reducing deal costs. In fact, however, some law firms explicitly charge clients a flat fee,[130] and still others give clients large and arbitrary discounts that essentially change hourly billing into flat fees. Yet even when fees are fixed, unbundling occurs. This suggests that unbundling may not be driven entirely by lawyers' self-interest, because even lawyers who bill a flat fee (and who stand to gain by minimizing hours worked) use unbundled bargains.

3. Disclosure Differentiation

Finally, a third critique assumes away any complacency on the part of lawyers. Instead, it argues that unbundled bargaining is a bad thing because it allows companies to obscure certain parts of deals. Both public and private companies may want to engage in disclosure differentiation. Public companies may use ancillary agreements to obscure parts of the deal from the public, while private companies may use ancillary agreements to obscure parts from internal stakeholders. Each is described here.

Private companies are companies that are not traded on a public securities exchange. They are not required to register with the Securities and Exchange Commission (SEC), and their public disclosure obligations are set by state laws, which generally require little more than a public filing of formation documents (such as a short charter).[131] Still, when a private company engages in an M&A deal, documents governing parts of the bargain make their way around the company. A transition services agreement, for example, may be passed along to the division that is offering the ongoing services, and an employment agreement may make its way to the human resources department. Using ancillary agreements to unbundle the M&A bargain may be a way to separate information, so that when a particular division or individual needs a piece of deal-related information, only the smallest pieces are passed around.

This kind of disclosure differentiation may be efficient for two reasons. First, consider a private company with two founders, *A* and *B*, each of whom owns half the company. The buyer wants to retain both postclosing, but *A* is a squeaky wheel who wants $1 million per year, and *B* is happy with half as much. Because both *A* and *B* are signatories to the acquisition agreement, in theory, their employment terms could be part of the acquisition agreement. But if the two

130 *See* Susan Beck, *A Glimpse into Wachtell's Mysterious Billing Structure*, AM. L. DAILY (Jan. 8, 2015), http://www.americanlawyer.com/id=1202714414505/A-Glimpse-Into-Wachtells-Mysterious-Billing-Structure [https://perma.cc/4FRV-NUAY] (reporting that the elite New York law firm Wachtell, Lipton, Rosen & Katz, which is well-known within the industry for charging a flat fee, "typically charges clients fees for M&A deals that range from 1 percent to 0.1 percent of the transaction amount").

131 Howard Liebman, *Public Disclosure Requirements for Private Companies: U.S. vs. Europe*, JONES DAY (Oct. 2012), http://www.jonesday.com/public_disclosure_requirements [https://perma.cc/TGW5-EN7B].

agreements are separated out of the acquisition agreement, neither *A* nor *B* will know each other's compensation, which means *B* will be unable to negotiate for a higher amount based on *A*'s demands. In fact, employment agreements usually *are* separated out—doing so lowers the buyer's costs (because *B* is less likely to negotiate for a higher salary). Like many deal technologies discussed here, this one bridges a gap between what the buyers and sellers want.

A second, related reason for private company disclosure differentiation is a soft factor: disclosure differentiation soothes hurt feelings. In many cases, M&A transitions can be hard—rank and file employees worry that they will not like their new employers or that their job security will be threatened. They are also likely to find parts of the deal unsavory—for example, they may find that the CEO's exit package is grossly large, and represents the CEO "selling out" to a behemoth that nobody likes. Obscuring certain details about the deal—like the CEO's exit package—helps mitigate those dips in morale.

For public companies, these efficiency rationales also hold: disclosure differentiation can reduce deal costs for the buyer and perhaps mitigate changes in rank and file morale. However, since public companies give up much of their right to disclosure differentiation when they become public, their use of ancillary agreements to achieve efficiency is more suspect. Public companies—companies with securities traded on a public exchange, like the New York Stock Exchange or Nasdaq—are required to disclose material contracts not made in the ordinary course of business to the SEC.[132] In practice, this means that for a material M&A deal, companies disclose acquisition agreements,[133] but they often do not disclose ancillary agreements—even ones that are essential parts of the bargain.

Perhaps in no place is the oddity of public company disclosure differentiation more stark than in REIT separation deals. In 2010, HCP, a REIT, bought the real property of HCR ManorCare, a company that operates more than 300 nursing homes.[134] Because REITs enjoy tax advantages, the deal would lower overall tax payments. An essential part of the HCP–ManorCare deal—and, indeed,

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132 *See* Jim Moloney et al., *What's the Big Deal? Why Some Seemingly Material Acquisition Agreements Might Never See the Light of Day*, DEAL LAW., Nov.–Dec. 2014, at 1, 1 , http://www.gibsondunn.com/publications/Documents/Moloney-Titera-Hill-Whats-the-Big-Deal-Deal-Lawyers-2014.11.pdf [https://perma.cc/ TS5C-YLL8] (discussing the materiality analysis under items 601(b)(2) and (b)(10) of Regulation S-K, which requires material contracts not made in the ordinary course of business to be filed with the SEC).

133 *See* Additional Form 8–K Disclosure Requirements and Acceleration of Filing Date, 69 Fed. Reg. 15,594, 15,596 (Mar. 25, 2004) (noting in the release issued concurrently with the adoption of disclosure requirements in Item 1.01 of SEC Form 8-K, to be codified at 17 C.F.R. pts. 228-230, 239-240, 249, that Item 1.01 "requires the disclosure of material definitive agreements entered into by a company that are not made in the ordinary course of business" and that "[this] item parallels Items 601(b)(10) of Regulation S–K with regard to the types of agreements that are material to a company").

134 Michael J. de la Merced, *Carlyle to Sell ManorCare Real Estate for $6.1 Billion*, N.Y. TIMES: DEALBOOK (Dec. 14, 2010, 4:14 AM), http://dealbook.nytimes.com/2010/12/14/hcr-manorcare-in-6-1-billion-deal-with-hcp [https://perma.cc/G2DE-LHFD].

a key selling point of many such deals—was that, postclosing, the buyer leased back the real property to the seller.[135] It is hard to imagine how the deal could have been done without the promised leaseback, which was governed by a master lease.[136] For ManorCare, the leaseback meant that it could continue to provide services undisturbed (and could gain a hefty sum from the sale of its real property, without disturbing its services). For HCP, the leaseback meant that the more than 300 commercial nursing properties it acquired in the deal had ready and steady tenants (in fact, tenants who were flush with cash from HCP's payment). Nonetheless, when the parties announced the deal, they filed only the main acquisition agreement, and not the essential master lease, even though the deal would not have been possible without the master lease. The master lease—an ancillary agreement, but one of enormous import—was able to be disclosed differently from the acquisition agreement, even though it was part of the unbundled bargain.

Disclosure differentiation is a tricky critique to address. On the one hand, in the case of both private and public companies, disclosure differentiation has some efficiency-promoting properties. On the other hand, in cases involving public companies—and especially in cases like REIT M&A deals—it is hard to justify why one essential deal document is disclosed and the other is not. One way to address public company disclosure differentiation is through the securities laws and regulations. For example, disclosure requirements could be tweaked so that *all* contracts relating to a material *deal* (rather than just "material contracts") must be disclosed. A narrower version of this might demand that all *major* contracts of material deals be disclosed.

The change above requires that securities regulators recognize that a set of contracts could be an unbundled bargain. Reframing a set of related contracts as an unbundled bargain could lead to more accurate disclosure of the parties' intent related to a material deal.

C. *Redefining the Boundaries of the Deal*

Ancillary agreements are ubiquitous in M&A deals. Regardless of why they arose—as a more efficient way to make deals or as a way to further lawyers' self-interest—they indisputably do exist in concert with the acquisition agreement to form deals. M&A deals are unbundled bargains: they are deals that are governed by multiple agreements, rather than just one.

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135 *See* HCP, Inc., Current Report (Form 8-K) 4 (Dec. 13, 2010) [hereinafter HCP Report] ("Immediately after the Closing, certain wholly-owned subsidiaries of PropCo will lease the Facilities to a wholly-owned subsidiary of HCR ManorCare pursuant to a triple-net master lease . . . ."). This is also a key selling point of most similar REIT deals. *See* Polster et al., *supra* note 58 ("Spun-off REITs engage in ongoing lease and contractual relationships with the legacy operating companies.").

136 HCP Report, *supra* note 135, at 4.

Most M&A scholars have focused on the acquisition agreement, so it often appears that the boundaries of a deal end at the acquisition agreement. This confusion is understandable. When deciding whether to keep a particular provision in the acquisition agreement or to parcel it out to an ancillary agreement, an M&A lawyer faces a decision like the one faced by a firm in Ronald Coase's *The Nature of the Firm*.[137] Specifically, Coase noted that the size of a firm—defined by its boundaries—is determined by whether a firm chooses to integrate vertically (by making production components internally) or to buy that component from outside the firm. The former grows the size of the firm (and its boundaries), and the latter does not. Applying this idea to M&A contracting appears to reveal that the boundaries of the deal align with the boundaries of the acquisition agreement. Parceling out a provision to an ancillary agreement shrinks the deal, and keeping a provision in the acquisition agreement does not.

While the M&A lawyer's decisionmaking process may resemble the firm's, however, the result of those decisions on the size of the core unit (the firm or deal) is not the same. When a firm decides to buy from outside the firm, it is making a decision not to grow its boundaries. In contrast, when an M&A lawyer allocates part of a deal to a specialist (rather than keeping it in the acquisition agreement), she is not making an affirmative decision about the size of the deal—instead, she is merely modularizing that part of the deal. The size of the deal remains the same, but part of it is governed by an ancillary agreement, rather than by the acquisition agreement. That particular outsourced provision is not excised from the deal completely. It is simply sequestered.

A better analogy between M&A deals and Coase's firm might be that modular ancillary agreements are like divisions within a firm: they are self-contained, but still part of the whole. If modular ancillary agreements are part of the deal, then the deal and its boundaries are actually much larger than scholars have assumed. That is, the way courts, scholars, and parties think about the deal's boundaries must be expanded, extending that conception to encompass not just the acquisition agreement, but also deal-related ancillary agreements.

To be sure, the assertion that the deal's boundaries extend beyond the acquisition agreement presents a significant line-drawing problem. When a deal's boundaries map perfectly onto the acquisition agreement, the boundaries are clear: the deal ends where the acquisition agreement ends. Extending those boundaries to ancillary agreements can muddle the matter. For example, which ancillary agreements are part of the unbundled bargain? And which ones are actually entirely different deals between the same parties (but perhaps entered into at the same time as the acquisition agreement)? Does approximately contemporaneous signing with the acquisition agreement determine whether an ancillary agreement is

137 *See supra* note 69 (discussing how firm boundaries are established under the Coasean model).

part of an unbundled bargain, or can parts of the unbundled bargain be signed far before or after the acquisition agreement?

Somewhat unsatisfyingly, there is no absolute test to determine precisely the boundaries of a deal. Using a deal checklist as a starting point is a relatively low-cost and low-tech way to determine the approximate deal boundaries, although that method comes with its own shortcomings.

Deal lawyers tend to list everything related to a particular deal in the checklist, so all of the enforceable ancillary contracts on a deal checklist can presumptively be part of the unbundled bargain. Checklists, however, are susceptible to manipulation. Part III argues that if a dispute arises over the interpretation of one piece of an unbundled bargain, the other pieces of that unbundled bargain might provide useful context. If parties know that checklists are used to determine the boundaries of the deal ex post, they may be motivated to change the checklist ex ante in an attempt to influence the context that is considered in later interpretation disputes. Changing the checklist to influence later dispute resolution erodes the usefulness of the checklist as an organizational tool. Moreover, because checklists are nonbinding and nonenforceable, and both can be and *are* changed unilaterally (many times) throughout the deal, their usefulness as boundary-setters is limited to being guideposts, rather than definitive documents.

In the absence of a precise rule for where to draw a deal's boundaries, it is still possible to identify ancillary agreements that fall clearly within the boundaries, those that fall clearly outside, and those that fall at the edge. This Article uses easily identifiable agreements to develop Part III's implications. For example, it assumes that ancillary agreements entered into at roughly the same time as the acquisition agreement, or at the deal's closing, are part of the unbundled bargain.[138] Term sheets and other preliminary agreements are outside the boundaries because they do not augment the terms of the acquisition agreement—rather, they contain an earlier version of some of the acquisition agreement's terms. Confidentiality agreements, as noted, are on the edge of the deal's boundaries: they are entered into at a preliminary stage of the deal, but are not, themselves, preliminary agreements.[139]

III. IMPLICATIONS FOR CONTRACT THEORY AND DEAL DESIGN

Reframing sets of related M&A agreements as unified unbundled bargains has important implications for contract interpretation and deal design. A fresh look at how complex bargains are struck suggests that when parties' intent is memorialized in an unbundled bargain, courts could consider, for example, examining a larger set of deal documents when interpreting deal disputes.

138 For the purposes of interpretation, which is discussed *infra* Section III.B, this subset is further narrowed to only those ancillary agreements that are *enforceable contracts*.

139 *See supra* Section I.B.

Interpreting more deal documents in a deal dispute may also motivate more efficient unbundling in deal design.

The rest of this Part is organized as follows. Section A overviews current textualist and contextualist approaches to contract interpretation. Section B suggests that because bargains are unbundled, it may make sense for courts to consider parts of the deal that are not in the main contracts when interpreting deal disputes. Section C suggests that this approach may improve ex post interpretative accuracy and ex ante deal design. Finally, Section D shows how *Martin Marietta* is better viewed as an unbundled bargain.

A. *Textualism and Contextualism*

Both contract scholars and courts are divided over whether to admit extrinsic evidence to interpret disputed contracts. While textualists argue that generalist courts should not use context to interpret a disputed contract, contextualists argue that courts should (and must).[140] Each method has its own benefits and shortcomings, overviewed briefly here.

Textualism begins with two fairly uncontroversial views. First, "although accurate judicial interpretations are desirable," "no interpretative theory can justify devoting infinite resources to achieve interpretive accuracy."[141] Second, both contract drafting and litigation are costly. The cost of a contract is the sum of (1) its drafting costs and (2) the product of the probability of litigation multiplied by litigation costs.[142] Ex ante and ex post costs are inexorably linked. More investment on front-end drafting reduces the probability of back-end litigation (and associated costs), and less investment (and less specificity) on the front end increases back-end costs. Textualists argue that when drafting contracts, sophisticated parties make a considered decision whether to allocate more time and money to the front-end drafting costs, or whether to roll the dice on back-end litigation costs. As a result, they have already "embed[ded] as much or as little of the contractual context as they wish in a written, integrated contract."[143] Because they have already made this tradeoff, sophisticated parties prefer textualist interpretations

140 *See* Ronald J. Gilson et al., *Text* and *Context: Contract Interpretation as Contract Design*, 100 CORNELL L. REV. 23, 25-26 (2014) ("In a textualist regime, generalist courts cannot choose to consider context; in a contextualist regime, these courts must consider it. Thus text or context."); Alan Schwartz & Robert E. Scott, *Contract Interpretation Redux*, 119 YALE L.J. 926, 931-32 (2010) [hereinafter Schwartz & Scott, *Redux*] (considering several basic differences between textualist and contextualist interpretation regimes). *See generally* Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L.J. 541 (2003) (outlining a modern formalist-textualist theory of contract law and contractual interpretation).

141 Schwartz & Scott, *Redux*, *supra* note 140, at 930.

142 This is a simplified take on Judge Posner's formula, which characterizes the transaction costs C of a contract as $C = x + p(x)[y + z + e(x, y, z)]$, where x is the ex ante contracting costs, p is the probability of litigation, y is the parties' litigation costs, z is the judiciary's costs, and e is judicial error costs. R. Posner, *Contract Interpretation*, *supra* note 65, at 1583.

143 Gilson et al., *supra* note 140, at 26.

of contracts. If they had wanted courts to examine more context when interpreting a contract, the sophisticated parties would have added the context ex ante.

It should come as no surprise that textualists prefer that courts default to a plain meaning rule, use a hard parol evidence rule, and define the boundaries of a contract by its integration clause.[144] The plain meaning rule "supposes the parties to be communicating in the standard language," rather than admitting extrinsic evidence to show that when parties said *X*, they actually meant *Y*, because in their private or technical language, *X* actually meant *Y*.[145] A plain meaning rule prescribes that *X* means *X*. The parol evidence rule is a substantive rule of law that states that courts "will refuse to use evidence of the parties' prior negotiations in order to interpret a written contract unless the writing is (1) incomplete, (2) ambiguous, or (3) the product of fraud, mistake, or a similar bargaining defect."[146] As Eric Posner notes, there are hard and soft interpretations of the parol evidence rule, "each of which turns on the use of extrinsic evidence to determine whether any of the exceptions apply."[147] Textualists prefer a hard parol evidence rule that "restricts courts to a narrow evidentiary base when identifying the contract's terms."[148]

In contrast, contextualists argue that courts *need* to consider extrinsic evidence in contract interpretation both when dealing with unsophisticated and sophisticated contract parties.[149] When one party to a contract is unsophisticated—such as in mass market clickwrap terms and conditions—context should be considered to protect unsophisticated and passive parties from exploitation through take-it-or-leave-it contract terms. When all parties are sophisticated, contextualists argue that they may be communicating in a private, industry-standard language that is not plain on its face. Thus, extrinsic evidence from the parties' course of dealings should be considered in a contract interpretation dispute, so that the nuances of that private language can be ascertained. In fact, contextualists argue that "willfully restricting a court's access to the trove of information bearing on the parties' real relationship degrades judicial interpretation and frustrates the[] parties' efforts to govern their transactions efficiently."[150]

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144 *See id.* ("[S]ophisticated parties prefer textualist interpretation, as embodied in the parol evidence and plain meaning rules and the effect of integration, anti-waiver, and modification clauses."); Schwartz & Scott, *Redux*, *supra* note 140, at 932 (noting that a formalist or textualist interpretation "embodies a hard parol evidence rule, retains the plain meaning rule, gives presumptively conclusive effect to merger clauses [(also called integration clauses)], and, in general, permits the resolution of many interpretation disputes by summary judgment" (footnote omitted)).

145 Schwartz & Scott, *Redux*, *supra* note 140, at 932.

146 Eric A. Posner, *The Parol Evidence Rule, the Plain Meaning Rule, and the Principles of Contractual Interpretation*, 146 U. PA. L. REV. 533, 534 (1998) [hereinafter E. Posner, *Parol Evidence Rule*].

147 *Id.*

148 Schwartz & Scott, *Redux*, *supra* note 140, at 932.

149 Gilson et al., *supra* note 140, at 27.

150 *Id.*

Contextualists prefer a soft parol evidence rule: a rule that uses extrinsic evidence to determine whether the exceptions to the parol evidence rule apply.[151] For example, one exception is that extrinsic evidence can be used to explain terms when a contract is deemed incomplete. An application of a hard parol evidence rule suggests that, if a contract is complete "on its face"—for example, if it is long and detailed, covers many contingencies, and contains an integration clause that states that the contract is complete—then courts will not admit extrinsic evidence.[152] In contrast, contextualists might not presumptively declare such a contract complete, but rather may look for extrinsic evidence that suggests that the contract is incomplete.[153] Eric Posner notes, "In practice, . . . courts adopting this soft version of the completeness exception generally admit all relevant extrinsic evidence, because any inconsistent extrinsic evidence suggests . . . that the contract is incomplete."[154]

Each approach has its shortcomings, and both scholars and courts are divided over which to use for contract interpretation.[155] New York courts (and many others), for example, take a textualist approach, while California courts veer contextualist.[156]

One major criticism of textualism is that it sacrifices accuracy in favor of cost savings. Schwartz and Scott, in their defense of textualism, "concede that a court is more likely to make an accurate interpretation if it sees more evidence, but . . . argue that sometimes accuracy is not worth the costs of achieving it."[157] For example, textualist courts are more likely to grant summary judgment, because they do not need to conduct a trial to examine extrinsic evidence. Ending a trial at summary judgment substantially reduces ex post enforcement costs[158]—so much, in fact, that sacrificing accuracy may be well worth it. Contextualism, on the other hand, is criticized for being a costly way to interpret contracts, because it does not incentivize parties to draft carefully but *does* incentivize perverse

151 *See* E. Posner, *Parol Evidence Rule*, *supra* note 146, at 535 ("The softer courts declare a writing complete only if the extrinsic evidence supports that determination.").

152 *See id.* ("The harder courts declare a writing complete if it looks complete 'on its face.' Writings generally look complete if they are long and detailed, or at least contain unconditional language, cover many contingencies, or at least the most important contingencies, and contain a clause, such as a merger clause, which says that the contract is complete."); *see also* E. ALLAN FARNSWORTH ET AL., CONTRACTS: CASES AND MATERIALS 419-20 (8th ed. 2013).

153 E. Posner, *Parol Evidence Rule*, *supra* note 146, at 535.

154 *Id.*

155 Gilson et al. do a particularly good job of summing up the two sides' arguments. *See generally* Gilson et al., *supra* note 140.

156 Schwartz & Scott, *Redux*, *supra* note 140, at 928; *see also* Bionghi v. Metro. Water Dist., 83 Cal. Rptr. 2d 388, 393 (Ct. App. 1999) (noting that in California, as a default, extrinsic evidence is admissible when "the language of the contract is reasonably susceptible to the meanings urged by the parties," in light of "any evidence offered to show that the parties' understanding of words used differed from the common understanding").

157 Schwartz & Scott, *Redux*, *supra* note 140, at 933.

158 *See* Gilson et al., *supra* note 140, at 41-42 ("[T]extualist interpretation permits legally sophisticated commercial parties to economize on contracting costs by shifting costs from the back end . . . . Importantly, when parties fully integrate the agreement and use a merger clause, an interpretation dispute over contract terms may be resolved on summary judgment, thereby substantially reducing ex post enforcement costs.").

behavior.[159] As Gilson et al. note, under a contextualist interpretation, a party on the losing end of a deal is motivated to argue that the parties meant something *other* than what the contract states on its face.[160] And when parties look hard enough, they "can often find in the parties' negotiations, in their past practices, and in trade customs, enough evidence to ground a full, costly trial, and thus to force a settlement on terms more favorable than those that the contract, as facially interpreted, would direct."[161]

A principal canon of contract interpretation is that, when contracts are in dispute, the court seeks to ascertain the intent of the parties.[162] This Article has argued that M&A deals are unbundled bargains, governed by sets of related contracts. Textualists and contextualists agree that when one contract *provision* is in dispute, other provisions in that contract should be used to provide interpretive guidance—that is, courts should, at the least, look within the boundaries of the disputed contract for interpretive clues.

But how should disputes be interpreted when parties' intent spans not just multiple provisions in one contract, but multiple contracts? Thinking about deals as unbundled bargains complicates an already rich literature on how to interpret contract disputes. When deals are unbundled bargains, the line between what is text and what is context is muddied. Is a particular ancillary agreement part of the unbundled bargain, and therefore a part of the deal's *text*? Or is it not part of the unbundled bargain and therefore *context*?

Although there is much to be said about how to interpret disputes that arise out of unbundled bargains, this Article outlines one potential approach below, which it calls the "permeable approach" to thinking about deal contract interpretation. Discussion of the permeable approach here is not meant to be exhaustive, nor does this Article suggest that the permeable approach is a complete prescription for how unbundled bargain disputes should be interpreted in the future. Rather, the discussion here is meant to serve as a starting point for thinking about how reframing deals as unbundled bargains may change how deal disputes are interpreted.

B. *Integration Clauses Under the Permeable Approach*

The permeable approach suggests that agreements in an unbundled bargain may be useful in interpreting each other. Unlike contextualism, the permeable approach does not propose that most extrinsic evidence be introduced into the

159 *See id.* at 41.

160 *Id.*

161 *Id.*

162 *See* Greenfield v. Philles Records, Inc., 780 N.E.2d 166, 170 (N.Y. 2002) ("The fundamental, neutral precept of contract interpretation is that agreements are construed in accord with the parties' intent.").

interpretation of a contract.[163] Instead, the permeable approach recognizes that unbundled bargains are intentionally memorialized in several contracts and agreements, and suggests that roughly contemporaneous, enforceable pieces could be considered in the interpretation of any one disputed piece. Like a textualist approach, the permeable approach starts from the assumption that sophisticated parties have written down all of their intent in binding and enforceable contracts, and that investigation of the parties' intent ought to be limited to those written, binding, and enforceable contracts. Yet the permeable approach also notes that intent spans many contracts, so an investigation of more than one contract may better ascertain intent.

The permeable approach to interpreting unbundled bargain disputes examines more extrinsic evidence than a strict textualist approach, so it may be more accurate. Compared to contextualism, the permeable approach is cheaper because it only brings into the inquiry executed and enforceable deal components.[164] In striking this middle ground, the permeable approach sacrifices some cost savings in favor of increased accuracy.

Perhaps the most glaring shortcoming of the permeable approach is that it calls into question whether courts should honor parties' intent when that intent is set out in an integration clause. An acquisition agreement invariably contains an integration clause noting that only a certain subset of deal documents—in a public deal, often the acquisition agreement, voting agreement, and confidentiality agreement—constitutes the entirety of the deal. Through an integration clause, parties are explicitly drawing the boundaries of the deal around those few enumerated agreements. Recognizing deals as unbundled bargains, however, suggests that deals extend beyond those integration clauses, and that an integration clause artificially restricts the boundaries of the deal to a small subset of deal documents. Should courts look beyond integration clauses to determine parties' intent?

It is fairly hard to make the case that courts should look outside the integration clause when all parties involved are sophisticated. Textualists argue that sophisticated parties are able to make accurate tradeoffs between front- and back-end contracting costs,[165] and that an integration clause is a front-end decision to limit the scope of back-end interpretation to a few documents.[166] While this argument is compelling, it relies on the assumption that sophisticated parties are carefully engineering

163 In contrast, contextualism would tend to admit any evidence that might shed light on the dispute at hand. *See* 67 Wall St. Co. v. Franklin Nat'l Bank, 333 N.E.2d 184, 186-87 (N.Y. 1975) ("Thus, while the parol evidence rule requires the exclusion of evidence of conversations, negotiations and agreements made prior to or contemporaneous with the execution of a written lease which may tend to vary or contradict its terms, such proof is generally admissible to explain ambiguities therein." (citation omitted)).

164 *See supra* Section II.C.

165 *See* Schwartz & Scott, *Redux*, *supra* note 140, at 963 ("Parties know better than courts how best to trade off these front-end and back-end contracting costs.").

166 *See* Gilson et al., *supra* note 140, at 35 ("Textualist jurisdictions, such as New York, use a 'hard' parol evidence rule that gives presumptively conclusive effect to merger or integration clauses . . . .").

front- and back-end costs.[167] In practice, parties may not be so intentional in their drafting. For example, they may be drafting from a precedent agreement, which had a similarly narrow integration clause. Relatedly, deals may have become more unbundled over time, while integration clauses have not been broadened to reflect this unbundling. Whether courts ought to look outside of integration clauses for interpretive context in deal disputes involving sophisticated parties depends on whether parties are carefully managing front- and back-end costs through integration clauses.

It is somewhat easier to argue that courts should look outside integration clauses in disputes involving a sophisticated party and an unsophisticated party. In these cases, an integration clause may have been put in place at the behest of one party—the sophisticated one—while the unsophisticated party had little opportunity to protest. These situations are common in all sorts of transactions, big and small. Even in simple transactions like car purchases, for example, buyers are often given little opportunity to modify standard purchase agreements. Instead, they are offered ancillary agreements, perhaps for extended service or premium parts, that are part of the unbundled car-buying bargain. In cases involving parties of different sophistication, then, it makes more sense to think of the integration clause as a starting point for determining a deal's boundaries. In fact, even textualist courts have occasionally found that when there is a high degree of overlap between two related contracts, it may make sense to read them together despite the lack of an integration clause.[168]

In any case, the permeable approach argues that even when contract interpretation looks outside of the integration clause, it ought to be limited to an investigation of binding, enforceable contracts, signed roughly contemporaneously with the acquisition agreement or closing, and between the same parties. The reason for limiting interpretation to contracts—rather than opening a full contextualist inquiry—is to limit back-end enforcement costs.

Parties use integration clauses to limit costly contextualist investigation of parties' intent.[169] The permeable approach *also* limits costly investigation by cabining extrinsic evidence considered to other contemporaneous, enforceable contracts between the parties. This, admittedly, does not limit back-end costs as well as a narrow integration clause. In exchange for the additional cost of investigating other

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167 *Id*.

168 Textualist courts have occasionally agreed with this approach when there is a high degree of textual interconnectivity between the contract in dispute and a related contract that is not in dispute. *See, e.g.*, Barrow v. Lawrence United Corp., 538 N.Y.S.2d 363, 366-67 (App. Div. 1989) (finding the overlapping provisions of a purchase agreement and employment contract provided "ample reason" to interpret the documents together).

169 *See, e.g.*, Primex Int'l Corp. v. Wal-Mart Stores, Inc., 679 N.E.2d 624, 627 (N.Y. 1997) ("[T]he purpose of a general merger provision . . . is to require full application of the parol evidence rule in order to bar the introduction of extrinsic evidence to vary or contradict the terms of the writing." (citations omitted)).

parts of the unbundled bargain, however, disputes are able to be resolved in light of a fuller expression of the parties' intent.

One test of whether the permeable approach truly limits cost is to ask whether disputes can still be resolved through summary judgment when parties' intent is determined using this approach. A fully contextualist inquiry can never be resolved on summary judgment because contextualist inquiries always yield issues of fact that require trial.[170] Textualist inquiries, on the other hand, often can be resolved on summary judgment because they begin and end with the words on the page. The permeable approach also examines only the words on the page—it just examines more pages.

* * *

The issue of how to square the permeable approach with integration clauses is, admittedly, a thorny one. The discussion in this Section has been a very preliminary investigation of how the permeable approach may play out in a deal dispute. Like any approach to contract interpretation, it has shortcomings. In this case, the main shortcoming is whether—and how much—ex post contract interpretation should push back against the ex ante intent of sophisticated parties. Fully reconciling this tension is beyond the scope of this paper, but this marks a spot for further research.

C. *Optimal Unbundling*

One interesting feature of the permeable approach—or any interpretive approach that recognizes deals as unbundled bargains—is that it may also motivate parties to design deals more efficiently. Parties want to have the freedom to unbundle,[171] and interpreting deal documents together on the back end may give parties more freedom to unbundle on the front end. Suppose, for example, that parties can choose to put a particular intellectual property provision in an acquisition agreement or in an ancillary agreement. They would prefer to put the provision in an ancillary agreement and assign it to a specialist.[172] Under a textualist approach, putting that provision in an ancillary agreement runs the risk of that part not being considered part of the deal (if, for example, the lawyer forgets to note in an integration clause that the relevant intellectual property agreement is part of the deal). Under the permeable approach, however, regardless whether that provision is in the acquisition agreement or in a separate

170 *See* Schwartz & Scott, *Redux*, *supra* note 140, at 932 ("[S]ophisticated parties prefer textualist interpretation . . . . [It] permits the resolution of many interpretation disputes by summary judgment.").

171 *See supra* subsection II.A.1.

172 *See supra* subsection II.A.1.a.

ancillary agreement, it will be interpreted as part of the deal if it is determined to be within the boundaries of the unbundled bargain.

The permeable approach may also disincentivize parties from obfuscating parts of the deal in ancillary agreements. Suppose that the parties hide an intellectual property provision in an ancillary agreement to improperly avoid disclosure to regulators, counterparties, or third parties. Under the permeable approach, courts, ex post, see no meaningful difference based on whether a provision is in an ancillary agreement or in an acquisition agreement—in either case, it could be part of the bargain. A court would at least *examine* that provision to determine whether it should be used for interpretive context. Thus, in a dispute, provisions improperly hidden in ancillary agreements would be revealed to deal counterparties (and, through court filings, to regulators and third parties). Because the likelihood of disclosure of ancillary agreements increases under the permeable approach, parties are less motivated to use ancillary agreements purely for the purpose of obfuscation.

Under the permeable approach, parties are more likely to have a meaningful choice whether to allocate a provision to the acquisition agreement or to an ancillary agreement. Rather than allocate a particular term into the acquisition agreement to keep it within the boundaries of the deal, parties can allocate that term outside the acquisition agreement and be reasonably assured that if that term is part of the unbundled bargain, it will later be interpreted as part of the deal. When parties have a meaningful choice about where to put a term, the resulting allocation is also more likely to be the result of a reasoned choice, rather than of path dependent contracting.

D. Martin Marietta *as an Unbundled Bargain*

It is helpful to return to this Article's original case study—*Martin Marietta*—to better understand unbundled bargains in action.[173] After *Martin Marietta*, in which a deal was forestalled entirely because of an ancillary agreement, deal lawyers lambasted the courts for reading into the confidentiality agreement an "implied standstill provision" where none was explicitly written.[174] *Martin Marietta* is a particularly good case in which to see this Article's ideas play out, for two reasons. First, confidentiality agreements are a boundary case: they reside at the outermost edge of a deal's boundaries, and share characteristics with both preliminary agreements and ancillary agreements.[175] Thus, if they can be part of an unbundled agreement, then many agreements that are more obviously ancillary agreements—like agreements signed as closing conditions—are certainly within the boundaries of an unbundled bargain. Second, while ancillary agreements

173 *See supra* notes 1–24 and accompanying text.

174 *See supra* note 21 and accompanying text.

175 *See supra* Section I.B.

typically shape or tweak the terms of the main deal, the provisions in *Martin Marietta*'s confidentiality agreement did more than shape or tweak: they prevented a deal from happening at all, or at least in the timeframe the parties wanted. In other words, the *Martin Marietta* confidentiality agreement, an ancillary agreement at the boundaries of the unbundled bargain, had the maximum possible effect on the deal.

A textualist approach to thinking about *Martin Marietta* would suggest that the courts decided the case wrongly. Many deal lawyers, who looked only at the text of the confidentiality agreements, noted that the courts reached far outside the confidentiality agreements' text to ascertain the parties' intent. Under a textualist approach, the confidentiality agreement was a standalone contract, the sophisticated parties knew what was in their contract, and so the courts were wrong to consider extrinsic evidence of prior negotiations in interpreting the contract.[176]

But another way to look at *Martin Marietta* is to think of the confidentiality agreement as one part of an unbundled bargain in the making: as the first step toward an M&A deal between Martin Marietta and Vulcan. Reframing the confidentiality agreement this way means that *Martin Marietta* should actually buoy deal lawyers. *Martin Marietta* means that the Delaware courts decided that even the most tenuous ancillary agreement—the confidentiality agreement—is a part of the unbundled bargain. By drawing such wide boundaries around the deal, the courts have given parties a wider berth within which to craft their unbundled bargains and allocate deal terms.

Conclusion

Existing M&A scholarship focuses on acquisition agreements and overlooks ancillary agreements, which govern a substantial portion of any complex M&A deal. This Article argues that complex M&A deals are unbundled bargains—deals made up of many agreements. Reframing an M&A deal as an unbundled bargain expands the theoretical boundaries of the deal, and has implications for contract interpretation and deal design. While this Article has focused on unbundled bargains in the context of complex M&A deals, the concept has potentially broad applicability in the law.

176 The Chancery Court considered the drafting history of the parties, and concluded that the parties appeared to be "strengthening the protections offered by [the NDA] rather than weakening them." *Martin Marietta I*, 56 A.3d 1072, 1118 (Del. Ch. 2012).

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