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UNBUNDLED BARGAINS:
Multi-Agreement Dealmaking in Complex Mergers and Acquisitions

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UNBUNDLED BARGAINS:

Multi-Agreement Dealmaking in Complex Mergers and Acquisitions

Cathy Hwang[*]

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Why are some bargains memorialized in dozens of related agreements, rather than just 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—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 undertakes the literature's first 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 dealmaking costs ex ante and deal enforcement costs ex post by making deals more modular and improving the quality of each modular part. Third, reframing many related agreements as one unbundled bargain has significant implications for contract theory and transactional practice. This Article argues that when parties' intent is memorialized in an unbundled bargain, courts should take a more expansive view of what constitutes the boundaries of the deal and interpret disputes arising out of deal agreements using other parts of the unbundled bargain as context. This "permeable interpretation" default, when applied to M&A deal disputes, incorporates many of the benefits of both textualist and contextualist approaches to contract interpretation. It also motivates parties to unbundle their bargains when doing so improves deal quality and reduces dealmaking cost, because no matter how unbundled a deal becomes, all of the parts will be interpreted as one.

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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] The courts' decisions in *Martin Marietta v. Vulcan* 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 in 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 their implications for contract interpretation, deal design, and bargaining.

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 frequently enter into these short, simple agreements to protect non-public 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 the parties had used before as the template.[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

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[1] Martin Marietta Materials, Inc. v. Vulcan Materials Co., 56 A.3d 1072, 1137 (Del. Ch. 2012) (*Martin Marietta I*) (enjoining Martin Marietta's hostile bid for Vulcan for four months), *aff'd*, 68 A.3d 1208 (Del. 2012) (*Martin Marietta II*).

[2] *Martin Marietta I*, 56 A.3d at 1075.

[3] *See* ABA Model Confidentiality Agreement 341 (2011) (noting that confidentiality agreements are "usually the first agreement[s] entered into between the parties to a potential transactions" when "neither party [is] committed to pursuing a transaction").

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

[5] *Id.* at 1083 ("Under the NDA, '[e]ach party ... shall use the other party's Evaluation Material solely for the purpose of evaluating a Transaction.' A 'Transaction' is defined as "a possible business combination

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 non-public information in the process. Eventually, the friendly talks fizzled, just as changes in Vulcan's stock price made the deal particularly attractive to Martin Marietta.[6]

On December 12, 2011, Martin Marietta launched an unsolicited exchange offer for Vulcan's shares, preparing the offer using non-public information Vulcan had shared with Martin Marietta.[7] 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. Vulcan stockholders could exchange each Vulcan share for half a share of Martin Marietta's more valuable stock.[8] 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. Vulcan countersued, seeking to enjoin Martin Marietta's exchange offer.[9]

Ultimately, both Chancery and the Delaware Supreme Court agreed with Vulcan, granting a four-month injunction against Martin Marietta's hostile takeover. The opinions turned, in part, on the courts' interpretations of the word "between" in the confidentiality agreement. The parties had disputed the meaning of the provision barring the parties from using information for purposes other than "a possible business combination transaction . . . *between* the parties."[10] The courts found that the parties meant to limit use of the information to pursuit of a

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transaction [ ] *between* [Martin Marietta] and [Vulcan] or one of their respective subsidiaries.") (emphasis added).

[6] In early 2011, the companies' chief financial officers met and exchanged non-public information. After that meeting, and 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.

[7] 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.")

[8] 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." 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. For a detailed account of Martin Marietta's offer to Vulcan, *see Martin Marietta II*. For an overview of types of unsolicited takeovers, *see* FRANK AQUILA & MELISSA SAWYER, SULLIVAN & CROMWELL LLP, *Unsolicited Takeover Offers*, 2008 EMERGING ISSUES 3287, *available at* https://www.sullcrom.com/siteFiles/Publications/Lexis_Unsolicited_Bids.pdf (describing common unsolicited takeover methods).

[9] *Martin Marietta I*, 56 A.3d at 1076-77.

[10] *Id.* at 1083 (emphasis added).

transaction *between* the two parties—Martin Marietta and Vulcan. The hostile takeover was an attempt by Martin Marietta to buy shares from Vulcan's stockholders on the public market, rather than from Vulcan, so it was not a transaction between the two parties. Therefore, Martin Marietta violated the provision when it used non-public information in the hostile transaction.[11]

The *Martin Marietta* decision caused a stir among deal lawyers. Companies seeking to sell themselves often require potential buyers to sign confidentiality agreements that have explicit "standstill provisions."[12] 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.[13] 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 a standstill provision.[14]

Many deal lawyers lambasted the decisions for finding an "implied standstill provision."[15] One law firm noted that "the court . . . gave very little, if any, weight to [the fact that] that two sophisticated parties (with sophisticated counsel) did not discuss or include a standstill provision [in the agreement]."[16]

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[11] *See Martin Marietta I* and *Martin Marietta II*.

[12] Christina M. Sautter, *Promises Made to be Broken? Standstill Agreements in Change of Control Transactions*, 37 DEL. J. CORP. L. 929, 931 (2013) (noting that "[w]hen 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").

[13] *Id.* at 931-32 (2013) (describing typical standstill provisions in public M&A transactions and their effects).

[14] *Martin Marietta I*, 56 A.3d at 1083.

[15] *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), *available at* http://www.stblaw.com/docs/default-source/cold-fusion-existing-content/publications/pub1418.pdf (noting, in an update to clients, that in light of the Chancery's decision in *Martin Marietta*, "[p]articular consideration needs to be given to whether the terms of a confidentiality agreement create an implied standstill provision"); BAKERHOSTETLER, SILENCE IS NOT NECESSARILY GOLDEN ON STANDSTILL PROVISIONS (Jun. 13, 2012), *available at* http://www.bakerlaw.com/alerts/silence-is-not-necessarily-golden-on-standstill-provisions-6-13-2012/ (noting, a memorandum to clients, that "in this case, the Court's strict enforcement resulted in an implied standstill provision being read into the Confidentiality Agreements"); MORGAN LEWIS, WHY DRAFT A STANDSTILL PROVISION WHEN "BETWEEN" IS ENOUGH? (May 11, 2012), *available at* http://www.morganlewis.com/pubs/why-draft-a-standstill-provision-when-between-is-enough (noting that, as a practical implication, "the 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" and that "[a]lthough the Court repeatedly emphasized the fact-specific nature of the case, the detailed parsing of the contractual language leaves little doubt on how these provisions would be construed in future situations").

[16] JONES DAY, DELAWARE UPDATE: THE IMPLIED STANDSTILL (May 2012), *available at* http://www.jonesday.com/delaware-update--the-implied-standstill-05-18-2012/ (last accessed Mar. 26, 2015) (describing the *Martin Marietta* decision from the Delaware Court of Chancery, and providing analysis thereof).

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Others called the decisions "a wake up call . . . that confidentiality agreements negotiated in the early stages of a deal can have significant consequences down the road."[17] 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 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."[18]

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 periphery to the heart of the deal that it just barely qualifies as part of the deal at all[19]—nonetheless determined the most important aspect of a deal: whether it could go forward at all.

But 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. [20]

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[17] Abbe L. Dienstag, et al., Reconsidering NDAs in light of Martin Marietta Materials, Inc., v. Vulcan Materials Co. (May 21, 2012), *available at* http://www.lexology.com/library/detail.aspx?g=e23a4a91-fb4a-4321-9f3e-acc4ee81ab4b (last accessed Mar. 26, 2015) (providing analysis of the *Martin Marietta* deal in the Delaware Court of Chancery).

[18] Liz Hoffman, *A Year After* Martin Marietta*, Deal Drafters Still Skittish*, LAW 360 (May 16, 2013, 7:27 P.M.), *available at* http://www.law360.com/articles/424138/a-year-after-martin-marietta-deal-drafters-still-skittish (last accessed Mar. 10, 2015) (describing how the *Martin Marietta* decision has transformed confidentiality agreement drafting and negotiations from a routine task for junior associates to a task requiring serious negotiation and partner review).

[19] This Article will show that confidentiality agreements, which share characteristics with ancillary agreements and with preliminary agreements, lie at the outer-most boundaries of deals. An ancillary agreement at the deal's outer-most 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. Ancillary agreements further within the deal's boundaries can also have enormous impact on deals. *See infra* Parts II.A.2.c.

[20] 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, e.g.*, Afra Afsharipour, *Transforming the Allocation of Deal Risk Through Reverse Termination Fees*, 64 VAND. L. REV. 1163 (2010) (discussing the use of reverse termination fees—which are 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, at 855 (2010) (demonstrating that vague provisions may work better at preserving certain goals of material adverse change clauses in definitive M&A agreements than precise and costly proxies); 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); 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). Others focus on how deal lawyers help to grow the deal surplus, but that scholarship, too, focuses on the acquisition agreement. *See, e.g.*, Ronald J. Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 94 YALE L.

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 deal document. This Article provides the first comprehensive account of the dynamic interactions between ancillary agreements and acquisition agreements in M&A dealmaking. In doing so, this Article begins to develop a new theory of the deal, and posits that a deal's boundaries extend beyond the acquisition agreement into the corners of unbundled bargains. Reframing complex deals as unbundled bargains has important implications for contract theory and transactional practice: it reveals a new way to interpret contractual disputes that arise out of complex deals, and suggests ways in which dealmaking practice can be made more efficient.

Absent an understanding of deals as unbundled bargains, both courts and parties routinely underestimate the boundaries of the deal. This underestimation affects both the way that courts interpret disputes arising out of deal contracts and the content of the unbundled pieces themselves. For example, reframing the *Martin Marietta* deal as an unbundled bargain sheds new light on both the courts' decisions and on how parties should allocate deal terms between acquisition agreements and ancillary agreements going forward. The courts' decisions in *Martin Marietta* actually suggest that those courts understood unbundling—they interpreted a confidentiality agreement as part of the M&A deal, thereby allowing it to change fundamental aspects of the deal. If parties can rely on courts to interpret M&A deals as unbundled bargains regularly, parties should feel comfortable unbundling their bargains when doing so reduces dealmaking costs, because no matter how many agreements memorialize a deal, those parts will be interpreted together should a future contract dispute arise. Furthermore, when all deal parts are routinely interpreted together, parties are less incentivized to obfuscate parts of the deal by burying them in unfiled or less-scrutinized ancillary agreements.

This Article proceeds in four Parts. Part I introduces the concept of unbundled bargains. In the process, 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

J. 239 (1984) (describing the work of deal lawyers in M&A transactions through an examination of provisions of definitive M&A agreements); 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); and 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).

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and precision, which increase dealmaking efficiency ex ante and reduce deal enforcement cost ex post. Part III considers the implications of unbundled bargains for contract interpretation and deal design. This Article suggests that, as a default, disputes arising out of contracts in unbundled bargains should be interpreted with context from other parts of the unbundled bargain. This "permeable interpretation" strikes the right balance between traditional textualist and contextualist approaches to contract interpretation and also has significant implications for deal design: it incentivizes parties to unbundle deals into as many individual parts as they deem efficient. Part IV concludes.

The principles developed in this Article can be applied beyond M&A to help illuminate when and why bargains are struck in single contracts and when they are memorialized by 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.[21] 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 easy to spot in contexts where parties enter into a default bargain that has a pre-set bundle of rights and obligations, and where parties then 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,

[21] This Article uses the terms "deal" and "bargain" 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 RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS § 1:1 (4th ed. 2012) (*Williston on Contracts*) (noting that "[t]he 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'" and that "the word ['contract'] may, to one in business or a lay person, mean the writing that evidences a bargain or agreement").

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 to develop insights that can be applied to other areas of the law where unbundling occurs.

The remainder of this Part shows how M&A deals are unbundled bargains and proceeds as follows. Subpart A provides a brief overview of the acquisition agreement and its functions. Subpart 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 another central, definitive deal contract that forms the backbone of an M&A deal.[22] 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).[23]

Acquisition agreement terms allocate risk, and thereby divide deal surplus, between parties.[24] Representations and warranties, for example, allocate the cost of obtaining information about the target company to the lowest-cost

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[22] Choi & Triantis, *supra* note 20 (describing corporate acquisition agreements as the agreements that govern transactions such as "drafting of corporate acquisition agreements, such as asset purchases, stock purchases, and mergers").

[23] Manns & Anderson, *supra* note 20, at 1151-52 (describing the common parts of an acquisition agreement).

[24] Afsharipour, *supra* note 20 (discussing how reverse termination fees change the allocation of deal risk); Choi & Triantis, *supra* note 20 (demonstrating that vague provisions may work better at preserving certain goals of material adverse change clauses in definitive M&A agreements than precise and costly proxies); Gilson, *supra* note 20 (describing the work of deal lawyers in M&A transactions through an examination of provisions of definitive M&A agreements); Manns & Anderson, *supra* note 20 (examining empirically how financial markets value the terms of public company acquisition agreements); and Davidoff & Sautter, *supra* note 20 (describing the prevalence of lock-up provisions in definitive M&A agreements).

information provider,[25] and covenants, closing conditions, and other terms also help to allocate risk or mitigate moral hazard.[26] The acquisition agreement's terms can 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.[27] Terms also help to reduce overall

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[25] The seller knows more about the business being sold, so it is the lowest-cost acquirer of information about the business. As a result, instead of having the buyer do very extensive due diligence on the state of the business before signing, it is most efficient for the seller simply 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 20, at 271-73 (providing a discussion of 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, at closing, if representations are warranties are untrue (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 20, at 1170-80 (providing a detailed discussion of how deal terms in an acquisition agreement help to allocate risk between buyers and sellers).

[26] 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 20, at 260 (discussing the gap between signing and closing); Lou R. Kling, et al., *Summary of Acquisition Agreements*, 51 MIAMI L. REV. 779, 781 (1997) (identifying the need to secure financing as a reason for a delay between signing and closing), and at 795–99 (describing covenants in typical acquisition agreements); Manns & Anderson, *supra* note 20, at 1152 (describing common closing conditions and their functions); and Choi & Triantis, *supra* note 20, at 871-72 (discussing deal financing); and Afsharipour, *supra* note 20 (demonstrating empirically the increased use of reverse break-up fees in M&A deals.).

For example, under the Premerger Notification Program of the Hart-Scott-Rodino Antitrust Approval Acts of 1976, 15 U.S.C. § 18a (HSR), 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* U.S. FED. TRADE COMM'N, WHAT IS THE PREMERGER NOTIFICATION PROGRAM?: AN OVERVIEW (Mar. 2009), *available at* https://www.ftc.gov/sites/default/files/attachments/premerger-introductory-guides/guide1.pdf. Parties may condition the closing of a deal on the expiration or termination of the HSR 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.*, Agreement and Plan of Merger among Time Warner Cable Inc., Comcast Corporation and Tango Acquisition Sub, Inc. (Feb. 12, 2014) 1, *available at* http://www.sec.gov/Archives/edgar/data/1166691/000119312514107315/d681637ds4.htm#toc681637_71 (*Time Warner-Comcast Agreement*) (conditioning the merger's closing on the expiration or termination of the HSR waiting period).

[27] Gilson, *supra* note 20. A pricing structure like an earnout, for example, bridges parties' differing expectations about a target company's expected performance post-closing. 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 post-closing. Without an earnout provision, the buyer and

deal costs by, for instance, strategically reducing upfront deal cost on the belief that the probability of costly back-end litigation is very low.[28]

Other scholars have done much work in discussing the functions and value of acquisition agreements.[29] The existing literature, however, largely ignores the many ancillary agreements that invariably buttress the acquisition agreement. The acquisition agreement and its ancillary agreements create an unbundled bargain that, together, 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, and, while the acquisition agreement is the central deal document 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 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).[30] Before signing, parties may enter into a preliminary agreement—such as a memorandum of understanding, a letter of intent, or a term sheet—that describes the deal's basic terms, and is essentially a stripped-down version of the eventual definitive acquisition agreement.[31] At signing, parties "negotiate, draft, and execute a

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 post-closing, but the seller believes the target will generate $9.25 million. 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 262-67. 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* Dent, *supra* note 20 (arguing that transactional lawyers are "enterprise architects" who engage in enterprise design); Fleischer, *supra* note 20, at 239 (arguing that deal lawyers "quarterback the deal" and can create value by engaging in regulatory arbitrage when they "identify gaps between legal form and academic substance"); and Schwarcz, *supra* note 20 (arguing that deal lawyers can reduce regulatory costs).

[28] Choi & Triantis, *supra* note 20, at 883 (noting that "the ex ante cost of drafting more precise contract language may be greater than the expected litigation cost entailed in enforcing the standard").

[29] *See supra* note 20 and accompanying text.

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

[31] 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

package of final agreements"[32]—one of which will be a definitive acquisition agreement—and, at that point, parties "become legally obligated to effect the transaction."[33] At closing, the deal is performed—the buyer pays, and the seller hands over what is being sold.[34]

Most ancillary agreements are entered into at or after signing, but an important one is signed early. Confidentiality agreements, like the ones in *Martin Marietta*, are often the first ancillary agreements signed during negotiations.[35] 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 *Marin 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, a preliminary-agreement-like ancillary agreement. 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

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claim. 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 (so, in that sense, it is "preliminary" to the acquisition agreement), but which, this Article argues, more closely resembles an ancillary agreement. For a discussion of preliminary agreements, *see, e.g.,* Alan Schwartz & Robert E. Scott, *Precontractual Liability and Preliminary Agreements*, 120 HARV. L. REV. 661 (2007) (arguing that contract law should encourage the relationship-specific investments in preliminary agreements in certain instances); Gregory Klass, *Intent to Contract*, 95 VA. L. REV. 1437, 1441 (2009) (analyzing the best rules for interpreting parties' intent to be bound and suggesting that in the preliminary agreement context, there should be a requirement that "parties who want such agreements to be legally binding say so"); 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); Juliet P. Kostritsky, *Uncertainty, Reliance, Preliminary Negotiations and the Holdup Problem*, 61 S.M.U. 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); Albert Choi & George Triantis, *Multi-Stage Contracting in Complex Transactions* (Jan. 2, 2014) (unpublished manuscript, on file with author and *available at* http://www.law.uchicago.edu/files/files/choi_paper.pdf) (discussing preliminary agreements that arise in complex cases, rather than in cases where joint investment and reliance is key).

[32] Barnett, *supra* note 30 (describing the package of agreements that is signed at the time of signing in typical deals).

[33] Kling et al., *supra* note 26, at 781.

[34] *Id.* (describing the moment of closing as "when the acquisition actually occurs" and providing an example of what constitutes performance of the contract).

[35] Sasha S. Hahn, *"Between" a Rock and a Hard Place:* Martin Marietta v. Vulcan *and the Rise of the Backdoor Standstill*, 65 HASTINGS L.J. 1393, 1396 (2013) (noting that "[i]n the context of merger discussions, a confidentiality agreement is generally the very first agreement signed").

agreement particularly interesting. When this Article discusses how ancillary agreements should 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 categorize 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).[36] 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 catalogue—but most serve a few similar functions. Some facilitate deal execution: the exchange of assets or shares for consideration. Acquisition agreements, unlike a deed or assignment of rights, do not actually transfer assets or money—rather, "separate filings or recordings may be necessary to effect the transfer [of assets]."[37] These documents and filings are ancillary agreements. In a real estate deal, for example, a deed effects the transfer.[38] 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 post-closing matters.[39] That escrow is governed by an ancillary agreement: the escrow agreement.[40]

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[36] Manns & Anderson, *supra* note 20, at 1152 (describing closing conditions as provisions that "delineat[e] the circumstances that give the bidder or target company the right to walk away from the agreement during the pre-closing period").

[37] Byron F. Egan, *Asset Acquisitions: Assuming and Avoiding Liabilities*, 116 PENN. ST. L. REV. 913, 917 (2012) (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).

[38] CRAIG CIRCOSTA & SANDRA WINTNER, BALLARD SPAHR LLP, ANCILLARY AGREEMENTS (Oct. 4, 2012), *available at* http://www.lexology.com/library/detail.aspx?g=7fae6b8a-6b93-4c19-8908-efa3e0e2822c (last visited May 22, 2015), (providing an overview of ancillary agreements executed and delivered at the closing of an M&A transaction).

[39] PRACTICAL LAW, *Negotiating and Drafting M&A Escrow Agreements* (Nov. 21, 2013), *available at* http://us.practicallaw.com/1-549-7438 (last visited May 22, 2015) (noting that "[i]n 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," and that amounts to meet such obligations are often "placed into escrow with a third-party escrow agent, rather than being retained by the buyer").

[40] Sanjai Bhagat, Sandy Klasa, & Lubomir P. Litov, *The Use of Escrow Contracts in Acquisition Agreements* (January 2014) at 7, *available at* http://fic.wharton.upenn.edu/fic/papers/13/13-19.pdf (describing the parties and common terms of escrow agreements in M&A deals).

Other ancillary agreements govern rights and obligations that survive post-closing. Most of the acquisition agreement's rights and obligations end at closing,[41] 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, the deal is not worth doing. In those cases, the transition services agreements or employment agreements that govern the parties' ongoing relationship are essential.[42] Ongoing lease agreements, which are essential to continuing operations after Real Estate Investment Trust (REIT) spin-off transactions, are particularly salient recent examples. In a REIT spin-off deal, a company with substantial real estate assets spins off its real estate assets and either sells those assets to an existing REIT or puts the assets into a newly-formed REIT.[43] The REIT leases the same property back to the legacy operating company.[44] In 2011, for instance, assisted living company ManorCare sold its real estate assets to HCP, a REIT, for $6.1 billion.[45] At the same time, HCP and ManorCare entered into a long-term lease, leasing the properties back to ManorCare.[46] The lease is an essential ancillary agreement, without which the deal is not worth doing.

Still other ancillary agreements provide deal protection or other assurance to the parties. Voting agreements, for example, are common contracts between

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[41] Of course, parties may look to the acquisition agreement for guidance about how to deal with post-closing price adjustments, like earn-out calculations or indemnifications. They may also look to the acquisition agreement if a dispute arises with respect to, for example, a fraudulent representation or warranty. For the most part, however, post-closing, 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 post-closing actions.

[42] PAUL A. CHANDLER & LINDSAY BLOHM, MAYER BROWN LLP, *Transition Services Agreements in Acquisitions and Divestitures: An Introduction*, MAYER BROWN BUS. & TECH. SOURCING REV. (Fall 2010), at 7, *available at* http://www.mayerbrown.com/files/Publication/8f250357-3487-4d7c-8a0a-23deddc90e93/Presentation/PublicationAttachment/4df434ff-1035-43bc-b0b1-49320a2095fd/BTS-Review_Fall2010_Issue15.pdf (discussing types and features of transition services agreements, when they are needed, and when they should be entered into).

[43] WACHTELL, LIPTON, ROSEN & KATZ, *Spin-Off Guide* (2014) at 8, *available at* http://www.wlrk.com/files/2014/SpinOffGuide.pdf (discussing the kinds of companies that engage in REIT spin-offs). REITs, like partnerships, are "conduit entities,"—they 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* 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 spin-offs, and the effect of these transactions on erosion of corporate tax base).

[44] Borden, *supra* note 43, at 21–25 (discussing the structure of REIT-related leasebacks).

[45] *News Release,* HCP, *HCP Closes $6.1 Billion Acquisition of HCR ManorCare's Real Estate Assets* (Apr. 8, 2011), *available at* http://ir.hcpi.com/phoenix.zhtml?c=67541&p=irol-newsArticle&ID=1548205 (announcing the closing of HCP's purchase of ManorCare's real estate assets).

[46] *Id.*

the buyer and a group of stockholders, in which the stockholders agree to vote their shares in favor of the transaction.[47] They function as deal protection because a buyer may have the right to terminate the acquisition agreement if there is a material breach of the voting agreement (a breach of which would mean that the acquisition agreement may not be approved by a requisite number of shareholders).[48] Opinion letters—short letters in which the company's investment banks or lawyers opine on the fairness or anticipated regulatory treatment of a transaction—also protect the deal, by shifting some of the deal risk from parties to deal advisors.[49] 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 Section 368 of the Internal Revenue Code.[50] In tax-driven M&A deals, like tax inversions or REIT spin-offs, tax opinions are very important: they assure the parties that their deal will receive the tax benefit they desire.[51]

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 even keep most provisions in one agreement.[52] Acquisition

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[47] 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).

[48] *Id.*

[49] Lucian Ayre Bebchuk and Marcel Kahan, *Fairness Opinions: How Fair Are They And What Can Be Done About It?,* 27 DUKE L.J. 27, 28 (1989) (discussing how much judges should rely on fairness opinions, and "warn[ing] against excessive reliance on fairness opinions"); Gilson, *supra* note 20, at 275 (describing the content of opinions of counsel).

[50] AT&T, Inc., Amendment No. 3 to Registration Statement (SEC Form S-4) 18 (Aug. 19, 2014) (disclosing that, as a condition to closing, AT&T's lawyers, Sullivan and Cromwell LLP, 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").

[51] *See* Cathy Hwang, *The New Corporate Migration,* 90 BROOK. L. REV. 807 (2015) (discussing how parties to tax inversion M&A deal derive value from the favorable tax treatment of the combined company post-closing); Austan Golbsee and Edward Maydew, *Taxes and Organizational Form: The Case of REIT Spin-offs*, 55 NAT'L TAX J. 441 (2002) (discussing how companies can spin-off their real estate into real estate investment trusts (REITs), which are pass-through entities not subject to corporate tax); and David Polster, Sarah E. Ralph, John D. Rayis, Kevin M. Jones, Sarah Beth Rizzo and Christopher Sigmund, *Unlocking Value Through REIT Spin-Offs* (Jan. 2015), *available at* https://www.skadden.com/insights/unlocking-value-through-reit-spin-offs (discussing the mechanics of REIT spin-off transactions and how favorable tax treatment of the resulting REIT can "provide a means for companies to unlock the value of their real estate").

[52] To be sure, laws and regulations do provide a framework in which M&A deals can be struck. *See, e.g.,* Fleischer, *supra* note 20, at 237 (noting that the "complexity of the modern administrative state provides more opportunities for regulatory arbitrage—another form of value creation for the client—than ever

agreements are long, complicated, and cover broad subject-matter, but ancillary agreements nonetheless exist. What work is being done by ancillary agreements that is not being done—or cannot be done—by acquisition agreements? This is particularly puzzling because the easiest explanation for unbundling in other contexts—to contract around defaults—is not particularly applicable to M&A.

Most M&A scholars focus on the acquisition agreement. As a result, the acquisition agreement appears to govern the whole deal. This Part suggests an amendment to the existing M&A literature, and highlights, in the process, the dynamic relationship between ancillary agreements and the acquisition agreement. It shows that complex M&A deals are "unbundled bargains" and analyzes the mechanics of 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 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 are a way for parties to unbundle their bargains and form deals that are more modular and precise. Unbundling decreases deal cost ex ante (in the deal design and contract drafting stage) and ex post (when contracts are litigated and enforced). The remainder of this subpart 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 (and other interdependencies) are intense within the module but sparse and standardized

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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.

across modules."[53] 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 causing 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 cost. Simple modules reduce deal cost without losing much quality. Each is discussed in turn here.[54]

a. Complex Modules

M&A parties are almost invariably advised by a handful of elite law firms[55] that staff M&A deals the same way. A group of M&A lawyers responsible for deal design and primary-contract drafting is at 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.[56] 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.

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53 Henry E. Smith, *Modularity in Contracts: Boilerplate and Information Flow*, 104 MICH. L. REV. 1175, 1176 (2006) (discussing modularity within individual contracts).

54 Although some literature has discussed contract modularity, modularity has yet to be discussed in the context of deals. For discussions on contract modularity, *see, e.g.*, Smith, supra note 53; George 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); and Margaret Jane Radin, *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, and defining legal modularity as "the practice of creating a legal document by selecting and cobbling together terms from a source compendium or from different sources").

55 Fleischer, *supra* note 20, at 230 (noting that "[l]arge companies that can afford elite law firms employ more aggressive deal structures that push the regulatory frontier"); Davidoff & Sautter, *supra* note 20, at 709 (noting that the takeover M&A market "is a concentrated one where a few law firms dominate").

56 Fleischer, *supra* note 20, at 237 (noting that, "[i]n 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").

When complex deal pieces are assigned to specialist lawyers, it is not a given that those pieces will be modules—that is, they might be assigned to specialists, but still so connected to the rest of the deal that they are not modular. For example, an intellectual property representation and warranty may be drafted with specialist input, but 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.[57] As a result, that part of the deal is specialist-driven, but non-modular.

Many complex, technical, or regulatory pieces of an M&A deal, however, are assigned to specialists *and* are modular—these are complex modules. An employment agreement is one example. An employment agreement ensures that a key target-company employee remains employed by the buyer post-closing, 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 of 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.

The contracts literature identifies a tension between the cost of front-end contract drafting and back-end litigation cost.[58] Increasing front-end contracting costs tends to decrease the expected back-end enforcement and litigation costs,

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[57] For example, a target might represent and warrant that is has provided a list of "all material registered intellectual property" or represent that is has a right or title to all intellectual property "except as would not reasonably have a Material Adverse Effect." 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. *See, e.g.,* AT&T Inc., Amendment No. 3 to Registration Statement, *supra* note 50, at A-22-23 (in which the target represented and warranted with regard to intellectual property matters).

[58] Choi & Triantis, *supra* note 20, at 848 (noting that, "drawing 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) (noting that the cost of a contract is the ex ante negotiating and drafting cost, plus the probability of litigation multiplied by the sum of the parties' litigation costs, the judiciary's litigation costs, and judicial error costs).

because more attention up front decreases the probability of dispute later.[59] 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 therefore the expected cost of enforcement is low).[60] For instance, parties may use vague material adverse change clauses, especially if material adverse clauses are very rarely litigated to judgment.[61]

Like contract designers, the M&A lawyers who design deals need to consider the trade-off between front-end costs and back-end costs. One manifestation of the trade-off 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 to assign that issue to a specialist who frequently deals with similar matters.[62] 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 non-expert 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. A specialist lawyer does not need

[59] Choi & Triantis, *supra* note 20, at 848, citing Posner, *supra* note 58; Robert E. Scott & George G. Triantis, *Anticipating Litigation in Contract Design*, 115 YALE L.J. 814 (2006); Steven Shavell, *On the Writing and Interpretation of Contracts*, 22 J.L. ECON. & ORG. 2893 (2006).

[60] Choi & Triantis, *supra* note 20, at 852 (arguing that "[i]f 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").

[61] *Id.* at 896 (noting that material adverse change clauses, though vague, "are rarely pursued to judgment").

[62] This decision bears some resemblance to the Coasean theory of the firm. In part, Coase argues 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. 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* Peter G. Klein, *The Make-or-Buy Decision: Lesson from Empirical Studies*, in HANDBOOK OF NEW INSTITUTIONAL ECONOMICS 435 (Claude Menard & Mary M. Shirley eds., 2008) (surveying the empirical literature on firms' vertical integration, and providing a summary of Coase's theory of the firm); Ronald H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386 (1937). 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 to parcel out provisions for specialists. However, unlike the firm in Coase's theory, which has a boundary 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 is separate from the boundaries of the deal. The boundaries of the deal are larger than that of the acquisition agreement: it must be large enough to encompass the provisions that are not vertically integrated into the acquisition agreement, but that are nonetheless crucial to the deal. See discussion in Part II(C), *infra.*

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to spend time learning a complex area of regulation, so 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—i.e., the cost of a specialist learning the background of the M&A deal at hand—that startup cost is likely to be less than the cost of the M&A lawyer learning the specialist's area of expertise.[63]

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 garner benefits because the specialist is a repeat player with certain government agencies. An antitrust attorney may make dozens of filings a year under the Premerger Notification Program of the Hart-Scott-Rodino Antitrust Approvals Act. As a result, an antitrust attorney becomes a repeat player with the relevant departments and individual regulators at the Federal Trade Commission and the Department of Justice, 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 be more inclined to approve filings. An antitrust attorney may also be able to call a regulator he knows to ask for an informal status check on a pending filing. Regulatory attorneys may also spend their time alternating between working in regulatory agencies and working in private practice. As a result, regulatory attorneys may have personal knowledge of how certain client issues are evaluated within a regulatory agency, and, as a result, provide more nuanced and accurate advice to a client.

Moreover, making those complex pieces *modular* by moving them into separate ancillary agreements is key to reducing front-end costs. Non-modular pieces have many points of connection with the rest of the deal,[64] 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 non-modular complex pieces to ensure that the ripple effects they cause through the rest of the deal are addressed. This erodes some of the efficiency that is gained when a complex

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[63] This argument assumes that the specialists lawyers' 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 are revealed to be approximately the same as comparably-experienced M&A lawyers. *See, e.g.*, 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 Corporation et al., Dkt. No. 11662 (S.D.N.Y. 2014) (No. 11-15463), *available at* http://amrcaseinfo.com/pdflib/11662_15463.pdf, and 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, In re AMR Corporation et al., Dkt. No. 6492 (S.D.N.Y. 2014) (No. 11-15463), *available at* http://www.amrcaseinfo.com/pdflib/6492_15463.pdf.

[64] Smith, *supra* note 53, at 1176 (noting that "[t]wo 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").

piece is assigned to a specialist. In contrast, the more modular a complex piece is, the less time an M&A lawyer has to spend reviewing it. Because modular pieces are relatively self-contained, the complex module can be modified substantially 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.

It is important to note that even when complex modules do not *reduce* front-end costs, they can still make front-end contract design more efficient—they can help parties increase marginal contract quality by less than the marginal cost of increasing 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."[65] 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 cost actually increases, but the marginal cost is less than the marginal benefit: for a marginal cost of 10 hours, 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 attorney'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.[66] This is one of the reasons parties appear to prefer specific contract terms over vague ones.[67] Like vague terms, complex, highly technical deal terms are also more

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[65] Matthias Blume & Andrew A. Appel, *Hierarchical Modularity*, 21 ACM TRANSACTIONS ON PROGRAMMING LANGUAGES & SYSTEMS 813, 817 (1999) (discussing the need for modularity in code-writing in order to allow teams to "divide and conquer").

[66] Choi & Triantis, *supra* note 20, at 852 (noting that "[c]ontract theorists focus on the cost of verifying facts and typically posit that parties avoid terms that are costly to verify").

[67] *Id.*

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expensive to litigate than simple terms because complex commercial terms, when litigated, introduce high levels of judicial uncertainty.[68]

One way to reduce the uncertainty of judicial interpretation is to make complex terms simpler—a seemingly impossible task. Making a complex term more *modular*, however, may do some of this work by making complex terms easier to understand. Modularity appears to "allow[] complexity to become manageable by interrupting information flow within the system."[69] Breaking complex projects into smaller, self-contained, modules enhances human understanding of the entire complex M&A system.[70] Thus, *ceteris paribus*, 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 non-modular way. Another 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, do 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 post-closing. 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 that deal with 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-refer to a complex commercial contract), and specialists can provide expert input into that

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[68] Because judicial accuracy is uncertain in complex commercial disputes, many practicing litigators prefer that complex commercial cases be litigated 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. ONLINE 239 (2015).

[69] Smith, *supra* note 53, at 1180.

[70] *Id.* at 1180-81. *See also* Kathrin Figl & Ralf Laue, *Cognitive Complexity in Business Process Modeling*, 6741 LECTURE NOTES ON COMPUTER SCIENCE 452, 465 (2011) (noting that "[r]esearch on [business process models] suggests that decomposing complex models into smaller submodules can improve model comprehensibility").

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 mail-room support may benefit from the expert advice of the person who manages the target company's mail room. A transition services agreement that is a complex module both enhances contract executors' ability to understand the terms of the contract, and allows for the contract to benefit from 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.[71] 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 is that both modular and boilerplate: across different types of commercial contracts and different contractual parties, counterparts provisions are nearly identical.[72] 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 be easily used in a variety of different contracts.

Complex M&A deals contain many boilerplate provisions. As with complex modules, an M&A lawyer running a deal can either find and draft boilerplate provisions herself or assign boilerplate provisions to another person. Complex modules are often assigned to subject-matter specialists. Perhaps

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[71] Triantis, *supra* note 54, 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 cost of agreement production).

[72] In the Actavis/Allergan deal, 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.

See Actavis plc, Amendment No. 1 to Registration Statement (SEC Form S-4) 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 Inc., Registration Statement, *supra* note 50, at A-49 and Actavis plc, Amendment No. 1 to Registration Statement (SEC Form S-4) A-74 (May 2, 2014).

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surprisingly, M&A lawyers are assisted not just by subject-matter specialists, but also by specialists whose practices focus on *simplicity*—that is, by 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: junior associates' work is billed to a client a lower hourly rate, junior associates have enough experience to accomplish simple tasks well, and simple tasks allow junior associates to gain lawyering skills (so they are a way for law firms to train junior associates). 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 he is assigned to work on a discrete, boilerplate contract. In both cases, junior associates are working on simple modules, 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 in which to inject lawyers' judgment or expertise, and where changes to the simple module will cause few, if any, ripple effects throughout the deal. Moreover, as was the case 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.

However, in contrast to complex modules, where assigning a module to a specialist can increase deal design *and* reduce enforcement costs, assigning a simple module 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 at simple modules than senior associates, 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 remains about simple modules: why are some boilerplate pieces of the deal (like escrow agreements) part of ancillary agreements, while other boilerplate pieces (like representations and warranties)

remain part of the acquisition agreement? There are at least two possible reasons. The simplest explanation is that making a particular boilerplate provision *X* part of an acquisition agreement requires more senior attorney review of *X* than if *X* was part of a separate agreement. For example, consider an M&A deal team that is comprised of a partner, a senior associate, and a junior associate. Almost as a rule, a partner will read acquisition agreements 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 and reviewed by the senior associate.[73] 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.

A less intuitive reason for boilerplate to exist in a simple module rather than in the acquisition agreement is that, perhaps, the term "simple module" is something of a misnomer. 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. But even the simplest modules of a complex M&A deal are, by the standards of those who are not regularly steeped in complex commercial contracts, technical and complex. Thus, it may make sense for *boilerplate* provisions to be made into modules, even if those boilerplate provisions are not simple in the sense that they are easy to understand. It may make sense to assign boilerplate to junior associates because they are easy to *draft*, and may also make sense to put boilerplate into a separate ancillary agreement because, like all of the complex pieces of the deal, that separation makes it easier to comprehend.[74]

c. *Modularity and Hierarchy*

A growing literature applies the concept of modularity to the drafting of individual contracts. That literature identifies a modular contract provision as one that can be drafted in a way that does not affect other parts of the contract.[75] Modular provisions are self-contained, and can be ported from contract to

[73] 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 be sufficient to ensure quality. Adding the M&A partner's review will probably add more marginal cost than marginal deal quality.

[74] Smith, *supra* note 53, at 1180 (noting that "[c]rucially, human understanding of any system is enhanced by breaking it up . . . into modules").

[75] For discussions on modularity in contracts, *see, e.g.*, Smith, *supra* note 53; Triantis, *supra* note 71; and Radin, *supra* note 54 (analyzing the interaction between standardization and customization in contract-drafting, and defining legal modularity as "the practice of creating a legal document by selecting and cobbling together terms from a source compendium or from different sources").

contract, or manipulated within a contract, without affecting the rest of the contract.[76]

This Article takes a step beyond the contracts-modularity literature, and argues that *deals*, rather than *contracts*, are also modular. The many contracts that govern deals are, therefore, modular parts of a deal. Each contract may also contain modules. This "hierarchical modular structure" is observed within other contexts, including in the writing of computer software, where modules-within-modules arise as a way to deal with multiple layers of system complexity.[77]

Hierarchical modularity also helps explain why M&A deals are not just governed by one very modular contract. Rather, they are modular *deals* that contain multiple modular *contracts*, because multiple layers of modularity help to capture and process an M&A deal's complexity. Good modular systems contain "not too many" modules, none of which should be too complex.[78] But M&A deals are very complex, so it seems impossible to satisfy both the competing demands of not having too many modules, on one hand, and having each module be "not too complex," on the other. For example, a modular-but-bundled deal could have simple modules, but far too many of them in one agreement. It could also have very few modules, but have each module be so complex—perhaps by each encompassing too many substantive areas of the law—to truly reap the benefits of modularity.

Hierarchical modules relieve the tension between the 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 so as 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 and sections 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.

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[76] Triantis, *supra* note 54, at 191.

[77] Blume and Appel, *supra* note 65, at 818 (noting that [t]o cope with complexity, large projects are routinely divided into parts); and Smith, *supra* note 53, at 1180 (discussing the need for modularity to enhance human understanding of complex systems).

[78] Blume and Appel, *supra* note 65, at 818 (noting that "[i]n 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").

2. Deal Precision

In addition to increasing deal modularity, unbundled bargains can also increase deal precision. An acquisition agreement is a somewhat monolithic agreement: 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 subpart discusses each of these in turn, and analyzes the impact on dealmaking efficiency of increasing deal precision through ancillary agreements. For the most part, ancillary agreements that are used to increase deal precision appear, like modularity, 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 necessary to the transaction, like a majority stockholder or a non-operating corporation that will be used in the structure for regulatory reasons.[79] 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 that 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 on to the acquisition agreement, it is increasing the deal's party specificity: that is, it is identifying some part of 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 generally to the acquisition agreement, except that Adam and Beth specify that they do not agree to X, and Carla and David specify that they do. This arrangement, however, is rarely observed in complex M&A deals. Instead, a separate ancillary agreement containing only X is drafted, and only Carla and David sign on to that agreement.

[79] *See, e.g.*, Time Warner-Comcast Agreement, *supra* note 26, at A-1 (listing the parties to the acquisition agreement as only Time Warner, Comcast, and a merger subsidiary).

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Parties may prefer the separate ancillary agreement to deal with a party specificity issue as a way to reduce cost both on the front and back ends. On the front end, carving out separate agreements to deal with party specificity issues can reduce contract-drafting costs. In general, parties to complex M&A deals are represented by a host 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 particular 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 back-end 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, for example, 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.[80] 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—i.e., the parties most likely to have signed the acquisition agreement—own the relevant rights directly. Rather, each may hold its rights via a subsidiary or series of subsidiaries. Rather than try to include those subsidiaries in the acquisition agreement, a series of assignment agreements are used to assign the rights. For example, one 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 sliver of the deal that touches on their interests.

At times, however, parties add ancillary agreements in order to pull in deal parties for not-so-innocuous reasons. Delaware's merger statute provides that the target's minority shareholders do not need to approve a private-company merger.

[80] 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/ (reporting on the sale of Louisville Slugger to Wilson).

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. The letter of transmittal itself is a fairly innocuous deal-precision device: it pulls minority shareholders into the deal for the part of the deal that concerns them (the exchange of shares and money). In recent years, however, parties have slipped extra provisions into the letter of transmittal—for example, they have asked the minority shareholders to give general releases of liability to the buyer, or to indemnify the buyer post-closing for certain things. In a recent Delaware Chancery case, *Cigna v. Audax*, the court found those extra provisions unenforceable.[81] Before *Cigna*, however, those extra provisions had long been in letters of transmittal—and had been ways to rope minority shareholders into parts of the deal that were against their interest.

In most cases, however, no matter the rationale, using party-specific ancillary agreements reduces ex post 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 it appears that an inappropriately small subset of interested parties was separated out into an ancillary agreement, party specificity can reduce litigation costs: the smaller subset can join additional interested parties to the litigation, as necessary.[82] In contrast, in cases where litigation commences with too many parties (including some who have little stake in the litigation), 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 carve out small portions of risk from acquisition agreements to increase deal precision. Under Delaware's merger statute, private-company mergers like the *Cigna* merger require the approval of the target company board's and majority shareholders.[83] The majority shareholders also sign the acquisition agreement, and, through that, take on a certain portion of post-closing risk.[84] The minority shareholders, however, do not sign the acquisition agreement and therefore do not assume that

[81] Cigna Health & Life Ins. Co. v. Audax Health Solutions, Inc., 107 A.3d 1082 (Del. Ch. 2014).

[82] 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).

[83] 8 Del. Code Ann. § 251 *et seq.*

[84] CLEARY GOTTLIEB STEEN & HAMILTON LLP, WAKE UP CALL FOR PRIVATE M&A DEAL STRUCTURING (Dec. 15, 2014), *available at* http://www.cgsh.com/wake-up-call-for-private-ma-deal-structuring/ (analyzing the rise of letters of transmittal in private mergers and the effect of *Cigna* on private mergers going forward).

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post-closing risk. The improper letter of transmittal in *Cigna* is an ancillary agreement by which some post-closing risk is carved out of the acquisition agreement and passed specifically to the minority shareholders. 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 post-closing risk, leaving much of the risk still on the table. Other ancillary agreements also shift small portions of risk in complex M&A deals. Opinion letters—letters in which a financial advisor 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 lawyers.

As with improvements to other types of specificity, improving risk specificity can make both the dealmaking process more efficient, and reduce litigation and enforcement costs down the road. More so with risk specificity than with other types of specificity, it is important to note that there is a tradeoff between deal efficiency and cost reduction, on one hand, and the policy of protecting non-consenting parties in deals, on the other. Returning to the *Cigna* example helps to clarify this tension.

In *Cigna*, indemnification appears in the acquisition agreement, the supporting documents (signed by consenting stockholders), and the letter of transmittal (signed by non-consenting stockholders).[85] All shareholders, consenting or not, agree to indemnify the buyer. This creates a level of protection for the buyer that cannot be achieved when an indemnification is in the acquisition agreement alone. In a recent article, Tony Casey argued 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 the whole firm, or just a portion of it.[86] The complex "corporate web" created by partitions and cross-liabilities creates a more precise relationship between creditors and borrowing firms, which lowers creditors' monitory and enforcement costs, lowers the borrowing firm's cost of capital, and thereby creates value.[87] In *Cigna*, ancillary agreements reduce the buyer's deal risk, and, by extension, the buyer's deal cost. Often in deals, the buyer and seller have differing valuations of the target: for example, the seller thinks the target is worth *X*, while the buyer thinks the target is worth *X*-5.[88] A mechanism that can bring the two parties' valuations closer together saves deals that would otherwise be lost, thereby

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[85] *See* Cigna Health & Life Ins. Co., 107 A.3d 1082.

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

[87] *Id.* at 2684-85.

[88] Gilson, *supra* note 20, at 263.

creating value.[89] Gilson uses earnouts as an example of a provision that brings parties' values closer together, but an ancillary agreement that lowers the buyer's deal cost also achieves the same goal—that is, more deals happen when parties are able to be closer in valuation of the target. The indemnification in *Cigna* serves the same purpose: it lowers the buyer's risk and cost, making it more likely that the parties will agree on a deal.

General releases, like the ones used in *Cigna,* can also serve a similar function. Unlike the indemnification, which appeared in the acquisition agreement and two ancillary agreements, the general release in *Cigna* appeared only in the two ancillary agreements. At first blush, this provision-allocation decision is somewhat puzzling: why allocate risk X to two documents that, together, obtain general releases from all shareholders? 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 lowers back-end litigation and enforcement costs. The purpose of a general release is to release the buyer, broadly, from post-closing claims. If a shareholder who has signed the release sues the buyer post-closing, the buyer will want to point to the release in order to have the case dismissed. If 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 into a nimble, usable document in later litigations, which makes future litigations 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 some parties who 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 non-signatory group: the minority shareholders. Although the court found that risk allocation improper under Delaware's merger statute, parties had, for years before *Cigna* went to court, been offloading that risk onto the minority through an ancillary agreement. Even outside of the letter of transmittal context, ancillary parties may be disadvantaged. An employee who is not a majority shareholder may sign an employment agreement, for example, 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.

[89] *Id.*

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c. Time Specificity

An acquisition agreement comes into effect when it is signed, and generally loses its potency at closing.[90] But parties interact before signing, and often continue interacting post-closing. 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.[91] There is a rich literature on why and how preliminary agreements add value to deals; namely, that they help parties deal with early-stage uncertainty and deal complexity.[92] This Article sets aside a discussion of preliminary agreements, and, within the realm of pre-acquisition agreement interaction, focuses only on the confidentiality agreement.

Unlike preliminary agreements, confidentiality agreements are not bare-bones versions of acquisition agreements: instead, they govern party behavior during deal negotiation. Confidentiality agreements 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).[93] Because of the timing of confidentiality agreements—they are the first agreements signed in potential deals[94]—they play a critical role in creating space for parties to consider deals. In the preliminary negotiation stage, parties want to share information to evaluate the deal's potential, but also do not want to share information, because they are fearful that the information will be used improperly—for example, to poach each others' employees, or to reverse-engineer proprietary technologies. Confidentiality agreements help to resolve that tension by causing parties to agree to use confidential information only for deal evaluation.[95] In much the same way as the

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[90] Kling, et al., *supra* note 26, at 804-05 (noting that most conditions and representations and warranties do not survive closing).

[91] Schwartz & Scott, *supra* note 31, at 664 (describing preliminary agreements as written memorializations of the parties' intent where certain material terms are decided, but others are open).

[92] Choi & Triantis, *supra* note 31, at 1 (arguing that commercial agreements are entered into in stages because "uncertainty and transaction costs make it infeasible for parties to settle on core issue of their contract" and also because "some agreements are simply too complex or time-consuming to be completed in a single stage").

[93] Hahn, *supra* note 35, at 1396 (noting that confidentiality agreements are signed before acquisition agreements).

[94] *Id.*

[95] Igor Kirman, M&A & PRIVATE EQUITY CONFIDENTIALITY AGREEMENTS LINE BY LINE: A DETAILED LOOK AT CONFIDENTIALITY AGREEMENTS IN M&A AND PRIVATE EQUITY AND HOW TO CHANGE THEM TO

deal technologies Gilson describes, confidentiality agreements create economic value by bridging parties' differences and making deals possible in the first place.

Parties also use ancillary agreements to govern post-closing party interactions. Transition services agreements, lease-backs of real property, and employment agreements are ready examples.[96] These agreements cover parts of the deal that are essential to making the deal worthwhile, but that exist outside of 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 technology that saves deals that would die in their absence.

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

B. Alternative Explanations for Unbundling: Anticipated Critiques and Responses

So far, 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 up front. Suppose that one of these alternative explanations is true: unbundled bargains are not the result of considered contracting innovation, but rather an accident of path dependency, the result of a principal-agent problem, or a way to dodge disclosure. Even if these are true, they 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 or how unbundled bargains arose is not nearly as interesting as the question of what unbundled bargains actually do.

MEET YOUR NEEDS (1st ed., 2008); *Id.* (noting that "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").

[96] *See* Part II(A)(1)(a), *supra*, for a discussion of ancillary agreements governing ongoing relationships post-closing.

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1. *Precedent and Path Dependency*

One set of critiques may suggest that unbundled bargains are not the result of considered contracting decisions, but 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.[97] 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, and, once that ancillary agreement becomes part of a deal and that deal becomes the precedent for another deal, that ancillary agreement is there to stay.[98] While this explanation for the rise of unbundled bargains may have some truth, it should not undermine the fact that unbundled bargains do appear to have efficiency benefits.

It is no secret that deal lawyers rely on precedent for almost every aspect of a deal.[99] 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 they particularly like 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—junior associates' documents—that she has used in the past.

But adherence to precedent is not necessarily inefficient. Other scholars have noted that "[f]orms and precedent are undoubtedly the backbone of corporate practice and there is often no reason to start from scratch."[100] Blank-page drafting is, at a minimum, time-consuming: just taking the time to type hundreds of pages from scratch consumes many hours. Moreover, precedent can improve dealmaking in several ways. First, because deal terms are often complex and convoluted, precedent documents have the benefit of containing already ironed-out language. This saves the lawyer from having to spend time drafting terms to reflect the complex terms that the parties desire. Second, in negotiations, deal lawyers often discuss whether or not a particular deal term is "market"—that

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[97] *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 (1996) (arguing that behavioral biases, rather than increasing returns, may lead to industry standardization of contracts).

[98] Davidoff & Sautter, *supra* note 20, 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. . . . As soon as there are a handful of examples, the precedent-based argument becomes the downhill snowball").

[99] *Id.*

[100] Victor Fleischer, *Deals: Bringing Corporate Transactions Into the Law School Classroom*, 2002 COLUM. BUS. L. REV. 475, 482 (2002).

is, whether it falls within the current market norms. A lawyer who uses a precedent deal can often, in negotiations, name her precedent and note that a particular previous deal used a term she is proposing. This cuts down on negotiation time. Third, because of widespread precedent use, many deal documents are now remarkably similar. That 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 have to spend remarkably little time learning a new deal document organizational structure from deal to deal. Marcel Kahan and Mike Klausner identified this phenomenon as a "network benefit," and discussed the fact that they can mirror the learning benefits of network products like standardized hardware, thereby increasing contract quality, lowering drafting costs, lowering enforcement costs, and making it easier for investors to price terms.[101] 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 in her favor, she can be more confident that a lawsuit involving her deal may come out in her favor, too. The first three benefits of relying on precedent reduce front-end design costs, while the last benefit reduces the probability of an unfavorable litigation outcome, which reduces back-end enforcement costs.

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.[102] 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 figured it out and been handsomely rewarded for their innovative contracting practices.

2. *Lawyers as Agents*

Another set of critiques suggests that unbundled bargains are not accidents of transactional practice, but rather, the result of concerted effort 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

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[101] Kahan & Klausner, *supra* note 97, at 351-52 (discussing the benefits of network-benefit contractual provisions over time).

[102] Shayndi Rice, *How Tax Inversions Became the Hottest Trend in M&A*, WALL ST. J. (Aug. 5, 2014, 3:34 P.M.) (reporting on how lawyers on a law-firm retreat "figured out a plan that could persuade clients to take the brakes off mergers and acquisitions," and, after pitching the so-called tax inversion to clients, was able to benefit handsomely from the deal innovation).

a bargain means more hours can be billed to the matter, which maximizes a deal lawyer's interest (to collect more in fees) rather than a client's (to reduce overall deal cost on the front end and the back end). 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 always bill for work by the hour, and deal lawyers get paid only for front-end deal design. If these assumptions are true, then unbundled bargains are perhaps not efficient for the client—rather, they simply add value for the lawyer.

This argument, however, relies on an overly simplistic characterization of deal lawyers as agents. As others have argued, 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 relationships. Deborah DeMott calls lawyers "distinctive agents," and argues that a lawyer's good behavior is monitored not just by clients, but also monitored by courts (who can sanction lawyers for bad behavior) and self-regulated by peers.[103] As a result, although lawyers *are* agents, the fact that that lawyers are answerable to non-clients who help monitor lawyers' behavior mitigates the bad behavior one would expect from a more typical agency relationship.[104]

Moreover, while features of the legal industry can exacerbate an agency problem, neither of these features is necessarily present. 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. If this were true, then deal lawyers, regardless of whether they are acting as good agents 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, but only that front-end billing is a way to extract more rent from the client.

In reality, however, neither a good lawyer nor a bad lawyer focuses only on the front of deal design. The market for providing deal advice is competitive, so even front-end focused lawyers cannot cartoonishly drive up the client's bill, for fear of the client taking her business elsewhere. Relatedly, clients and lawyers are repeat players. A deal lawyer is highly incentivized to provide good counsel, good service, and reasonable prices to a client. This automatically

[103] Deborah A. DeMott, *The Lawyer as Agent*, 67 FORDHAM L. REV. 301, 305-06 (1998) (arguing that "[c]oncurrently with the lawyer's representation of the client, the lawyer owes duties directly to the court. . . . Furthermore, lawyers are distinctive as agents as a consequence of the robust professional culture and standards that define a lawyer's professional identity").

[104] *Id.*

causes the lawyer to internalize some of the back-end enforcement costs: if a lawyer routinely turns out a bad product that ends up being litigated, a client is likely take her future business elsewhere. Finally, law firms that provide elite front-end advice often 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.[105]

The second and related assumption that could exacerbate the agency problem is that, in general, deal lawyers bill by the hour. Hourly billing incentivizes lawyers, good or bad, to drive up front-end deal costs, which misaligns with the client's interest in reducing deal cost. In fact, however, some law firms explicitly charge clients a flat fee,[106] and still others give clients large and arbitrary discounts that, for all intents and purposes, change bills into flat fees. Yet, even when fees are fixed, unbundling occurs. This suggests that unbundling, even though it may create more work for the lawyers, is still being used because it promotes a worthwhile increase in deal efficiency.

3. Disclosure Differentiation

Finally, a third critique assumes away any complacency on the part of lawyers. Instead, it concedes that parties and lawyers created unbundled bargains, but argues that unbundled bargaining is nonetheless 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, and 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

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[105] A client returning to the same firm that provided front-end advice for back-end advice is not as far-fetched 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 fault of deal lawyers. Moreover, clients may have ongoing relationships with certain firms that make it beneficial for clients to return to the same firm for litigation advice: for example, a client may have a firm on retainer, may receive a discount for services from a particular firm, or may believe that having its original deal lawyers available to advise on the litigation is cost-efficient. *See* CORNERSTONE RESEARCH, SHAREHOLDER LITIGATION INVOLVING ACQUISITIONS OF PUBLIC COMPANIES: REVIEW OF 2014 M&A LITIGATION (2015) 1, *available at* https://www.cornerstone.com/GetAttachment/73882c85-ea7b-4b3c-a75f-40830eab34b6/-Shareholder-Litigation-Involving-M-and-A-2013-Filings.pdf (reporting that in 2014, 93% of M&A deals valued over $100 million were litigated, and that this figure was down slightly from previous years' trends).

[106] Susan Beck, *A Glimpse into Wachtell's Mysterious Billing Structure*, AM. L. DAILY (Jan. 8, 2015) (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").

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).[107] 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, each of whom owns half the company: A and B. The buyer wants to retain both post-closing, but A is a squeaky wheel who wants $1 million per year, and B is happy with half as much. Both A and B are signatories to the acquisition agreement, so, in theory, their employment terms could be part of the acquisition agreement. But if the two agreements are separated out of the acquisition agreement, A and B will not know each other's compensation, which means B will not be able to negotiate for a higher amount based on A's demands. And, in fact, employment agreements usually *are* separated out—doing so lowers the buyer's costs (when B does not negotiate for a higher salary), which, like many deal technologies discussed here, begins to bridge the expectation gap between buyers and sellers. 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 is 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 to 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. The difference, however, is that public companies give up much of their right to disclosure differentiation when they become public, so their use of ancillary agreements to achieve that goal 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.[108] In practice, this means

[107] JONES DAY, PUBLIC DISCLOSURE REQUIREMENTS FOR PRIVATE COMPANIES: U.S. V. EUROPE (Oct. 2012), *available at* http://www.jonesday.com/public_disclosure_requirements/.

[108] JIM MOLONEY, MIKE TITERA, & KEVIN HILL, GIBSON, DUNN & CRUTCHER LLP, *What's the Big Deal?: Why Some Seemingly Material Acquisition Agreements Might Never See the Light of Day*, 8 DEAL LAW. 1, *available at*

that for a material M&A deal, companies disclose acquisition agreements,[109] 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 spin-off deals.[110] In 2010, HCP, a REIT, bought the real property of ManorCare, a company that owned more than 300 nursing homes.[111] Because REITs enjoy tax-advantageous treatment, the deal would lower overall tax payments. An essential part of the HCP/ManorCare deal—and, indeed, a key selling point of most REIT spin-offs[112]—was that, post-closing, the buyer leases back the real property to the seller.[113] It is hard to imagine how the deal could have been done without the promised lease-back, which was governed by a master lease.[114] For ManorCare, the lease-back 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 lease-back 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 be 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 clearly part of the unbundled bargain.

Disclosure differentiation is, admittedly, a tricky critique to address. On one hand, in the case of both private and public companies, disclosure

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http://www.gibsondunn.com/publications/Documents/Moloney-Titera-Hill-Whats-the-Big-Deal-Deal-Lawyers-2014.11.pdf (Nov.-Dec. 2014) (discussing the SEC's disclosure requirements for material contracts).

[109] *Id.* at n.4, citing SEC Release No. 33-8400, Additional Form 8-K Disclosure Requirements and Acceleration of Filing Date (Aug. 23, 2004), *available at* http://www.sec.gov/rules/final/33-8400.htm (noting, in the release issued concurrently with the adoption of disclosure requirements in Item 1.01 of SEC Form 8-K 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").

[110] Although a full examination of REIT spin-off deals is outside of the scope of this Article, I will address REIT spin-offs in a future article about the rise of innovative deal structures.

[111] Michael J. de la Merced, *Carlyle to Sell ManorCare Real Estate for $6.1 Billion,* N.Y. TIMES DEALBOOK (Dec. 14, 2010), http://dealbook.nytimes.com/2010/12/14/hcr-manorcare-in-6-1-billion-deal-with-hcp/, (reporting on the sale of ManorCare to HCP).

[112] Polster, et al., *supra* note 51 (noting that "[s]pun-off REITs engage in ongoing lease and contractual relationships with the legacy operating companies.").

[113] HCP, Inc., Current Report (SEC Form 8-K) 4 (Dec. 14, 2010) (disclosing that "[i]mmediately 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.").

[114] *Id.*

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, the requirements could be tweaked so that *all* contracts relating to a material *deal* (rather than just "material contracts") be disclosed. A more tailored version of this might demand that all *major* contracts of material deals be disclosed.

The tweak, interestingly enough, requires that securities regulators recognize that a set of contracts could be, in fact, an unbundled bargain. Reframing a set of related contracts as an unbundled bargain could lead to more holistic disclosure of the main documents related to material deals.

C. Redefining the Boundaries of the Deal

Ancillary agreements are ubiquitous in M&A deals. And, whether they are an efficient way to make deals or not, and whether they arose to make deals more efficient or out of lawyers' own self-interest, they do, as a matter of fact, exist in concert with the acquisition agreement to form deals. M&A deals are, in fact, unbundled bargains—they are deals that are governed by multiple agreements, rather than just one.

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 a particular provision out to an ancillary agreement, an M&A lawyer faces a decision that resembles the decision a firm faces in Ronald Coase's seminal work, *The Nature of the Firm*.[115] Specifically, Coase notes that the size of a firm—its boundary—is determined by whether a firm chooses to integrate vertically by making production components internally, or to buy that component from outside of the firm. The former grows the size of the firm (and its boundary), 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 ancillary agreements shrinks the deal, and keeping a provision in acquisition agreement enlarges the deal.

While the M&A lawyer's *decision-making process* resembles the firm's, however, the result of those decisions is not the same. When a firm decides to buy from outside of the firm, the firm's boundaries do not grow. In contrast, when an M&A lawyer allocates a part of the deal to a specialist (rather than

[115] *See supra* note 62 (discussing how firm boundaries are established under the Coasean model).

keeping it in the acquisition agreement), it is not shrinking the size of the deal—it 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. Rather, it is simply sequestered, but still part of the deal.

A better analogy between M&A deals and the firm, then, 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 whole deal, the whole deal is actually much larger than scholars have assumed. The boundaries of the deal, too, are much larger than assumed. That is, the way courts, scholars, and parties think about the deal's boundaries must be expanded, extending that conception to cover deal-related ancillary agreements as well as the acquisition agreement.

To be sure, the assertion that the deal's boundaries extend beyond the acquisition agreement presents a fairly significant line-drawing problem. That is, 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 muddles the matter: 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)? Is approximately contemporaneous signing with the acquisition agreement the determinant of whether an ancillary agreement is part of an unbundled bargain, or can parts of the unbundled bargain be signed far in advance of, or far after, the acquisition agreement?

Somewhat unsatisfyingly, the answer to these questions is that there is no absolute test to determine precisely where the boundaries of a deal end. Using a deal checklist as a starting point is a relatively low-cost and low-tech way to determine the approximate deal boundaries right now, 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. This Article argues, in Part III, that if a dispute arises over the interpretation of one piece of an unbundled bargain, the other pieces of that unbundled bargain ought to be used as interpretive context. If parties know that checklists are used to determine the boundaries of the deal, they may be motivated to change the checklist in order 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 in its primary

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function—that is, it makes checklists less useful as an organizational tool. Moreover, because checklists are non-enforceable and non-binding, can be changed unilaterally, and *are* changed unilaterally (many times) throughout the deal, their usefulness as a boundary-setter is limited to being used as a guidepost, rather than as a definitive document that shows the deal's boundaries.

In the absence of a precise rule for where a deal's boundaries end, 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 boundaries. This Article uses those easily-identifiable points to develop Part III's implications. For example, ancillary agreements entered into roughly at the same time as the acquisition agreement or the deal's closing are part of the unbundled bargain. Assuming no manipulation of the checklist to influence later litigation outcomes, agreements listed on the deal checklist are ancillary agreements that are presumptively part of the unbundled bargain.[116] Term sheets and other preliminary agreements are outside of the boundaries, as they do not qualify and tweak the acquisition agreement's terms—rather, they are setting an early version of the acquisition agreement's terms. Confidentiality agreements, as this Article has noted elsewhere, 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.[117]

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 for deal design. This Part builds on the theory of the deal established in prior parts to make two additional contributions to the literature. First, it argues that if parties' intent is manifest in multiple agreements in an unbundled bargain, then courts should consider the entire set of deal documents when interpreting one contract disputed within that set. This "permeable approach" to contract interpretation best enables a court to ascertain the parties' intent. Second, a permeable approach can also motivate more efficient unbundling during the deal design phase, and ultimately give parties more freedom to design deals the way they want.

The rest of this Part is organized as follows. Subpart A provides a brief overview of current textualist and contextualist approaches to contract interpretation. Subpart B introduces permeable interpretation as a way to approach contract disputes that arise out of unbundled bargains, and discusses how that interpretation can improve interpretive accuracy. Subpart C suggests that

[116] For the purposes of interpretation, which is discussed in Part III(B), *infra*, this subset is further narrowed to only those ancillary agreements that are *enforceable contracts*.

[117] *See supra* Part II(B).

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interpretive permeability can also motivate parties to engage in more efficient dealmaking ex ante. In totality, this Part argues that reframing an M&A deal as an unbundled bargain can improve both deal contract enforcement ex post, and deal design ex ante.

A. Textualism and Contextualism

Contract theorists and courts are divided over whether to admit extrinsic evidence in interpreting disputed contracts. While textualists argue that generalist courts should not use context to interpret a disputed contract, contextualists argue that courts should (and must).[118] Each method has its own benefits and shortcomings, overviewed briefly here.

Textualism begins with two fairly uncontroversial views, both of which this Article shares. First, "although accurate judicial interpretations are desirable," "no interpretative theory can justify devoting infinite resources to achieve interpretive accuracy."[119] Second, both ex ante contract drafting and ex post litigation are costly. The cost of a contract is the sum of its ex ante drafting cost, and the probability of an ex post litigation, the latter of which is multiplied by litigation cost.[120] Ex ante and ex post costs are inexorably linked: more investment in the front end reduces back-end costs, and less investment (and less specificity) on the front end increases back-end litigation costs. Textualists argue that when drafting contracts, sophisticated parties make a considered decision about 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[ed] as much or as little of the contractual context as they wish in a written, integrated contract."[121] Because they have already made this trade-off, sophisticated parties prefer textualist interpretations 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.

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[118] Ronald J. Gilson, Charles F. Sabel & Robert E. Scott, *Text* and *Context: Contract Interpretation as Contract Design*, 100 CORNELL L. REV. 23, 25 (2014) (noting that "[i]n 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) (laying out some basic differences between textualist and contextualist interpretation regimes); Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L.J. 541 (2003) (setting out a modern formalist/textualist theory of contract law and contractual interpretation).

[119] Schwartz & Scott, *Contract Interpretation Redux*, *supra* note 118, at 930.

[120] This is a simplified take on Judge Richard 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 cost, and e is judicial error costs. Posner, *supra* note 58, at 1583.

[121] Gilson, Sabel & Scott, *supra* note 118, at 26.

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.[122] The plain meaning rule "supposes the parties to be communicating in a 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*.[123] 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 similar bargaining defect."[124] 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."[125] Textualists prefer a hard parol evidence rule that "restricts courts to a narrow evidentiary base when identifying the contract's terms."[126]

In contrast, contextualists argue that courts *need* to consider extrinsic evidence in contract interpretation in dealing with both unsophisticated and sophisticated contract parties.[127] When a contract party is unsophisticated—such as in mass-market clickwrap terms and conditions—context should be considered to protect those unsophisticated, passive parties from exploitation through take-it-or-leave-it contract terms. When 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, "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."[128]

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[122] *Id.*; Schwartz & Scott, *Contract Interpretation Redux*, *supra* note 118, 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").

[123] Schwartz & Scott, *Contract Interpretation Redux*, *supra* note 118, at 932.

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

[125] *Id.*

[126] Schwartz & Scott, *Contract Interpretation Redux*, *supra* note 118, at 932.

[127] Gilson, Sabel & Scott, *supra* note 118, at 27.

[128] *Id.*

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Contextualists prefer a soft parol evidence rule: one that uses extrinsic evidence to determine whether the exceptions to the parol evidence rule apply.[129] For example, one exception to the parol evidence rule is that extrinsic evidence can be used to explain terms when a contract is deemed incomplete. An application of hard parol evidence 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.[130] In contrast, contextualists might not presumptively declare such a contract complete, and rather may look for extrinsic evidence that suggests that the contract is incomplete.[131] Eric Posner notes that "[i]n 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."[132]

In recent years, a rich literature has arisen around textualist and contextualist interpretations of contract.[133] Courts, too, have adopted different methods of approaching contract interpretation—New York courts (and many others) take a textualist approach, while California courts veer contextualist.[134] The main shortcoming of textualism is that it sacrifices accuracy in favor of cost savings. Schwartz and Scott, in their defense of formalism (*i.e.,* 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."[135] For example, textualist courts are more likely to grant summary judgment, because they do not need to conduct a trial to examine extrinsic

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[129] Posner, *supra* note 124, at 534.

[130] *Id.* (noting that "[t]he 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"); citing E. Allan Farnsworth, Contracts, §73, at 474 (2d ed. 1990).

[131] *Id.*

[132] *Id.*

[133] Gilson, Sabel, & Scott do a particularly good job of summing up the two sides' arguments. *See* Gilson, Sabel & Scott, *supra* note 118 (describing the major points of textualist and contextualist views of contract interpretation).

[134] Schwartz & Scott, *Contract Interpretation Redux*, *supra* note 118, at 928 (noting that "states holding the [textualist] view are led by New York, while California is the most significant contextualist jurisdiction"). *See also* Bionghi v. Metro. Water Dist. of So. Cal., 83 Cal. Rptr. 2d 388, 393 (Cal. 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") (quotations omitted).

[135] Schwartz & Scott, *Contract Interpretation Redux*, *supra* note 118, at 934.

evidence, which reduces ex post enforcement costs.[136] Contextualism, on the other hand, is criticized for being a costly way to interpret contracts, and one that does not incentivize parties to draft carefully and *does* incentivize perverse behavior.[137] As Gilson, Sabel, and Scott 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. 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, facially interpreted, would direct."[138]

B. Permeable Interpretation: Improving Deal Enforcement Ex Post

A principal canon of contract interpretation is that, when contracts are in dispute, the court seeks to ascertain the intent of the parties.[139] This Article has argued that every M&A deal is an unbundled bargain, 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. Analogously, permeable interpretation argues that when one *agreement* in an unbundled bargain is in dispute, the other agreements in the unbundled bargain should provide interpretive context. Because the parties' intent in an unbundled bargain is memorialized in several agreements, courts can ascertain the parties' intent only by examining all of the agreements in which that intent is memorialized. To analyze less would be to sever, artificially, parts of the bargain that can provide essential interpretive context.

Permeable interpretation proposes a default that is different from the limited context in which courts will currently consider other agreements in interpreting a disputed agreement. Courts will currently consider other agreements only where the court deems those other agreements "collateral" to the one in dispute[140]—a narrow and technical exception to the general rule. In

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[136] Gilson, Sabel & Scott, *supra* note 118, at 42 (noting that "textualist interpretation permits legally sophisticated commercial parties to economize on contracting costs by shifting costs to the back end . . . . Importantly, when parties fully integrate the agreement and use a merger clause, an interpretation dispute over contract terms may be resolved in summary judgment, thereby substantially reducing ex post enforcement costs").

[137] *Id.* at 41.

[138] *Id.*

[139] Greenfield v. Philles Records, Inc., 780 N.E.2d 166, 170 (2002) (noting that "[t]he fundamental, neutral precept of contract interpretation is that agreements are construed in accord with the parties' intent").

[140] 11 *Williston on Contracts*, *supra* note 21, at § 33:28 (noting that the parol evidence rule "does not apply to a collateral agreement").

contrast, permeable interpretation brings in, as a default, all of the parts of the unbundled bargain, without inquiry into whether they satisfy the narrow definition of "collateral."[141]

The idea that all of the agreements in an unbundled bargain can be used to interpret each other is what this Article calls "permeable interpretation." A permeable interpretation is not the same as contextualism—it does not propose that much extrinsic evidence be introduced into the interpretation of a contract, at all.[142] Instead, permeable interpretation is based on the premise that unbundled bargains are memorialized in several pieces, by intention, and that those pieces of the puzzle that are roughly contemporaneous, and enforceable, need to be considered in the interpretation of any one piece. In one sense, permeable interpretation is more textualist than contextualist. It posits that 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. It adds, however, that intent spans many contracts, rather than just one, so an investigation of more than one contract is necessary to ascertain intent.

In the context of deal disputes, permeable interpretation has benefits over both textualist and contextualist interpretations. As compared to textualism, a permeable approach is more accurate: it includes extrinsic evidence. As compared to contextualism, a fully permeable approach is cheaper. While contextualism might consider preliminary agreements, or even deposing witnesses to determine intent, permeable interpretation does not: it simply brings into the inquiry executed and enforceable deal components.[143] In striking this middle ground, permeable interpretation does sacrifice some cost savings in favor of increased accuracy. In reality, however, when a deal is in dispute, the parties' lawyers likely already investigate all of the parts of the unbundled bargain to gain a fuller picture of the parties' dealings. Thus, permeable interpretation adds little to the parties' investigation costs, although it does add more to the judiciary's cost, in that it requires judges to investigate more documents in making an interpretative determination.

Permeable interpretation can be applied broadly to disputes arising between primary deal parties and third parties, or in disputes arising between

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[141] An agreement is collateral if "the court is convinced . . . reasonable parties situated as these parties were would naturally or obviously or normally" "simultaneously make both the agreement in writing, which is before the court, as well as the alleged parol agreement." *Id.* In other words, an agreement is "collateral" only if, in the eyes of the court, it contains a part of the deal that is customarily broken out of the disputed agreement.

[142] In contrast, contextualism would tend to admit any evidence that might shed light on the dispute at hand. *See* 67 Wall St. Co., 333 N.E.2d 184, at 186 (1975).

[143] *See supra* Part II(C) (discussing the difficulty in identifying what belongs in the permeable inquiry).

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primary deal parties. The former is an easy case, and the latter is harder; the following subparts consider each in turn.

1. *Easy Cases*

Suppose that Seller Corp. and Buyer Corp. enter into an acquisition agreement under which Buyer, an Alaska-based department store, would buy the intellectual property of Seller, an Italy-based fashion house that owns several prominent clothing brands. A closing condition is that several members of Seller's design team must sign employment agreements with Buyer, which include provisions agreeing to relocate from Italy to Alaska. Post-closing, one of these agreements, between Buyer and designer Joan, is in dispute, and resolution turns on interpretation of one provision.

A strict textualist approach to interpreting that contract would look within the four corners of the employment agreement for resolution of this dispute. If the employment agreement had an integration clause that brought the acquisition agreement into the dispute, then a textualist court would look beyond the employment agreement, and at the acquisition agreement and other integrated agreements.[144] In contrast, a contextualist approach may look far outside of the four corners of the employment agreement, at term sheets and preliminary versions of the agreement, or rely on the testimony of Joan and the Buyer's executives, in order to ascertain the parties' intent.

A permeable approach takes a third path. The employment agreement's existence suggests that the primary deal parties have chosen to express part of their intent outside of the four corners of the acquisition agreement—part of it is in the employment agreement between Buyer and Joan. The employment agreement also cannot exist in a vacuum—the rest of the unbundled bargain is the but-for cause of the employment agreement. Because the employment agreement and the other parts of the unbundled bargain are inextricably linked, they ought to be considered together when one of them is in dispute.[145] Without considering the other parts of the bargain when interpreting one agreement in dispute, courts are unable to determine the whole intent of the parties.

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[144] An integration clause specifically including other agreements would "evidence clear intent" that the agreements be read together. Fundamental Long Tem Care Holdings, LLC v. Cammeby's Funding LLC, 985 N.E.2d 893, 897 (N.Y. 2013).

[145] Even textualist courts have, at times, 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 (N.Y. App. Div. 1989).

2. *Hard Cases*

A harder case arises when interpretation disputes are between primary deal parties over the primary deal document—the acquisition agreement. Most acquisition agreements have an integration clause that specifically sets forth the few ancillary agreements that ought to be considered part of the bargain—for example, ancillary agreements X, Y, and Z. Together, the acquisition agreement and X, Y, and Z are meant to form the entirety of the deal, and the deal's boundaries are drawn around those items.

A textualist approach to interpreting a dispute between Buyer and Seller, in these cases, would dictate that only the acquisition agreement and X, Y, and Z be considered in a dispute arising out of the acquisition agreement. Textualists argue that sophisticated parties are able to make an accurate trade-off between front- and back-end contract costs, and therefore, they have made a front-end decision to limit back-end interpretative scope to those few agreements.[146] In contrast, a contextualist might take a far more expansive view, perhaps again deposing key executives on either side to determine the parties' intent.

A permeable approach, however, suggests that in disputes between two sophisticated primary deal parties over the primary deal agreement, it may still make sense to look beyond the integration clause. There are several reasons for this somewhat radical suggestion. First, in an unbundled bargain, the full intent of the parties is memorialized in a dispersed set of agreements that, together, form one bargain. Integration clauses artificially limit interpretation to a subset of that full expression of intent. The textualist approach presumes that parties intentionally excluded parts of the deal through careful engineering of front- and back-end costs. This presumes too much—in fact, the parties may not recognize that their deal is unbundled to the extent that it is, and have, instead, chosen to integrate only the most important agreements to the inadvertent exclusion of other significant, but physically smaller, agreements that still form part of the deal.

Second, the permeable approach effects the goal of the integration clause without sacrificing a full understanding of the parties' intent. In that way, a permeable approach takes parts of the benefits of both textualist and contextualist approaches. Parties use integration clauses to limit costly contextualist investigation of parties' intent.[147] This investigation can be both costly and unreliable, as parties dig into preliminary agreements, prior

[146] Schwartz & Scott, *Contract Interpretation Redux*, *supra* note 118.

[147] *See, e.g.*, Primex Int'l Corp. v. Wal-Mart Stores, Inc., 679 N.E.2d 385, 388 (1997) (noting that "the 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").

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negotiations, and potentially faulty memories of the individuals involved.[148] A permeable approach also limits costly investigation, although admittedly not to the extent of a tight integration clause. In exchange for the additional cost of investigating other parts of the unbundled bargain, however, disputes are able to be resolved in light of the full expression of the parties' intent.

One test of whether permeable interpretation truly limits cost is to ask whether parties can still have summary judgment in a dispute that is interpreted this way. A fully contextualist inquiry can never be resolved on summary judgment; contextualist inquiries always yield issues of fact that require trial.[149] 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 simply examines more pages.

C. *Deal Design: Optimal Unbundling*

Taking a permeable approach to interpreting ex post deal disputes also motivates parties to engage in efficient deal design ex ante. This Article has argued that parties often unbundle their bargains in order to increase dealmaking efficiency: they might delegate the modules of a deal to subject-matter or simplicity specialists in order to improve deal quality while only marginally (if at all) increasing deal cost.[150]

Parties *want* to have the freedom to unbundle, and permeable interpretation makes that possible. Specifically, if parties know that their dispute will be interpreted in a permeable way, then they will have the freedom to slice and dice their deals into as many pieces as they think efficient, with the full assurance that all of the parts of the deal will be interpreted together if there is a dispute. For example, suppose that parties can choose to include a particular intellectual property provision in an acquisition agreement, or to put it in a module and assign that module—a separate part of the unbundled bargain—to a specialist. Under a strict textualist interpretation, putting part of the agreement in a module runs the risk of that part not being considered in an interpretation dispute. Under a more contextualist interpretation, that module will come into play in the inevitable trial phase of enforcement. Under a permeable interpretation, however, that module, as long as it is enforceable and part of the unbundled bargain (i.e., signed approximately contemporaneously with the

[148] *See, e.g.*, 67 Wall St. Co. v. Franklin Nat'l Bank, 333 N.E.2d at 186 (noting that, when admissible, parol evidence may include "evidence of conversations, negotiations and agreements made prior to or contemporaneous with the execution of" a contract).

[149] Schwartz & Scott, *Contract Interpretation Redux*, *supra* note 118.

[150] *See supra* Part II(A)(1)(a).

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acquisition agreement), will certainly be considered in interpreting an acquisition agreement dispute.

Permeable interpretation also disincentivizes parties from obfuscating parts of the deal in ancillary agreements. Returning to the example above, suppose that the parties want to excise the intellectual property provision in order to avoid having to disclose the details of that provision to regulators, counterparties, or third parties. Permeable interpretation means that, should parts of that unbundled bargain be disputed, details from those ancillary agreements *could* be disclosed. To be fair, those details could be filed with a court under seal to prevent widespread public disclosure, but it is likely that those parts will be disclosed to deal counterparties. Because the likelihood of disclosure of ancillary agreements increases under a permeable interpretation scheme, parties have less reason to use ancillary agreements purely for the purpose of obfuscation.

The effect of permeable interpretation on ex ante deal design brings the analysis back to this Article's original case study: *Martin Marietta*. After *Martin Marietta*, in which a deal was forestalled entirely because of an ancillary agreement, deal lawyers lambasted the court for reading into the confidentiality agreement an "implied standstill provision" where none was explicitly written.[151] *Martin Marietta* is a very special case, and one that demonstrates, particularly well, the new theory of the deal, the act of unbundled bargaining, and permeable interpretation set forth in this Article, for two reasons. First, as this Article has noted, confidentiality agreements reside at the outermost edge of a deal's boundaries: they share characteristics with both preliminary agreements and ancillary agreements, but this Article has argued that they fall slightly closer to ancillary agreements.[152] Thus, confidentiality agreements represent a boundary case: 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 part of an unbundled bargain. Second, while this Article has argued that ancillary agreements can shape or tweak the terms of the main deal, the provisions in *Martin Marietta*'s confidentiality agreement do more than "shape" or "tweak": they prevented a deal from happening at all, or at least not in the timeframe the parties wanted. In that sense, the confidentiality agreement, an ancillary agreement that lies on the boundaries of the unbundled bargain, had the maximum possible effect on the *Martin Marietta* deal.

There are two ways to think about the *Martin Marietta* case. First, many deal lawyers look only at the text of the confidentiality agreements, and note that the courts reached too far outside of those agreements' text to ascertain the parties' intent. This is a fairly typical textualist argument: sophisticated parties

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[151] *See supra* text accompanying note 16.

[152] *See supra* Part II(B).

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know what they are putting into their contracts, and it seems odd that the court would reach beyond the plain meaning of their contracts and into preliminary drafts to ascertain the parties' intent. Under a textualist approach that considers the *confidentiality agreement* as a standalone contract, the court appears to have stepped out of bounds in considering extrinsic evidence of prior negotiations in interpreting the contract.[153] However, another way to look at the *Martin Marietta* decision is to think of the confidentiality agreement as one part of an unbundled bargain-in-the-making: that is, it was the first step toward a deal between Martin Marietta and Vulcan. Reframing the confidentiality agreement as part of an unbundled bargain means that the *Martin Marietta* decision should actually buoy deal lawyers: it means that the Delaware courts have decided that even the most tenuously ancillary of agreements—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. That is, if a confidentiality agreement is part of the unbundled bargain, then the boundaries of the deal are very large—allowing parties more flexibility to slice and dice their deal documents within those boundaries. Reframing the Martin Marietta-Vulcan deal as an unbundled bargain, then, shows that, in fact, the *Martin Marietta* decision reflected the court's sophistication in identifying an unbundled bargain, and an ability for parties, in the future, to have more freedom in deal design.

IV. 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, rather than just one. Reframing an M&A deal as an unbundled bargain greatly expands the theoretical boundaries of the deal, and has significant implications for contract interpretation and transactional practice. Because the parts of an unbundled bargain—the deal's ancillary agreements—provide useful context for the entire deal, this Article argues that, when one deal document is in dispute, other parts of the unbundled bargain should be used as context for interpretation. This permeable approach to interpretation also incentivizes parties to use unbundled bargains efficiently when they are designing deals, because they can split one deal into many modules with the knowledge that the modules will be interpreted together in a dispute. While this Article has focused on unbundled bargains in complex M&A deals, the concept of unbundled bargaining has potentially broad applicability in the law.

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[153] The court in *Martin Marietta I* 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 at 1118.