

THE RECOGNITION OF PRELIMINARY AGREEMENTS IN NEGOTIATED CORPORATE ACQUISITIONS: AN EMPIRICAL ANALYSIS OF THE DISAGREEMENT PROCESS

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INTRODUCTION

One can hardly imagine a more dramatic example of the significance of preliminary corporate acquisition agreements than that found in the case of *Texaco, Inc. v. Pennzoil, Co.*,¹ in which the jury rendered a \$10.53 billion damage award against Texaco, Inc. ("Texaco").² That case arose out of what was held to constitute Texaco's intentional interference with a preliminary agreement between Pennzoil, Co. ("Pennzoil") and Getty Oil Company ("Getty") under which Pennzoil proposed to acquire Getty. In order to reach that result, it was necessary for the court to find that an enforceable agreement in that regard existed between Pennzoil and Getty despite the fact that, among other things, the ultimate agreement involved had neither been formally approved by the Getty board of directors nor executed by Getty.³

The decision in *Texaco* certainly punctuates the importance to third party bidders of determining the status of these agreements in negotiated acquisition transactions. The issue will, however, be equally important to the principal parties themselves, as that issue will determine the circumstances under which neither party may unilaterally walk away from the deal with impunity. The question will also be important to the principal parties in determining the circumstances under which their merger discussions will become "material" for purposes of the Securities Exchange Act of 1934,⁴ under the standard recently announced in *Basic, Inc. v. Levinson*.⁵ The exist-

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1. 729 S.W.2d 768 (Tex. Ct. App. 1987).

2. *Id.* at 784. The damage award at trial included \$7.53 billion in compensatory damages and \$3 billion in punitive damages; the punitive award was reduced by remittitur on appeal to \$1 billion. *Id.* at 866.

3. *Id.* at 785-86. See *infra* notes 120-21 and accompanying text.

4. 15 U.S.C. §§ 78a-78kk (1982).

5. 108 S. Ct. 978 (1988). *Basic* resolved the division among the federal circuit

ence of a binding preliminary agreement may also trigger board of directors duties,⁶ as well as important consequences under a variety of other agreements affecting the parties.⁷

Despite the critical importance of this issue, the decisions in this area, taken as a whole, continue to appear both confusing and inconsistent to the point where it is said to be virtually impossible to predict the outcome in a particular case.⁸ This, in turn, is said to make planning in negotiated merger or acquisition transactions extremely difficult.⁹

courts as to the standard for determining the materiality of preliminary merger discussions for purposes of section 10b of the Securities Exchange Act of 1934. *Id.* at 980, 982. The decision in *Basic* and its implications are reviewed in this volume at 22 CREIGHTON L. REV. 851 (1989).

6. See generally Brudney and Chirelstein, *Fair Shares in Corporate Mergers and Takeovers*, 88 HARV. L. REV. 297 (1974); Comment, *The Case for Facilitating Competing Tender Offers*, 95 HARV. L. REV. 1028 (1982); Buxbaum, *The International Division of Powers in Corporate Governance*, 73 CALIF. L. REV. 1671 (1985); Santoni, *The Integration of Contract, Corporate and Tort Law Principles: ConAgra, Inc. v. Cargill, Inc.*, 20 CREIGHTON L. REV. 317 (1986).

7. See J. FREUND, ANATOMY OF A MERGER, 60-62 (1975); Bryan, *Letters of Intent*, in 1 BUSINESS ACQUISITION 134-36 (J. Hertz & C. Baller 2d ed. 1981).

8. Temkin, *When Does the "Fat Lady" Sing?: An Analysis of "Agreements in Principle" in Corporate Acquisitions*, 55 FORDHAM L. REV. 125, 131 n.24 (1986); see Farnsworth, *Precontractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations*, 87 COLUM. L. REV. 217, 259-60, 269 (1987); Volk, *The Letter of Intent*, 16 INST. ON SEC. REG. 143, 145 (1985); Volk & McMahon, *Letters of Intent: Getty and Beyond*, 16 INST. ON SEC. REG. 445, 464 (1984). Temkin observes in this context: "The question of whether the parties to a contract intended to be bound is a factual one. As a result, decisions in this area appear inconsistent, and it is almost impossible to tell in advance how a court or jury would decide any particular case." Temkin, 55 FORDHAM L. REV. at 131 n.24 (citations omitted). Volk simply notes that the decisions have "come out all over the board." Volk, 16 INST. ON SEC. REG. at 464. Professor Farnsworth observes that the uncertainty in the area of preliminary agreements has generally been with us for some time:

It would be difficult to find a less predictable area of contract law. Nearly a century ago, the Supreme Court of Maine lamented that "the solution of the question is often difficult, doubtful and sometimes unsatisfactory." Some fifty years ago, Llewellyn singled out the rules governing such disputes to illustrate "accepted rules about our case-law which are utterly devoid of . . . meaning" when applied to the facts.

Farnsworth, 87 COLUM. L. REV. at 259-60 (quoting *Mississippi & Dominion S.S. Co. v. Swift*, 86 Me. 248, 259, 29 A. 1063, 1067 (1894); Llewellyn, *On Our Case-Law of Contract: Offer and Acceptance*, 48 YALE L.J. 1, 13 (1938)). The apparent confusion and inconsistency in these decisions is highlighted by the frequent reversals in the cases on appeal. See *Reprosystem, B.V. v. SCM Corp.*, 727 F.2d 257 (2d Cir. 1984), *cert. denied*, 469 U.S. 828, (1984); *Arnold Palmer Golf Co. v. Fuqua Indus., Inc.*, 541 F.2d 584 (6th Cir. 1976); *V'Soske v. Barwick*, 404 F.2d 495 (2d Cir. 1968), *cert. denied*, 394 U.S. 921 (1969); *Itek Corp. v. Chicago Aerial Indus.*, 248 A.2d 625 (Del. 1968); *infra* notes 147-48 and accompanying text; see also *Jewel Cos. v. Pay Less Drug Stores Northwest, Inc.*, 741 F.2d 1555 (9th Cir. 1984).

9. Temkin, 55 FORDHAM L. REV. at 131 n.24. Temkin states:

Because the results of these cases are seemingly unpredictable, planning becomes very difficult. Even well-advised parties may be unable to determine whether a contract had resulted from their action. This uncertainty may

The purpose of this Article is to examine these decisions empirically to determine whether, and to what extent, they may be reconciled. The Article will provide a brief background of the recurring factual patterns found in these cases and the legal principles held to be applicable to them. The discussion will then turn to a comparative analysis of the principal decisions,¹⁰ focusing on the objective distinctions between the cases that appear to produce opposite results in the context of otherwise synonymous operative facts.¹¹ Several possibilities will then be offered to explain the underlying rationale in these decisions. The conclusion is that, while the results reached in the decisions taken as a whole appear inconsistent with one another in terms of the facts found and legal analysis applied, these decisions may be reconciled through an empirical analysis. When so viewed, the results in these cases are not only consistent and highly predictable, they may also be placed on a sound analytical footing.

RECURRING FACT PATTERNS AND APPLICABLE LEGAL PRINCIPLES

By definition, the fact patterns found in preliminary acquisition agreement cases appear in the context of a "friendly" negotiated

cause the parties to be more reluctant to enter into negotiations out of fear that they may find themselves embroiled in a lawsuit if one party withdraws from the negotiations.

Temkin, 55 *FORDHAM L. REV.* at 131 n.24. Professor Farnsworth notes with respect to the regime of the "agreement to negotiate": "Concern over the enforceability of agreements to negotiate cannot but discourage their use." Farnsworth, 87 *COLUM. L. REV.* at 269. See *infra* notes 61, 166 and accompanying text. For reasons relative to corporate law, this concern is most acute in transactions involving the sale of control by a target whose shares are widely held. In response to this concern, alternatives to the traditional negotiated approach to corporate acquisitions have been developed, including such devices as "lockups," "break-up fees" and "no shop" covenants, although these techniques also are not without their own peculiar difficulties. See generally Herzl & Shepro, *Negotiated Acquisitions: The Impact of Competition in the United States*, 44 *BUS. LAW.* 301 (1989). See also *infra* notes 26, 39-42 and accompanying text.

10. This Article does not provide an analysis of all the decisions on this subject. The focus here is on the group of recent decisions frequently discussed and cited as reflecting the current body of decisional authority on the question of recognition and enforcement of preliminary agreements in negotiated corporate merger and acquisition transactions. See *infra* notes 12, 14 and 39. For an analysis of the questions of enforceability of preliminary agreements in general, see generally Farnsworth, 87 *COLUM. L. REV.* 217; Knapp, *Enforcing the Contract to Bargain*, 44 *N.Y.U. L. REV.* 673 (1969). For a discussion of less recent decisions on this subject in the merger and acquisitions context, see Ward, *The Legal Effect of Merger and Asset Sale Agreements Before Shareholder Approval*, 18 *W. RES. L. REV.* 780 (1967).

11. See *infra* notes 62-64 and accompanying text. The references herein to "operative facts" are to those facts involved in these cases, as discerned from the opinions, that are or should be operative in terms of the legal principles held applicable to determining the existence, *vel non*, of a binding preliminary agreement.

transaction, as opposed to a hostile or unilateral takeover attempt.¹² Although the transaction may not necessarily be friendly in the ordinary sense,¹³ it is not marked by the specialized tactics and defenses characteristic of hostile takeover bids.¹⁴ On the other hand, it should be observed that the agreement process in these cases may take place under the spectre of an actual or threatened hostile bid, since the negotiations themselves may have been initiated by the suitor as a preliminary alternative to or in the wake of a hostile approach.¹⁵ From the facts of the cases, however, it appears that once the agreement process is set in motion, the basic patterns found therein are not materially affected by the fact that the negotiations were precipitated by a real or perceived threat of a hostile takeover or by other forces.¹⁶

12. See R. GILSON, *THE LAW AND FINANCE OF CORPORATE ACQUISITIONS*, 816-54 (1986); Freund and Easton, *The Three-Piece Suitor: An Alternative Approach to Negotiated Corporate Acquisitions*, 34 *BUS. LAW* 1679, 1687-90 (1979). The parties to these transactions refer to their preliminary agreements by a variety of terminology, such as "letter of intent," "memorandum of agreement," and "agreement-in-principle." See *infra* notes 26-27. As will be seen throughout the discussion that follows, this terminology has no legally operative import. This Article will borrow Professor Farnsworth's general definition of the term "preliminary agreement" as "any agreement, whether or not legally enforceable, that is made during negotiations in anticipation of some later agreement that will be the culmination of the negotiations." Farnsworth, *Recontractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations*, 87 *COLUM. L. REV.* 217, 249-50 (1987).

13. See *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 176-79 (Del. 1986), where the "strong personal antipathy" between certain principals involved seemed to play a considerable role in the failure of an attempted negotiated transaction, later leading to a hostile bid. *Id.* at 176.

14. See, e.g., *Revlon*, 506 A.2d at 180-84; *Edelman v. Fruehauf Corp.*, 798 F.2d 882, 884-86 (6th Cir. 1986); *Hanson Trust PLC v. ML SCM Acquisition Inc.*, 781 F.2d 264, 268-72 (2d Cir. 1986) [hereinafter "Hanson II"]; *Hanson Trust PLC v. SCM Corp.*, 774 F.2d 47, 50-52 (2d Cir. 1985); *Samjens Partners I v. Burlington Indus., Inc.*, 663 F. Supp. 614, 617-21 (S.D.N.Y. 1987); *Hastings-Murtagh v. Texas Air Corp.*, 649 F. Supp. 479, 481, 484-86 (S.D. Fla. 1986); see generally Clemens, *Poison Debt: The New Takeover Defense*, 42 *BUS. LAW* 747 (1987); Finkelstein and Abrahams, *Lock-ups in Contested Takeovers*, 19 *REV. SEC. & COMMODITIES REG.* 117 (1986); Helman & Junewicz, *Fresh Look at Poison Pills*, 42 *BUS. LAW* 771 (1987). This Article is concerned only with those transactions considered to be authentic negotiated transactions motivated by factors other than "to defeat a disfavored acquisition." See R. Gilson, *supra* note 12, at 445. Thus, the transactions of the type involved in *Hanson II*, *Revlon*, *Fruehauf*, and *Samjens* are beyond the scope of this Article and are referenced solely for the purpose of distinguishing them from what are referred to as "friendly" transactions.

15. See, e.g., *American Cyanamid Co. v. Elizabeth Arden Sales Corp.*, 331 F. Supp. 597, 599-600 (S.D.N.Y. 1971); *Revlon*, 506 A.2d at 176-79; *ConAgra, Inc. v. Cargill, Inc.*, 222 Neb. 136, 143-53, 382 N.W.2d 576, 581-85 (1986), *reh'g denied*, 223 Neb. 92, 388 N.W.2d 458 (1986); *supra* note 14. A negotiated transaction may frequently contemplate a public tender offer following a preliminary agreement. See Freund and Easton, 34 *BUS. LAW* at 1686-87. Sometimes, largely for tactical reasons, the sequence may be reversed, with a tender offer followed by the suitor approaching the target concerning a negotiated transaction. See *Texaco, Inc. v. Pennzoil, Co.*, 729 S.W.2d 768, 785-86 (Tex. Ct. App. 1987).

16. See *Jewel*, 741 F.2d 1557-59; *Mid-Continent*, 319 F. Supp. 1181-87. *But see*

The cases show that, once the process begins, a broad but fairly clear and consistent factual pattern develops with respect to the character and sequence of the important events involved. This pattern shows the parties moving through separate, though not always distinct, stages of an agreement process beginning with negotiations over the points that, at least to them, represent the most fundamental and important elements of the deal, which normally relate to basic pricing considerations and financial terms.¹⁷ Once an agreement, or at least an agreement-in-principle, is reached on these points, the parties proceed through further stages to negotiate relatively less critical and fundamental terms, reaching an incremental agreement at each successive stage before proceeding to the next stage.¹⁸

This process may move very quickly¹⁹ or it may take considerable time²⁰ and may not appear to proceed at a constant pace or in an altogether coordinated fashion.²¹ At some point along the spectrum of the process, however, the parties will appear to have reached substantial, if not complete, agreement on most, if not all, of the fundamental and critical elements of the deal. At this point, they will almost invariably attempt to memorialize the cumulative increments of their preliminary accord in some form of writing,²² whether in a

Pennsylvania Co. v. Wilmington Trust Co., 166 A.2d 726, 727-30 (Del. Ch. 1960); *ConAgra*, 222 Neb. at 138-39, 382 N.W.2d at 577-88; *Texaco*, 729 S.W.2d 785-87.

17. J. FREUND, *supra* note 7, at 56 (1975).

18. *Id.* at 57-59; Farnsworth, 87 COLUM. L. REV. at 219; Knapp, *Enforcing the Contract to Bargain*, 44 N.Y.U. L. REV. 673, 673-75 (1969).

19. See, e.g., *Texaco*, 729 S.W.2d at 785-87 (involving an interval between the announcement of Pennzoil's \$100 per share public tender offer for sixteen million Getty shares, and the Getty board's approval of a negotiated transaction, which was less than seven days and occurred over a weekend and New Year's holiday); *Cyanamid*, 331 F. Supp. at 600-01 (following initial negotiations, a final draft of preliminary agreement in a \$35 million asset acquisition transaction was agreed to and executed in less than two days); *Field v. Golden Triangle Broadcasting*, 451 Pa. 410, 305 A.2d 689, 691 (1973) (involving a much smaller and less complex transaction wherein the parties completed initial negotiations and executed a preliminary agreement in a matter of hours).

20. See, R.G. Group, Inc. v. The Horn & Hardart Co., 751 F.2d 69, 70-74 (2d Cir. 1984). The process may span a considerable period of time, even in relatively straightforward simple transactions. See *T.C. V'Soske v. E.T. Barwick*, 404 F.2d 495, 496-98 (2d Cir. 1968).

21. See, e.g., *R.G. Group*, 751 F.2d at 70-74; *Reprosystem, B.V. v. SCM Corp.*, 727 F.2d 257, 258-60 (2d Cir. 1984); *Chromalloy American Corp. v. Universal Housing Systems of America, Inc.*, 495 F. Supp. 544, 546-48 (S.D.N.Y. 1980) (involving a negotiation process that was characterized by fits and starts).

22. See, e.g., *R.G. Group*, 751 F.2d at 71-74; *Jewel Cos., Inc. v. Pay Less Drug Stores Northwest, Inc.*, 741 F.2d 1555, 1557 (9th Cir. 1984); *Reprosystem*, 727 F.2d at 259-60; *Arnold Palmer Golf Co. v. Fuqua Indus.*, 541 F.2d 584, 586-87 (6th Cir. 1976); *V'Soske*, 404 F.2d at 497-98; *Chromalloy*, 495 F. Supp. at 547-48; *Cyanamid*, 331 F. Supp. at 600; *Mid-Continent Telephone Corp. v. Home Telephone Co.*, 319 F. Supp. 1176, 1183-84 (N.D. Miss. 1970); *Pepsico, Inc. v. W.R. Grace & Co.*, 307 F. Supp. 713, 714-16 (S.D.N.Y. 1969); *Field*, 305 A.2d at 691; *Itek Corp. v. Chicago Aerial Indus., Inc.*, 248 A.2d 625, 627-28 (Del. 1968); *Pennsylvania Co.*, 166 A.2d at 728-29.

conscious or unconscious effort on the part of either party to bind one another, to preserve the status quo pending a formal closing on a final agreement, or simply to facilitate negotiations on the remaining points to be covered.²³ This writing may consist only of correspondence²⁴ or may be embodied in a formalized document,²⁵ and this writing may or may not be confirmed, formally authorized or executed by the parties.²⁶ When such a writing is present, it will usually

23. See Farnsworth, 87 COLUM. L. REV. at 257-58; Knapp, 44 N.Y.U. L. REV. at 679-84; Temkin, 55 FORDHAM L. REV. at 127-30.

24. See, e.g., *Pepsico*, 307 F. Supp. at 715-16; *V'Soske*, 404 F.2d 497-98; *Itek*, 248 A.2d 627-29.

25. See, e.g., *R.G. Group*, 751 F.2d at 70-74; *Jewel*, 741 F.2d at 1557; *Reprosystem*, 727 F.2d at 259-60; *Arnold Palmer*, 541 F.2d at 586-87; *Chromalloy*, 495 F. Supp. at 547-48; *Cyanamid*, 331 F. Supp. at 599-602; *Mid-Continent*, 319 F. Supp. at 1183; *Field*, 305 A.2d at 691; *Wilmington Trust*, 166 A.2d at 728-29.

26. See, e.g., *R.G. Group*, 751 F.2d at 74 (involving a development franchise form agreement neither executed nor approved by either party's board of directors); *Reprosystem*, 727 F.2d at 259-60, as well as the trial court's opinion at 522 F. Supp. 1257, 1261-63 (S.D.N.Y. 1981) (involving a memoranda that constituted an "agreement-in-principle" although not executed by either party, but more or less formally approved by SCM's board); *Chromalloy*, 495 F. Supp. at 548 (dealing with a "letter of intent" that was "confirmed and approved" on behalf of the target's board); *Cyanamid*, 331 F. Supp. at 600-02 (involving a "letter agreement" fully executed by both parties but contingent upon approval by Cyanamid's board, which approval occurred only after the conclusion of a separate agreement between Arden and a third party bidder); *Mid-Continent*, 319 F. Supp. at 1184-85, 1195 (holding that a letter agreement, executed by both parties and formally approved by Mid-Continent's board, but not formally approved by Home's board, was effectively approved due to express or implied shareholder approval); *Texaco*, 729 S.W.2d at 785-86 (involving a "Memorandum of Agreement" not formally approved by Getty board nor executed by Getty but, nevertheless, held to have been effectively approved by Getty's Board). Certainly, as a matter of corporate law, a final transaction for the sale of corporate control will not be effective absent the requisite approval by the shareholders entitled to vote on the matter or, in the case of a tender offer, their tender of the requisite number of shares. See Herzel & Shapiro, 44 BUS. LAW. at 302-03. In the cases examined in this Article, however, shareholder approval was not held to be a barrier to the enforceability of the preliminary agreement in question, apparently, either because the transaction did not involve a sale of control, see *R.G. Group*, 751 F.2d at 71-72 (involving the acquisition of a particular local franchise area from a national restaurant franchisor); *Chromalloy*, 495 F. Supp. at 546-47 (contemplating the formation of a joint venture corporation to be owned equally by the corporate principals), or because the principal parties to the preliminary agreement effectively controlled the disaffirming corporation against which the preliminary agreement was asserted. See *Texaco*, 729 S.W.2d at 785, 792-93 (involving principals owning 53% of the outstanding shares of the target); *Reprosystem*, 727 F.2d at 259 (targets consisted of six separate wholly-owned subsidiaries of principal); *Interway Inc. v. Alagna*, 85 Ill. App. 3d 1094, —, 407 N.E.2d 615, 617 (1980) (defendant principal was "principal shareholder" of target); *Arnold Palmer*, 541 F.2d at 586 (target owned by defendant corporation); *Field*, 305 A.2d at 690-91 (individual party to preliminary agreement owned 99.5% of outstanding shares of defendant target corporation); *Cyanamid* 331 F. Supp. at 1599 (parties to preliminary agreement owned 100% of target); *Itek*, 248 A.2d at 626-27 (parties to preliminary agreement owned 50% of the target's stock); *V'Soske*, 404 F.2d at 496 (individual plaintiffs owned all shares of the target; individual defendant and party to preliminary agreement was "majority stockholder" of corporate defendant); *Melo-Sonics Corp. v. Cropp*, 342 F.2d 856, 857 (3rd Cir. 1965) (individual defendant parties to preliminary agreement owned 100% of two corporate targets

provide that it is subject to various conditions, including the execution and delivery of a final definitive agreement.²⁷ At this stage, the parties may, particularly when the target is publicly held, regard the transaction as having reached the point of becoming "material"²⁸ for securities law purposes, thereby prompting either or both parties to issue a formal public announcement of their "agreement-in-principle."²⁹

At this juncture, the factual patterns diverge sharply. One party may introduce additional important issues for negotiation that may or may not have been contemplated by the parties' earlier agreement.³⁰ Alternatively, the negotiations over the final terms of the deal may falter due to intervening events,³¹ or simply because of dis-

and 42% of a third); *Wilmington Trust*, 166 A.2d at 727, (defendants owned 82% of target corporation). Accordingly, the cases discussed in this Article may not represent what are thought to be the "more typical situations, not dominated by a few large stockholders who can be tied up in advance by contract. . . ." Herzel and Shepro, 44 BUS. LAW. at 303. Nevertheless, the application of the principles contained in the cases discussed herein should not be viewed as restricted to transactions involving closely held concerns. See, e.g., *Jewel*, 741 F.2d at 1564 (holding that, under California law, depending upon the interpretation of a preliminary agreement approved by the target's board of directors, a widely-held, publicly-traded target could be bound "to forebear from negotiating or accepting competing offers until the shareholders have had an opportunity to consider the initial proposal").

27. See, e.g., *Arnold Palmer*, 541 F.2d at 586-88 (involving a memorandum of intent "subject to . . . preparation of the definitive agreement for the proposed combination in form and content satisfactory to both parties and their respective counsel"); *Chromalloy*, 495 F. Supp. at 547 (providing by letter of intent that "[n]either party shall have any liability nor in any way be committed to the other on account of the proposed transaction unless a definitive Agreement is executed. . . and thereafter any liability shall be only under the terms of the definitive Agreement"); *Cyanamid*, 331 F. Supp. at 602 (involving a letter agreement "conditioned upon the execution of a mutually satisfactory purchase agreement. . . . [I]f either Cyanamid or Elizabeth Arden is unable to reach such agreement . . . neither party shall have any obligation to the other."); *Field*, 305 A.2d at 693 (involving a letter agreement "subject to agreement on a formal contract . . ."); *Interway, Inc. v. Alagna*, 85 Ill. App. 3d 1094, —, 407 N.E.2d 615, 617 (1980) (indicating by letter of intent that "[o]ur purchase is subject to a definitive Purchase and Sale Contract to be executed by the parties"); *Texaco*, 729 S.W.2d at 789 (involving an agreement-in-principle subject to execution of a definitive merger agreement).

28. See *supra* note 5 and accompanying text.

29. See Bryan, *supra* note 7, at 127-28; J. FREUND, *supra* note 7, at 67-73. The court will sometimes scrutinize the particular terms of these announcements very closely. See, e.g., *Reprosystem*, 727 F.2d at 262; *Arnold Palmer*, 541 F.2d at 589; *Texaco*, 729 S.W.2d at 791.

30. See, e.g., *V'Soske*, 404 F.2d at 498-99; *Field*, 305 A.2d at 691; *Itek*, 248 A.2d at 628.

31. See, e.g., *R.G. Group*, 751 F.2d at 73, 76-77 (involving a mistake of parties as to what had in fact not been agreed to); *Reprosystem*, 727 F.2d at 260 (increasing purchase price due to discovery of accounting error following preliminary agreement); *Chromalloy*, 495 F. Supp. at 548 (involving securities law concerns over the target's acquisition of another publicly held company following execution of letter of intent).

agreements over important remaining issues.³² Thereafter, sometimes for no apparent reason, one party will abruptly break off further discussions and disclaim any obligation to proceed with the transaction. Although not always the case, it often appears that the about face was due to the fact that the target company had, without the knowledge of the original suitor, negotiated a better deal with an intervening third party,³³ in which case a subsequent formal public announcement is often made, announcing the new "agreement-in-principle" between the target and the third party. The about face may, on the other hand, have been due simply to the disaffirming party's inability or unwillingness to reach a satisfactory agreement with its counterpart on the remaining points of the negotiations,³⁴ or for other reasons not clearly expressed.³⁵

The litigation that follows the repudiation of the deal is normally brought by the nondisaffirming party alleging primarily a common law breach of contract claim and, sometimes, a violation of Section 10b of the Securities Exchange Act of 1934, all arising out of the alleged binding preliminary agreement.³⁶ When a third party bidder is involved, the action will typically be brought by the original suitor against the target, again based on breach of contract, and against the third party bidder based on a claim of tortious interference with the original preliminary agreement;³⁷ the third party may also bring a separate action for declaratory judgment, alleging that the original preliminary agreement is unenforceable.³⁸

In reviewing the legal principles applied in these cases, it should

32. See, e.g., *R.G. Group*, 751 F.2d at 73-74; *Reprosystem*, 727 F.2d at 260; *Chromalloy*, 495 F. Supp. at 548.

33. See, e.g., *Cyanamid*, 331 F. Supp. at 601; *Mid-Continent*, 319 F. Supp. at 1186 n.6; *Pepsico*, 307 F. Supp. at 716; *Itek*, 248 A.2d at 628; *Texaco*, 729 S.W.2d at 787.

34. See, e.g., *Reprosystem*, 727 F.2d at 260; *Chromalloy*, 495 F. Supp. at 548.

35. See, e.g., *Arnold Palmer*, 541 F.2d at 587.

36. See, e.g., *R.G. Group*, 751 F.2d at 70-71; *Reprosystem*, 727 F.2d at 258-59; *Arnold Palmer*, 541 F.2d at 587; *V'Soske*, 404 F.2d at 496; *Chromalloy*, 495 F. Supp. at 546; *Field*, 305 A.2d at 691. There are other issues frequently raised in this context, including claims of promissory estoppel and defenses involving the statute of frauds and the parol evidence rule. These issues, however, are not dispositive of these cases. Claims of promissory estoppel have, except in isolated cases, been uniformly unsuccessful. See Farnsworth, 87 COLUM. L. REV. at 236-37; Temkin, 55 FORDHAM L. REV. at 133, 143-47. The statute of frauds issue will not normally be critical when the record contains some evidence of a writing. See Temkin, 55 FORDHAM L. REV. at 132 n.29. The parol evidence rule will, depending upon its breadth and application, simply define the scope of extrinsic evidence that may be considered in determining the parties' intent. See, e.g., *Jewel*, 741 F.2d at 1565-66; *Arnold Palmer*, 541 F.2d at 588; *Itek*, 248 A.2d at 629.

37. See, e.g., *Jewel*, 741 F.2d at 1557; *Cyanamid*, 331 F. Supp. at 599; *Mid-Continent*, 319 F. Supp. at 1187; *Pepsico*, 307 F. Supp. at 714, 716; *Itek*, 248 A.2d at 626; *Wilmington Trust*, 166 A.2d at 727; *Texaco*, 729 S.W.2d at 784.

38. See *Texaco, Inc. v. Pennzoil Co.*, No. 7425, slip op. (Del. ch. Feb. 6, 1984).

be observed that the recognition of an auction rule³⁹ in these cases will lead almost invariably to the conclusion that the preliminary agreement is invalid.⁴⁰ This conclusion may be based upon the rationale that the target lacked corporate power to bind itself, or that the agreement represented an invalid attempt to divest the target's board of its fiduciary duties to shareholders, or that the agreement lacked mutuality of obligation.⁴¹ Regardless of the rationale employed, the result is essentially the same.⁴²

If an auction rule is not involved, the court will typically apply a two-step analysis to determine whether the parties have reached a binding preliminary agreement. This analysis asks first whether the parties intended to be bound by the preliminary accord and, if so, the second issue is whether the agreement in question is sufficiently definite to be enforced.⁴³ Both determinations are made at the point in the agreement process when the preliminary agreement was reached, but the courts will look to the facts and circumstances involved and

39. The term "auction" here in refers generally to those decisions holding that in competing bids, negotiations or offers for the target, a corporation may not, prior to shareholder approval, bind itself to an agreement with one suitor to the exclusion of others in a manner that operates to frustrate the bidding process. *See, e.g., Jewel*, 741 F.2d at 1563-64 (holding that California had not adopted an auction model in such cases); *ConAgra*, 222 Neb. at 154-58, 382 N.W.2d at 586-89 (holding that, under Delaware law, the target's board could not bind the corporation to a merger agreement prior to shareholder approval to the exclusion of a clearly improved offer). The implications of this rule raise fundamental and difficult questions that are beyond the scope of this Article. For an analysis of the issues involved, *see generally* Gilson & Kraakman, *Delaware's Intermediate Standard for Defensive Tactics: Is There Substance to the Proportionality Review*, 44 BUS. LAW. 247 (1989); Santoni, *The Integration of Contract, Corporate and Tort Law Principles: ConAgra, Inc. v. Cargill, Inc.*, 20 CREIGHTON L. REV. 317 (1986). *See also* Herzel & Shepro, 44 BUS. LAW. 301, 302. In the decisions examined, an "auction model" has not been held to be applicable. Thus, the central issue involved was the recognition and enforcement of preliminary agreements based upon an analysis of conventional contract principles. *See supra* notes 9 and 26 and accompanying text. *See also* Fortune, Apr. 24, 1989, at 296 for an account of the recent battle over the leveraged acquisition of RJR Nabisco in "a deal that ultimately lead to the largest, looniest auction in the history of capitalism."

40. This statement assumes that, by the terms of the preliminary agreement, the target would be prohibited from accepting a competing offer. The agreement may not, however, be so construed. *See Jewel*, 741 F.2d at 1564-67 (holding that the terms of the preliminary agreement were ambiguous as to whether the target was intended to be bound exclusively); *Samjens*, 663 F. Supp. at 625 (involving a preliminary agreement which contained a "window shop" provision, intended to permit the target to consider and accept a higher competing bid, but prohibit its solicitation of any offers). *But see Hastings-Murtagh*, 649 F. Supp. at 484-85 (preliminary agreement prohibiting target from soliciting or accepting any competing bid as the result of strict "no shop" provisions).

41. *See* Freund & Easton, 34 BUS. LAW. at 1684-90.

42. *Id.* *See also* R. Gilson, *supra* note 12, at 816-17, 834-38; Gilson & Kraakman, 44 BUS. LAW. at 249-51.

43. Temkin, 55 FORDHAM L. REV. at 131-40; Volk & McMahon, 16 INST. ON SEC. REG. at 464-506.

the conduct of the parties subsequent to that point in time in deciding these issues.⁴⁴ The question of intent is a factual one and is based upon the rationale of the traditional objective theory of contracts where the outward objective expressions or "manifestations" of the parties are examined to determine their intent.⁴⁵ In applying this principle to the facts involved, the courts have identified a number of individual factors held to be important in determining whether the parties intended to be bound.⁴⁶ While it is held that no one of these factors alone is determinative, the terms of any form of preliminary agreement, letter of intent or other writing involved will generally be given considerable weight in this analysis.⁴⁷

44. Temkin, 55 *FORDHAM L. REV.* at 131-40. Note, however, the suggestion in some decisions that conduct subsequent to a preliminary agreement may be irrelevant in the analysis. See *Reprosystem*, 522 F. Supp. at 1275; *Texaco*, 729 S.W.2d at 788, 792.

45. *Id.* See, e.g., *R.G. Group*, 751 F.2d at 74-76; *Jewel*, 741 F.2d at 1566; *Reprosystem*, 727 F.2d at 261-62; *Arnold Palmer*, 541 F.2d at 588; *V'Soske*, 404 F.2d at 499; *Cyanamid*, 331 F. Supp. at 606; *Mid-Continent*, 319 F. Supp. at 1189; *Field*, 305 A.2d at 693; *Itek*, 248 A.2d at 629; *Texaco*, 729 S.W.2d at 788; J. CALAMARI & J. PERILLO, *CONTRACTS* § 2.2, at 26-27 (2d ed. 1987); see also *RESTATEMENT (SECOND) OF CONTRACTS* §§ 2, 19, 26, 27 (1979).

46. In addition to any writing involved, these factors have been held to include: [W]hether the contract is usually one put in writing; whether there are few or many details; whether the amount involved is large or small; whether it requires a formal writing for a full expression of the covenants and promises; and whether the negotiations themselves indicate that a written draft is contemplated as the final conclusion of the negotiations.

Mid-Continent, 319 F. Supp. at 1189 (citing *Mississippi and Dominion S.S. Co. v. Swift*, 86 Me. 248, 29 A. 1063 (1894)). Additional factors cited are whether there is an explicit statement reserving the right to be bound only upon the execution of a written agreement; whether there has been partial performance of the agreement by one party; whether the terms agreed to reflected a complete agreement; and whether the degree of complexity involved in the transaction would normally be expected to be reflected only in a written agreement. *R.G. Group*, 751 F.2d at 75-76; accord *Texaco*, 729 S.W.2d at 789-96.

47. See, e.g., *Arnold Palmer*, 741 F.2d at 589 (holding that the "extensive" nature of Memorandum of Intent and "unqualified terms" such as "will" and "agrees" were important factors); *V'Soske*, 404 F.2d at 499-500 (determining that a preliminary agreement, the terms of which provided that, after a date agreed upon, business was to be run for benefit of purchaser, "strongly" indicated an intent to be bound); *Mid-Continent*, 319 F. Supp. at 1190 (holding that "We hereby offer" language was "clearly the expression of a present offer"); *Field*, 305 A.2d at 693 (stating that "terms, formality and the extraordinary care in . . . execution" of letter agreement constituted an important, if not determinative, factor); *Texaco*, 729 S.W.2d at 789-90 (determining that the repeated use of term "will" in Memorandum of Agreement was indicative of binding intent). See also *Jewell*, 741 F.2d at 1564-67 (holding that terms of the merger agreement restricting "extraordinary action" were ambiguous as to whether it was intended to bind the target to the exclusion of other bidders). In addition to the writing embodying the agreement, courts have looked to various other forms of written expression as indicative of contractual intent, such as correspondence, see, e.g., *R.G. Group*, 751 F.2d at 72; *Reprosystem*, 727 F.2d at 260; *V'Soske*, 404 F.2d at 498-99; *Mid-Continent*, 319 F. Supp. at 1186 n.6; *Field*, 305 A.2d at 691 n.1; *Wilmington Trust*, 166 A.2d at 728-29, 730-33; *Pepsico*, 307 F. Supp. at 715-16, board of directors resolutions, see, e.g., *Reprosystem*, 522 F. Supp. at 1262; *Chromalloy*, 495 F. Supp. at 547 (reviewing the terms of loan doc-

It is well settled and frequently repeated in the decisions in this area that, if the parties express an intention not to be bound until they have executed a final and formal document embodying their agreement, they will not be bound until then; however, the mere fact that the parties contemplate memorializing their initial agreement in a final definitive document will not prevent their preliminary agreement from becoming binding and enforceable prior to that event.⁴⁸ If the parties' written preliminary agreement expressly disclaims liability prior to the execution of a final agreement, that will usually be held indicative of an intent not to be bound by the preliminary document,⁴⁹ but the existence of such a disclaimer is not dispositive of the issue.⁵⁰

The second requirement, that the terms of the agreement be sufficiently complete and definite, is said to be grounded in the necessity of providing a standard by which performance thereunder can be judged and to provide a basis for an adequate remedy upon default.⁵¹

uments executed by the parties); *Pepsico*, 307 F. Supp. at 717-18; *Wilmington Trust*, 166 A.2d at 729, internal memoranda, see *R.G. Group*, 751 F.2d at 73-74; *Reprosystem*, 522 F. Supp. at 1267-68, press releases, see *Jewel*, 741 F.2d at 1558; *Reprosystem*, 727 F.2d at 260; *Mid-Continent*, 319 F. Supp. at 1184; *Pepsico*, 307 F. Supp. at 715; *Texaco*, 729 S.W.2d at 786, Securities and Exchange Commission filings, see *Reprosystem*, 727 F.2d at 260; *Pepsico*, 307 F. Supp. at 715-16, and other documents, see *R.G. Group*, 751 F. Supp. at 72 (construing the terms of a private placement memorandum).

48. See *R.G. Group*, 751 F.2d at 74; *Jewel*, 741 F.2d at 1566; *Arnold Palmer*, 741 F.2d at 587-88; *Reprosystem*, 727 F.2d at 261; *V'Soske*, 404 F.2d at 499; *Chromalloy*, 495 F. Supp. at 550; *Mid-Continent*, 319 F. Supp. at 1188-89; *Field*, 305 A.2d at 693; *Itek*, 248 A.2d at 629; *Wilmington Trust*, 166 A.2d at 732; *Texaco*, 729 S.W.2d at 788.

49. See, e.g., *R.G. Group*, 751 F.2d at 76; *Reprosystem*, 727 F.2d at 262; *Chromalloy*, 495 F. Supp. at 550.

50. There was a time when it was thought that adding such a disclaimer amounted to "gilding the lily," since simply including in the document a provision that the agreement was subject to a later formal agreement was believed to make "it clear that what has been signed is purely a letter of intent with no legally binding effect." J. FREUND, *supra* note 7, at 62. See Freund & Easton, 34 Bus. Law. at 1687-88. These observations may no longer be relied upon since such a disclaimer will clearly not prevent the preliminary agreement from becoming binding. See, e.g., *Arnold Palmer*, 741 F.2d at 589-90, 592; *V'Soske*, 404 F.2d at 497, 499; *Cyanamid*, 331 F. Supp. at 602-04, n.3; *Field*, 305 A.2d at 693; *Itek*, 248 A.2d at 627, 629; *Texaco*, 729 S.W.2d at 789-91. See also *infra* note 167 and accompanying text.

51. Temkin, 55 FORDHAM L. REV. at 131. Professor Farnsworth criticizes the "remedy" aspect of this rationale by distinguishing the nature of the interest to be protected in cases of preliminary bargains:

This specious argument is sometimes enhanced by characterizing the agreement pejoratively as an "agreement to agree." But the appropriate remedy is not damages for the injured party's lost expectation under the prospective ultimate agreement but damages caused by the injured party's reliance on the agreement to negotiate. If one party breaks off the negotiations before the other has relied on the agreement to negotiate, there is no need to fashion a remedy because no relief is called for. Once the other party has relied, it must prove the loss caused by its reliance, including any lost opportunities.

Farnsworth, 87 COLUM. L. REV. at 267 (footnotes omitted). See *Wilmington Trust*, 166 A.2d at 732-33.

A corollary of this requirement is the principle that a mere "agreement to agree" is unenforceable.⁵² The courts, however, often simply restate this question in terms of whether the parties have reached agreement on the "essential" or "material" elements of the transaction.⁵³

Once the court has determined that the requisite contractual intent is present, it will, through the use of what are called "gap-fillers," go to considerable lengths to find that the essential elements of the deal are present in the preliminary agreement and will often imply such terms as it determines to be reasonable when they are not otherwise clearly expressed.⁵⁴ In this context, the court will also frequently resort to what it perceives to be the "custom and practice in the field of corporate acquisitions."⁵⁵ This perspective will often provide cumulative support for the courts' analysis of whether the essential elements of the bargain were agreed upon, by permitting the court to find that, in the custom and practice of these transactions, the terms not explicitly agreed to were not essential.⁵⁶

The practical effect of this traditional analysis is said to result in a flawed "all or nothing" approach to the problem by regarding the parties as having reached either a complete and fully enforceable agreement or none at all, neither of which conclusion accurately reflects the expectations of the parties at the time in question.⁵⁷ The perceived shortcomings inherent in the "all or nothing" approach to this problem have prompted some commentators to call for reform of

52. Temkin, 55 *FORDHAM L. REV.* at 134-35.

53. See, e.g., *R.G. Group*, 751 F.2d at 76; *Arnold Palmer*, 741 F.2d at 589; *V'Soske*, 404 F.2d at 500; *Chromalloy*, 495 F. Supp. at 550; *Cyanamid*, 331 F. Supp. at 603; *Mid-Continent*, 319 F. Supp. at 1190; *Field*, 305 A.2d at 694; *Texaco*, 729 S.W.2d at 796; cf. *Wilmington Trust*, 166 A.2d at 733.

54. Temkin, 55 *FORDHAM L. REV.* at 133-34. These "gap-fillers" are derived from the courts' authority to imply or supply reasonable terms with respect to an otherwise enforceable agreement, as reflected in both the Restatement and the Uniform Commercial Code. *Id.* (citing *RESTATEMENT (SECOND) CONTRACTS* § 204 (1981); U.C.C. § 2-204(3) (1978)). See Farnsworth, 87 *COLUM. L. REV.* at 256.

55. *Jewel*, 741 F.2d at 1567.

56. See, e.g., *V'Soske*, 404 F.2d at 500 (stating that "audited net worth" has a "well defined meaning"); *Cyanamid*, 331 F. Supp. at 604 (stating that difference of a "few months" in a closing date was not material in the purchase of a "far flung business"); *Mid-Continent*, 319 F. Supp. at 1193 (stating that it is a "well-known custom in the area of corporate mergers involving tax-free stock exchange [sic] to issue unregistered stock"); *Field*, 305 A.2d at 694 (stating that "post agreement inventories" before closing "are standard practice"); *Texaco*, 729 S.W.2d at 795 (determining that "one page back-of-the-envelope kinds of agreements" are not particularly unusual). One may indeed wonder about the uniform reliability of assuming the existence of such "standard practices," particularly when there seems to be substantial doubt among "business people" as to what the term "agreement-in-principle" even means. See *Texaco*, 729 S.W.2d at 791.

57. See Knapp, 44 *N.Y.U. L. REV.* at 674-76, 719; Temkin, 55 *FORDHAM L. REV.* at 127-35.

the common law principles applicable to these cases. One such commentator has urged the courts to recognize and enforce a new specie of contract—the “contract to bargain.”⁵⁸ Alternatively, it has been suggested that an enforceable precontractual duty to negotiate in good faith be recognized, separate from any otherwise enforceable contract.⁵⁹ Both of these proposals have substantially the same effect by substituting a precontractual duty of good faith or duty to negotiate for contractual intent in these cases, thereby protecting what more closely resembles a reliance interest as opposed to an expectation interest in the event of breach.⁶⁰ While there is said to be some suggestion of decisional support for these propositions, neither traditional contract theory nor the decisions in this area have explicitly recognized the enforceability of a duty of good faith or duty to negotiate apart from an otherwise enforceable contract.⁶¹

THE EMPIRICAL PREDICTABILITY IN THE DECISIONS

When examined individually, the decisions in this area do not appear internally inconsistent in terms of the facts found and the legal principles held to be applicable. In addition, because the courts consistently find the same fundamental legal principles to be controlling in virtually all of these cases,⁶² there is no contradiction or disagreement among the decisions as to the essential rules of law to be applied. Therefore, it may safely be assumed, as suggested by Professor Corbin,⁶³ that the seeming inconsistencies among these decisions are not due to any actual conflict among them but are due simply to the individual variations in the facts presented in each case. While that conclusion is no doubt correct, it is only a partial answer, since the inconsistencies complained of exist among cases that appear similar in terms of their essential operative facts.⁶⁴

58. See Knapp, 44 N.Y.U. L. REV. at 684-726.

59. Temkin, 55 FORDHAM L. REV. at 141-61.

60. Neither proposal would view an award of specific performance in these cases as appropriate in the protection of the legitimate reliance interests of the parties. See Knapp, 44 N.Y.U. L. REV. at 725-26; Temkin, 55 FORDHAM L. REV. at 162-63.

61. Temkin, 55 FORDHAM L. REV. at 151; see Farnsworth, 87 COLUM. L. REV. at 221-43, 265-69. Professor Farnsworth posits that tools found within the existing common law are adequate to deal with this problem through the imposition of a “fair dealing” standard in negotiations in cases involving agreements with open terms and those involving agreements to negotiate. *Id.* at 286-87. See also *infra* note 166.

62. See *supra* notes 43-56 and accompanying text.

63. Compare CORBIN ON CONTRACTS § 30, at 47 (1952) with J. CALAMARI & J. PERILLO, CONTRACTS § 2.7, at 33 (2d ed. 1977). See *infra* note 157.

64. See Temkin, *When Does the “Fat Lady” Sing?: An Analysis of “Agreements in Principle” in Corporate Acquisitions*, 55 FORDHAM L. REV. 125, 130 n.23, 131 n.24 (1986); Volk & McMahon, *Letters of Intent: Getty and Beyond*, 16 INST. ON SEC. REG. 445, 464-506. See also *supra* note 11. The interpretative difficulties underlying the analyses that follow are not ignored. See *infra* note 149 and accompanying text.

AN INITIAL DISTINCTION: IMPASSE V. REPUDIATION DUE TO THIRD PARTY BID

An illustration of the problem will be seen initially in a comparison of two decisions. The first of these is *Chromalloy American Corp. v. Universal Housing Systems of America*.⁶⁵ That case involved the enforceability of a preliminary agreement between Chromalloy American Corp. ("Chromalloy") and Universal Housing Systems of America ("Universal") to form a joint venture for the manufacture and sale of prefabricated building materials. After ten months of negotiations and four separate drafts of a "letter of intent," the parties appeared to reach a preliminary agreement on the basic terms and structure of a joint venture relationship. The letter of intent described these basic terms and structure, outlined several conditions precedent to the formation of the joint venture⁶⁶ and provided that neither party would be bound prior to the execution of a formal definitive joint venture agreement.⁶⁷ This final letter of intent was approved by the board of directors of both parties and was executed on their behalf.

Meanwhile, the parties engaged together in a variety of transactions, including one whereby Chromalloy extended a loan to Universal, in part to facilitate Universal's acquisition of Extrudyne, Inc. ("Extrudyne") as part of the strategy contemplated by the joint venture plan.⁶⁸ During this period, Chromalloy even agreed to confirm Universal's credit to the vendors of Universal and informed those vendors that Chromalloy and Universal were "in the process of forming a joint venture."⁶⁹ The parties continued their discussions for nine additional months but, after exchanging numerous proposed drafts of a formal joint venture agreement, the parties were unable to reach an agreement on the final terms. The points of disagree-

65. 495 F. Supp. 544 (S.D.N.Y. 1980).

66. *Id.* at 547. The letter of intent provided that the joint venture was to be for a term of four to five years after which Chromalloy was given the option to purchase Universal's interest at a formula price based upon the earnings of the joint venture. The letter of intent contemplated the formation of a joint venture corporation of which each party would own fifty percent. Among the conditions contemplated were an employment agreement between the joint venture corporation and the president and major shareholder of Universal, and the acquisition by Universal of Extrudyne, Inc., an insolvent publicly-held company. *Id.* at 546-50.

67. *Id.* at 547. The letter of intent provided that the formation of the joint venture was subject to the execution of a formal agreement. Further, the letter stated that "[n]either party shall have any liability nor in any way be committed to the other on account of the proposed transaction unless a definitive [a]greement is executed . . . and thereafter any liability shall be only under the terms of the definitive [a]greement." *Id.*

68. *Id.* at 548. The loan agreement apparently repeated the language of the disclaimer contained in the letter of intent. *Id.*

69. *Id.*

ment had to do primarily with the terms of an employment agreement between the contemplated joint venture corporation and Universal's president, who was also a substantial shareholder of Universal; the amount of Chromalloy's capital contribution to the venture; a buy out formula; and securities law concerns over Universal's acquisition of Extrudyne.⁷⁰

Following the breakdown of the negotiations, Chromalloy brought an action in the United States District Court for the Southern District of New York to recover its loan to Universal and Universal defended on the ground that the letter of intent constituted an enforceable agreement between the parties to form the joint venture. The court applied the traditional analysis to determine whether the parties intended to be bound by the letter of intent and granted summary judgment to Chromalloy, holding that the case did not even present a triable issue on the question.⁷¹ The court's rationale was that the enforceability of the letter of intent was clearly made contingent upon the execution of a formal joint venture agreement and, since the parties were unable to reach such an agreement, "the parties were not bound by any contractual arrangement at all."⁷²

By comparison, we next examine *Mid-Continent Telephone Corp. v. Home Telephone Co.*⁷³ There, Mid-Continent Telephone Corp. ("Mid-Continent") and Home Telephone Co. ("Home") conducted negotiations for fifteen months before arriving at a preliminary agreement concerning Mid-Continent's purchase of Home, a closely held telephone company, in a stock-for-assets transaction.⁷⁴ The preliminary accord was reflected in a "letter agreement," which spelled out the basic terms of the transaction and set forth the conditions to the deal, including the requirement that the transaction was "contingent upon working out a mutually satisfactory arrangement" for Mid-Continent's employment of the son of Home's president and controlling

70. *Id.* at 548 n.3.

71. *Id.* at 548-50. In this case, a series of draft agreements were drawn up but never executed. The correspondence between the parties not only referred to a written agreement, but expressly disclaimed any intention to be bound until the execution of such a document. *Id.* at 550. The "series of draft agreements" referred to were drafts of a final joint venture agreement; the court seemed to ignore the terms of the letter of intent itself.

72. *Id.* at 550. An additional basis for the result was a finding that the enforceability of the joint venture agreement was barred by the statute of frauds, again failing to focus on the existence of the executed letter of intent. *Id.* The court also rejected Universal's claim of promissory estoppel on the familiar ground that no inequity resulted and that reliance expenses claimed were not "referable" to "the oral agreement." *Id.* at 551.

73. 319 F. Supp. 1176 (N.D. Miss. 1970).

74. *Id.* at 1183. The original structure called for an exchange of shares, but this was abandoned over concerns relative to the resulting tax treatment of the transaction. *Id.* at 1182.

shareholder.⁷⁵ A further condition was that the transaction qualify as a tax-free reorganization. This letter agreement was signed on behalf of the parties and approved by Home's shareholders. The day following the execution of the letter agreement, the parties issued a jointly approved press release announcing that they had "agreed to merge."⁷⁶

For the next several months, the parties continued their discussions in order to resolve the remaining issues, including the terms of the employment agreement and the mechanics required to preserve the appropriate tax status of the transaction. Due to intervening events, however, these issues were never resolved. During this same period, unknown to Mid-Continent, Home had been conducting similar negotiations with other parties and, shortly after it received what was apparently a substantially higher offer from a third party, Home broke off further discussions with Mid-Continent.⁷⁷

Mid-Continent then brought an action in the United States District Court for the Northern District of Mississippi against Home alleging breach of the letter agreement, and against the third party for its alleged tortious interference with the transaction. The court applied the same traditional legal principles to resolve the question of contractual intent, and held that the "overwhelming evidence" in the case compelled the conclusion that the parties intended to be bound by the letter agreement.⁷⁸ This conclusion was said to be based upon the language of the letter agreement and the parties' conduct both before and after its execution.⁷⁹ The court dismissed the argument that the letter agreement was contingent upon the parties' reaching an accord on the employment agreement or the mechanics of the corporate reorganization for tax purposes, holding that these were

75. *Id.* at 1182 n.3, 1184.

76. *Id.* at 1184. The news release read:

Directors of Home Telephone Company of Olive Branch, Mississippi, have agreed to merge into Mid-Continent Telephone Corporation, according to a joint announcement by Lon J. Darley, president, and Weldon W. Case, Mid-Continent Chief Executive.

Following approval by its shareholders and regulatory authority, Home Telephone Company will become an autonomous affiliate of Mid-Continent System, with its own officers, directors and employees.

Id.

77. *Id.* at 1186. Home began discussions with other suitors within a matter of weeks following the execution of the letter agreement. It is not clear from the opinion who initiated these discussions. Home did forward correspondence to Mid-Continent confirming its withdrawal from the deal, but concealed what clearly appeared to be its true motive for terminating the discussions. *Id.* at 1186 n.6.

78. *Id.* at 1189.

79. *Id.* The court laid considerable emphasis on the terms contained in the letter agreement, such as "would" and "we hereby offer" as evidencing a present offer "which ripened into a bilateral contract immediately upon its acceptance." *Id.* at 1190.

merely conditions subsequent, the failure of which did not prevent the letter agreement from becoming binding.⁸⁰ Having held that the parties intended to be bound, the court, through the use of gap-fillers, had no difficulty in finding that the letter agreement contained all the essential elements of the transaction.⁸¹ As a result, the court awarded compensatory damages against Home for breach of the letter agreement and punitive damages against the third party for its tortious interference with the original transaction.

In both *Chromalloy* and *Mid-Continent*, the transactions involved substantial sums⁸² and presented complex issues,⁸³ the preliminary agreements were extensively negotiated, executed by the parties with requisite corporate approvals and appeared to contain the essential elements of the respective deals. Both agreements contained definite conditions that were required to be satisfied before a final agreement would be reached, including explicit conditions as to the execution of additional agreements;⁸⁴ in both cases the respective parties worked toward the satisfaction of these and the other final issues involved for some time following the execution of the preliminary agreements; and, in both cases, important issues remained unresolved when the negotiations broke off. Both cases also involved open and written acknowledgments by the parties of their would-be transaction. In addition to the similarity in the facts, the determinative legal principles held to be applicable were substantially identical in both cases.

The only seemingly significant objective difference between these cases is the fact that, in *Chromalloy*, the breakdown in the negotiations occurred as a result of what appeared to be a genuine inability of the parties to reach agreement on the final points of the

80. *Id.* at 1190.

81. *Id.* at 1192-95.

82. The capital contribution proposed to be made by *Chromalloy* was \$100,000, which was to be converted from *Chromalloy's* outstanding loan to Universal in that amount to equity in the joint-venture corporation. See *Chromalloy*, 495 F. Supp. at 548. The exact amount of the acquisition price involved in *Mid-Continent* is not made clear from the opinion, but the offer that Home ultimately accepted included a purchase price of \$2 million in cash. *Mid-Continent*, 319 F. Supp. at 1186.

83. In *Chromalloy*, this complex issue related to the securities law concerns that developed with respect to *Chromalloy's* acquisition of *Extrudyne*. See *Chromalloy*, 495 F. Supp. at 548. In *Mid-Continent*, the primary complexity involved the terms and structure of the reorganization for tax purposes and the fact that the parties contemplated obtaining an I.R.S. private letter ruling in that regard prior to closing. See *Mid-Continent*, 319 F. Supp. at 1190.

84. The disclaimer language contained in the *Chromalloy* letter of intent is certainly stronger than that contained in the *Mid-Continent* letter agreement; however, it was certainly clear in *Mid-Continent* that a "mutually satisfactory" employment agreement and an agreeable plan of reorganization for tax purposes were critical preconditions to reaching a final agreement. See *Mid-Continent*, 319 F. Supp. at 1182, 1183 n.3.

deal; while, in *Mid-Continent*, the failure of the transaction clearly appeared to be due to Home's furtive and ultimately successful attempts to obtain a better deal from another party. This distinction, of course, has no basis in the legal principles held applicable in these cases. As noted earlier, it is a settled principle of law that there is no duty of good faith or duty to negotiate in these transactions absent a binding and enforceable contract.⁸⁵ In other words, these duties are the result of an enforceable contract, not the cause. Yet, it appears that, at least when compared with *Chromalloy*, *Mid-Continent* may appear to have transposed this principle.⁸⁶

A close parallel to *Mid-Continent* is seen in *American Cyanamid Co. v. Elizabeth Arden Sales Corp.*⁸⁷ That case involved the enforceability of a "letter agreement" concerning American Cyanamid Co.'s ("Cyanamid") purchase of the assets of Elizabeth Arden Sales Corp. ("Arden") for a cash price of \$35 million. Arden, at the time, was owned entirely by the three executors of the estate of Elizabeth Arden, the deceased founder of the company. During the initial discussions between the parties, Cyanamid expressed to Arden its concerns over the possibility of an auction sale, making it clear that Cyanamid would not pursue discussions with Arden if an auction of the company were contemplated. There was apparently a general understanding between the parties that Arden would not undertake an auction sale while negotiating with Cyanamid.⁸⁸ Based on that understanding, Cyanamid proceeded to conduct an in-depth examination of Arden and thereafter finally agreed to meet Arden's \$35 million cash asking price, subject to certain conditions aimed, among other things, at verifying Arden's net worth.⁸⁹

This preliminary understanding was reflected in a draft of a letter agreement which Cyanamid prepared and submitted to the Arden executors. On that day and the day following, various changes were agreed to and a final draft of the letter agreement incorporating those changes was prepared. The final document contained explicit disclaimer language similar to that contained in the *Chromalloy* letter of intent.⁹⁰ Cyanamid's president preexecuted the document and

85. See *supra* note 61 and accompanying text.

86. The court in *Mid-Continent*, after reaching its legal conclusions, went on at some length to discuss the invidious quality of Home's conduct in the transaction, see *infra* note 152 and accompanying text, and seemed to conclude that, but for such conduct, the transaction would have succeeded. See *infra* note 150 and accompanying text.

87. 331 F. Supp. 597 (S.D.N.Y. 1971).

88. *Id.* at 599-600. The parties' understanding on this point seems to have been exclusively oral.

89. *Id.* at 601-02.

90. This language provided:

sent it to the executors for execution. When the executors received the preexecuted document that same day, further modifications were suggested and agreed to between the parties by telephone. These changes were made to the final document by interlineation, whereupon the executors signed the agreement. It was understood by all parties involved that the preliminary agreement was conditional upon the approval of the Cyanamid board of directors and that a special meeting of the Cyanamid board had been called for that purpose, to be held five days hence. At that point, the parties exchanged congratulations on their deal and Cyanamid began arranging for the verification of Arden's net worth, as required by the terms of the letter agreement.

Meanwhile, unknown to Cyanamid, the Eli Lilly Company ("Lilly")⁹¹ had contacted the executors of the Arden Estate to discuss the sale of Arden. Although there was apparently some initial reluctance on the part of the executors to discuss the matter with Lilly, they relented after they received an opinion of counsel to the effect that Arden was not yet bound by the letter agreement and Lilly's offer improved upon Cyanamid's by several million dollars.⁹² Shortly thereafter, Arden concluded its agreement with Lilly. Cyanamid learned of the Lilly discussions scarcely a day prior to Cyanamid's board meeting, but the board meeting proceeded as scheduled, whereupon the directors ratified the letter agreement and authorized the ensuing action against Arden, the executors and Lilly.

Despite the fact that the matter came before the court on the defendants' motion for summary disposition,⁹³ the United States District Court for the Southern District of New York went far beyond the narrow scope of the issue raised by that motion and found affirmatively that the letter agreement contained the essential elements of the transaction, but stopped short of finding an intention to be bound.⁹⁴ The court dismissed Arden's argument that there was no mutuality of obligation under the letter agreement since Cyanamid's directors had not approved the agreement prior to Arden's concluding the deal with Lilly—the court suggesting obliquely that Arden

The consummation of such acquisition is conditioned upon the execution of a mutually satisfactory purchase agreement and, on the part of Cyanamid, the approval of its board of directors. *It is understood that, if either Cyanamid or Elizabeth Arden is unable to reach such agreement or obtain such approval, neither party shall have any obligation to the other.*

Id. at 602 n.3 (emphasis added).

91. *Id.* at 601. This contact clearly appears to have been initiated solely by Lilly.

92. *Id.* It was this advice that apparently provided the necessary comfort to the Arden executors in responding to the Lilly overture.

93. *Id.* at 599. The issues were presented in the context of defendants' motion for judgment on the pleadings or, alternatively, for summary judgment.

94. *Id.* at 603, 605.

may have owed a duty of good faith to Cyanamid to permit its directors to act, prior to accepting the competing offer from Lilly.⁹⁵

Compare, however, the result reached by the United States Court of Appeals for the Second Circuit in *Reprosystem, B.V. v. SCM Corp.*⁹⁶ In that case, the parties entered into discussions concerning Reprosystem, B.V.'s ("Reprosystem") purchase of six separate foreign subsidiaries of SCM Corp. ("SCM") that were engaged in the manufacture and service of photocopiers. After several weeks of negotiations, the parties reached an "agreement-in-principle" which, as in the previous cases, appeared to set forth the basic terms of the transaction and the conditions required to be satisfied, which included the requirement that the parties enter into a "formal agreement, satisfactory to both SCM and [Reprosystem]."⁹⁷ A short time later, SCM issued a press release formally announcing the agreement-in-principle.⁹⁸

After ten weeks and over fifteen drafts of a final agreement, the parties appeared to have resolved all of the final remaining issues. However, two weeks later, problems developed when it was discovered that the subsidiaries had been operating more profitably than expected.⁹⁹ In addition, the discovery of an accounting error resulted in a substantial increase in the purchase price, and doubt began to surface over Reprosystem's ability to deliver the increased purchase

95. *Id.* at 606. The court stated that the "inference may be drawn that the parties when they signed, before the appearance of Lilly as a competitor, intended in good faith that the Cyanamid board was to be given a reasonable time to act." *Id.* In addition, the court queried whether the history of negotiations and the conduct of the parties would evidence the intention of the parties in this regard. *Id.* (citing, *inter alia*, *Mid-Continent*, 319 F. Supp. at 1191).

96. 727 F.2d 257 (2d Cir. 1984).

97. *Id.* at 259. The "agreement-in-principle" was embodied in memoranda prepared by the president of SCM's business equipment division who, at that point, had led the negotiations on SCM's behalf. Although this memoranda was not in the form of an agreement and was never executed by the parties, it was undisputed that its terms had been fully agreed to and that it formed the basis for negotiations on further points. *Id.* at 259-60.

98. *Id.* at 260. The press release stated:

SCM Corporation has reached an agreement-in-principle to sell its office copier service organizations in the United Kingdom, France, Germany, Switzerland and Belgium and its distribution operations covering Europe, the Middle East and Africa to a company controlled by N. Norman Muller, a private investor. While the terms of the agreement-in-principle were not disclosed, Paul H. Elicker, president of SCM, indicated that SCM would incur a pre-tax loss of approximately \$1.4 million on the transaction.

Reprosystem, 522 F. Supp. 1257, 1262 (1981), *aff'd in part and rev'd in part*, 727 F.2d 257 (2d Cir. 1984).

99. *Reprosystem*, 727 F.2d at 260. During this period, the SCM officer in charge of the negotiations was reassigned to a new post. This action apparently had nothing to do with the negotiations or SCM's intention to proceed with the deal. However, the officer's successor in the negotiations did raise questions about the advisability of the transaction from SCM's point of view. *Id.*

price at closing.¹⁰⁰ Meanwhile, SCM took certain actions that appeared inconsistent with the terms of the deal.¹⁰¹ Shortly thereafter, SCM withdrew from the transaction, despite Reprosystem's claims that they had reached a binding preliminary agreement.¹⁰²

In Reprosystem's action against SCM for breach of contract, the trial court found that the parties intended to be bound by their preliminary agreement and awarded compensatory damages to Reprosystem in the amount of \$1.062 million.¹⁰³ However, the Second Circuit reversed, finding that the "uncontested evidence clearly establishe[d] the parties' intent not to be bound prior to execution of formal contracts."¹⁰⁴ The court's analysis cited the same legal principles held to be controlling in *Chromalloy*, *Mid-Continent* and *American Cyanamid* and the holding was based upon the language contained in the preliminary agreement and drafts of the proposed final agreement to the effect that the transaction was conditional upon the execution and delivery of a mutually satisfactory final agreement.¹⁰⁵

Substantially the same language was contained in the preliminary agreements in *Chromalloy*, *Mid-Continent* and *American Cyanamid*.¹⁰⁶ Here, as in *Chromalloy*, it seemed apparent to the Second Circuit that the transaction was derailed, not because of any self-serving or disingenuous conduct of the party terminating the deal,¹⁰⁷ but because of seemingly unanticipated and extrinsic difficulties that developed prior to closing—namely the unexpected substantial increase in the purchase price, Reprosystem's apparent inability to deliver that amount at closing and other problems that had developed in the interim.¹⁰⁸ Had a final agreement in *Reprosystem* been frus-

100. *Id.* The purchase price at closing was believed to have been "in the neighborhood of \$4.5 million"; the increase resulting from the accounting error amounted to approximately \$1 million. *Reprosystem*, 522 F. Supp. at 1271.

101. *Reprosystem*, 727 F.2d at 260. This action consisted of SCM's firing of a group of the subsidiaries' managers, who were to have been transferred to Reprosystem "intact" under the terms of the agreement-in-principle. This action was explained at trial largely as the result of SCM's mistaken understanding as to how the subsidiaries were to have been operated pending closing. However, this explanation was labeled by the trial court as "pretextual," the trial court believing that it was SCM's definite, but ulterior, intention "to kill the deal." *Reprosystem*, 522 F. Supp. at 1270. See *infra* note 152.

102. *Reprosystem*, 727 F.2d at 260.

103. *Id.* at 258.

104. *Id.* at 262.

105. *Id.* The basis for the court's rationale was not the explicit "subject to" language contained in the memorandum of understanding, but language in the drafts of the final agreement to the effect that it would be binding "when executed and delivered." *Id.*

106. See *supra* notes 67, 75, 84, 90, and 97.

107. See *supra* note 70 and accompanying text.

108. See *Reprosystem*, 727 F.2d at 260. The trial court, however, quite clearly found

trated by SCM's abrupt termination of the negotiations so that it could accept a better deal obtained in secret negotiations with a third party, it might be expected that the result would have been different, based upon the results reached in *Mid-Continent* and *American Cyanamid*.¹⁰⁹

A result analogous to that in *Reprosystem* was reached in *R.G. Group, Inc. v. The Horn & Hardart Co.*¹¹⁰ That case involved the enforceability of a "handshake deal" with respect to the grant of a restaurant franchise. At one of the parties' initial meetings, R.G. Group, Inc. ("R.G. Group") was provided with a copy of a standardized form of development franchise agreement and was advised that only minor modifications thereto would be permitted. This form of agreement appeared to the court to be lengthy and complex and contained blank spaces for the descriptions of the franchise development schedule and the geographic area to be developed.¹¹¹

After six months of intermittent discussions, several important issues remained unresolved.¹¹² During this period, the franchisor twice wrote the president of R.G. Group outlining the boundaries of the "proposed area" of the franchise, but no agreement was reached on that point. Thereafter, an operating officer of R.G. Group met with the franchisor's president to arrive at an agreement on the outstanding issues, including the franchise fee, development schedule and the development area. Although no accord was reached at this meeting, the parties reaffirmed their interest in the deal, and the franchisor's president suggested that R.G. Group's president contact the franchisor's attorney to work out a final agreement. Consistent with that suggestion, R.G. Group's president telephoned the franchisor's counsel and together they arrived at what appeared to them to be a complete agreement on all remaining terms, at which point the attorney confirmed over the telephone: "Yes, we have a handshake deal today and right now."¹¹³ The attorney further indicated that a "letter of understanding" would be prepared shortly, reflecting their agreement.¹¹⁴ The problem, however, was that they

that the transaction had failed as a direct result of SCM's determination, undisclosed to *Reprosystem*, not to complete the deal. See *Reprosystem*, 522 F. Supp. at 1270, 1274, 1279. See also *infra* notes 148 and 152. The decisions by the trial and appellate courts were also based upon the same principles cited in *Chromalloy, Mid-Continent, Cyanamid*. See *Reprosystem*, 727 F.2d at 261-62; *Reprosystem*, 522 F. Supp. at 1273-79.

109. See *supra* notes 78-81, 93-95 and accompanying text.

110. 751 F.2d 69 (2d Cir. 1984).

111. *Id.* at 71. The form of the agreement provided that "when duly executed [this agreement] sets forth your rights and your obligations." *Id.* at 71.

112. These issues included the amount of the franchise fee, the franchise area and the franchise development schedule. *Id.* at 72.

113. *Id.* at 73.

114. *Id.* This "letter of understanding" was apparently never prepared. *Id.* at 74.

had not discussed the subject of the development schedule or the boundaries of the franchise area, because, at the time, they both apparently believed these points had already been agreed to between R.G. Group's operating officer and the franchisor's president.¹¹⁵ Shortly thereafter, for reasons not expressed in the court's opinion, the franchisor's franchise committee rejected R.G. Group's franchise application.¹¹⁶

In R.G. Group's action against the franchisor for breach of contract, the trial court granted summary judgment for the franchisor.¹¹⁷ On appeal, the United States Court of Appeals for the Second Circuit, citing *Chromalloy* and *Reprosystem*, affirmed on the ground that both the terms of the development franchise agreement and the parties' conduct in the negotiations constituted "overwhelming" evidence of an intent not to be bound until the execution of a final agreement.¹¹⁸ While the reason for the franchisor's denial of the franchise is not at all apparent from the court's opinion, it is quite clear that the parties reached no agreement on the critically important subject of the development schedule and the area to be developed, even though they believed, albeit mistakenly, that those points had been agreed to earlier.

An opposite result was, of course, reached in *Texaco, Inc. v. Pennzoil, Co.*,¹¹⁹ where an "agreement-in-principle" had been reached, as reflected in a "Memorandum of Agreement," which was deemed to have been approved by the boards of directors of both Pennzoil and Getty.¹²⁰ The terms of the agreement outlined what appeared to be the basic components of the deal and contained an explicit provision that the transaction was subject to the execution of a definitive merger agreement, approval of Getty shareholders, regula-

115. *Id.* at 73, 76. This mistake appears to have been mutual.

116. *Id.* at 74. The notification of disapproval came eleven days after the "handshake deal." It is unclear at what point in the discussions the "application" was submitted, or what the application reflected as to the franchise area and development schedule. It is also unclear whether the absence of an agreement on these points formed any basis for the franchisor's ultimate denial of the application. *Id.*

117. The trial court's opinion in the case was apparently unreported. *Id.* at 70. The trial court's decision was based, in part, upon a finding that any oral agreement involved would be void under New York's statute of frauds. *Id.* at 77.

118. *Id.* at 75-77. The court also upheld the trial court's finding on the statute of frauds issue. *Id.* at 78.

119. 729 S.W.2d 768 (Tex. Ct. App. 1987).

120. The "Memorandum of Agreement," although explicitly made "subject to" approval by the Getty board, was never formally approved by the Getty directors or executed by Getty. Nevertheless, the court upheld the jury's determination that the Getty board had in fact approved the deal. *Id.* at 792. The other parties to the document were Gordon Getty, as trustee of the Sarah G. Getty Trust, and the J. Paul Getty Museum, whom together held 52% of the outstanding shares of Getty. These parties had executed the document, presumably with the requisite authority. *Id.* at 785.

tory filing requirements and waiting periods.¹²¹ Prior to, during, and after the agreement-in-principle was reached, Getty secretly continued to search out better offers, while preparing a press release announcing the merger with Pennzoil, and while Pennzoil's lawyers worked on a draft of the final definitive agreement.¹²² There appeared to be no disagreement between Pennzoil and Getty as to the terms of this final agreement but, due to the rapid sequence of intervening events, there was little time for any disagreement to develop.¹²³ Meanwhile, unknown to Pennzoil, Texaco extended a better offer to Getty, which Getty accepted without delay and without further word to Pennzoil;¹²⁴ immediately thereafter, Texaco issued its press release announcing its deal with Getty.¹²⁵

In affirming a jury finding that the parties intended to be bound by the preliminary agreement, the Texas Court of Appeals cited to the same principles and rules of law held to be controlling in *Chromalloy*, *Mid-Continent*, *American Cyanamid*, *Reprosystem* and *R.G. Group*.¹²⁶ As in *Mid-Continent* and *American Cyanamid*, the *Texaco* court disposed of the "subject to" language in the agreement-in-principle and in the press release on the basis that such language constituted at most a condition subsequent.¹²⁷ Numerous other challenges by Texaco on the issues of binding intent and whether the

121. *Id.* at 790. As finally agreed to, the Memorandum of Agreement set forth the basic structure of the transaction, including the cash price for the shares to be purchased and the method for payment of an additional "stub price" for the purchased shares. It did not, however, specify how the shares held by the J. Paul Getty Museum were to be acquired, how the "stub price" was to be paid in certain events, or whether any or all of the publicly-held shares could actually be acquired on the terms proposed. *Id.* at 792-94. Beyond these points, the court noted that "[t]he testimony is sharply conflicting on exactly what the 'Pennzoil proposal' was that the [Getty] board approved, as are the inferences that could be drawn from the record of that board meeting." *Id.* at 792.

122. Although during this period Pennzoil's counsel "periodically attempted" to contact the other parties' representatives to discuss the terms of a final "transaction agreement," there is no indication in the court's opinion that any substantive review or negotiation of those terms ever took place. *Id.* at 786, 790.

123. Only two-and-a-half days had elapsed between the Getty board's approval of the Pennzoil transaction and its later rejection thereof in favor of the Texaco offer. *Id.* at 785-87.

124. Although Texaco did apparently initiate the first direct contact with both Gordon Getty, through the Trust's counsel, and later with the Getty board, some evidence suggested that it did so upon the invitation of Getty's investment banker and with the assurances that there existed no binding agreement with Pennzoil. *Id.* at 800. The court, however, held that the jury might reasonably conclude that Texaco did not or should not have relied upon those assurances. *Id.* at 800-03.

125. *Id.* at 787.

126. *Id.* at 788-91.

127. *Id.* at 790. The court stated: "There was evidence that this was a paragraph of routine details, that the referred to merger agreement was a standard formal document required in such a transaction under Delaware law, and that the parties considered these technical requirements of little consequence." *Id.*

essential elements had been agreed to were dismissed by the court, primarily on the ground that there was sufficient evidence presented at trial to properly permit the jury to resolve those issues against Texaco.¹²⁸

In each of these cases, the pattern of operative facts appears quite similar, leading up to the point at which the agreement process was derailed and, at that point, this pattern diverges sharply. That divergence is paralleled in the results reached in each case. If the transaction failed as a result of a better and secretly negotiated deal with a third party, the court found that the parties intended to be bound by their preliminary agreement. If, on the other hand, the transaction failed simply due to the apparent inability or failure of the parties to reach a final agreement, the result was otherwise. All that can be observed at this point is that, among these decisions, which appear to reach inconsistent results based upon otherwise apparently similar operative facts, there appears to be a direct correlation between the reason for the failure of the transaction and the result reached by the courts.¹²⁹ As will be shown in the following discussion, this correlation does not stop here.

128. *Id.* at 791-96.

129. Additional support for this correlation may be found in *Arnold Palmer Golf Co. v. Fuqua Indus.*, 541 F.2d 584 (6th Cir. 1976); *Melo-Sonics Corp. v. Cropp*, 342 F.2d 856 (3d Cir. 1965); and in *Itek Corp. v. Chicago Aerial Indus.*, 248 A.2d 625 (Del. 1968). The operative facts and holding in *Itek* and *Melo-Sonics* are substantially similar to those in *Mid-Continent*. *Arnold Palmer* is consistent with this pattern because the target broke off further discussions after executing a "memorandum of intent," simply because the target's chairman of the board decided that "he did not want to go through with the Palmer deal." *Arnold Palmer*, 541 F.2d at 587. This represents a case of refusal to negotiate or renegeing similar to that found by the trial court in *Reprosystem*. See *infra* notes 148, 152. The analogy is perhaps less clear due to the fact that the holding in *Arnold Palmer* merely reversed the trial court's summary judgment for the target and remanded the case for further proceedings on the issue of whether the memorandum of intent was binding. *Arnold Palmer*, 541 F.2d at 589-90. While the conclusion reached as to this correlation appears safe with respect to the decisions examined, one case not examined, *Pepsico, Inc. v. W.R. Grace & Co.*, 307 F. Supp. 713 (S.D.N.Y. 1969), would challenge this correlation. The result in *Pepsico* may, however, be distinguishable from those reached in the decisions examined. First, the case appeared to solely involve a claim for securities fraud. *Id.* at 714. Second, the "holding" on the issue of whether a binding agreement was reached was expressly qualified by the court as dicta, since the issue before the court was acknowledged to be whether summary judgment for the defendants was warranted as to the securities fraud claim. *Id.* at 716. Third, there was apparently a serious deficiency in the facts contained in the record to support the claims. *Id.* at 720. A more serious challenge to this correlation may ostensibly be seen in *Interway, Inc. v. Alagna*, 85 Ill. App. 3d 1094, 407 N.E.2d 615 (1980). However, the result in that case is reconcilable on a different level. See *infra* note 159 and accompanying text.

A FURTHER DISTINCTION: IMPASSE V. UNILATERAL INSISTENCE UPON "NEW" TERMS

The reason for the failure of the transaction in these cases is not always due to the failure or inability of the parties to reach a final agreement, or an intervening third party bid. There appears to be at least one midpoint between these extremes when a preliminary agreement has been reached on the essential elements of the deal, and thereafter both parties appear to desire and intend to complete the transaction, but one party unilaterally imposes other or additional important conditions to a final agreement that appear inconsistent with the terms of the preliminary agreement. These situations are distinguishable from those found in *Chromalloy*, *Reprosystem* and *R.G. Group*, where the parties appeared to have simply reached an impasse with serious problems remaining on both sides of the transaction.

An illustration of this situation is found in the case of *Field v. Golden Triangle Broadcasting, Inc.*¹³⁰ There, the question involved the enforceability of a "letter agreement" for the purchase by Field, an individual, of two radio stations owned by Golden Triangle Broadcasting, Inc. ("Triangle"). At their first meeting, the parties discussed the terms of the transaction and reviewed a proposed form of a "letter agreement" that had been prepared by the president and virtual sole shareholder of Triangle. The letter agreement was in the form of an offer from Field and appeared to contain the basic terms of the transaction, including: the purchase price which was to be payable partly in cash with the balance payable in installments at a specified interest rate; the security for the installment obligation; an escrow provision; an initial deposit payment to be applied toward the escrow requirement; and a generic description of the assets to be transferred and liabilities to be assumed.¹³¹ The opening sentence of the document also contained the familiar qualification that the transaction was "'subject to agreement on a formal contract containing the provisions hereinafter set forth.'"¹³²

At this meeting, various changes were made manually to the letter agreement, including one recognizing that Field contemplated the possibility of forming a new corporation through which the assets were to be purchased and another which permitted Triangle to re-

130. 451 Pa. 410, 305 A.2d 689 (1973).

131. 451 Pa. at —, 305 A.2d at 691 n.1, 692-93. The letter provided a \$650,000 purchase price, \$175,000 of which was to be paid in cash, with the balance to be carried on a corporate note secured by a senior lien on the assets transferred in the purchase. *Id.* at —, 305 A.2d at 693, 695.

132. *Id.* at —, 305 A.2d at 693 (emphasis in opinion).

view and approve of the financial condition of any "existing corporation" used by Field for the purchase, to satisfy itself as to the financial security for the transaction.¹³³ Following these changes, the parties together inspected the broadcasting facilities and thereafter executed the letter agreement. Several days later, Field forwarded the deposit payment to Triangle as required by the letter agreement.

Over the next several weeks, the parties exchanged a number of documents in preparation for the closing while the parties' respective counsel discussed the terms of a final definitive agreement. Field, meanwhile, decided to form a new corporation to act as the purchaser. At this point, however, Triangle's counsel notified Field's counsel by letter that the structure of the deal outlined in the letter agreement "was completely unsatisfactory to Triangle from a security standpoint," and set forth five minimum requirements to be met before Triangle would be satisfied, including a minimum paid-in capital requirement for the new corporation and personal guaranties from Field's group; alternatively, a slightly reduced purchase price could be payable entirely in cash at closing.¹³⁴ Field continued to stand by the terms of the letter agreement and, when it was clear that Field would not accede to these additional requirements, Triangle broke off the deal. Field subsequently brought an action against Triangle for specific performance of the letter agreement.

The chancellor held the letter agreement to be binding and granted a decree of specific performance. On appeal, the Pennsylvania Supreme Court affirmed, holding that there was "ample evidence" of the parties' intent to be bound by the letter agreement.¹³⁵ With respect to the "subject to" language in the letter agreement, the court did not rely on the rationale of condition subsequent expressed in the decisions previously discussed but, rather, disposed of the issue with reference to the objective theory of contracts, citing the "manifestation" concept found in the Restatement of Contracts.¹³⁶ As in the other cases, however, once the necessary contractual intent was found, the court here had no difficulty in finding that the letter agreement contained all the essential elements of the transaction.¹³⁷

For purposes of the present analysis, what distinguishes *Field* from the cases previously discussed is that, in *Field*, once the preliminary agreement was in place, the transaction was derailed quite clearly as the result of Triangle's unilateral demand late in the nego-

133. *Id.* at —, 305 A.2d at 691-93.

134. *Id.* at —, 305 A.2d at 691, 695 n.7.

135. *Id.* at —, 305 A.2d at 692.

136. *Id.* at —, 305 A.2d at 693. The court quoted *Goldman v. McShain*, 432 Pa. 61, 69, 247 A.2d 455, 459 (1968) (quoting RESTATEMENT OF CONTRACTS § 26).

137. *Id.* at —, 305 A.2d at 692.

tiations for additional terms that were in conflict with the existing and previously agreed upon terms of the preliminary agreement. Thus, *Field* is distinguishable from *Chromalloy*, *Reprosystem* and *R.G. Group*, cases where the transaction broke down over the failure or inability of the parties to bilaterally reach a final agreement.¹³⁸ The analogy in this context to the results reached in the third party bid cases is that the effect on the transaction and on the disappointed party is substantially the same whether the other party accepts a secret third party deal or simply insists upon material new terms inconsistent with those originally agreed to.

This distinction reappears in the case of *V'Soske v. Barwick*.¹³⁹ In that case, after a lengthy period of negotiations for the purchase by Barwick of a small business owned and operated by the V'Soske family, the parties reached a preliminary agreement-in-principle which was embodied only in informal correspondence between them. As in *Field*, the agreement reached here set forth the basic, but rather vague, terms of the transaction and contemplated the execution of a final agreement by providing that the cash portion of the purchase price was to be payable "within 30 days after an agreement is reached," and further required employment contracts for V'Soske's senior management.¹⁴⁰ After additional discussions were had as to the final terms of the transaction, each party raised a number of important issues that had not been specifically addressed in the parties' preliminary agreement. One of these, raised by Barwick, concerned termination provisions in the employment agreement. Another, raised by V'Soske, was the issue of an expense account in one of the employment agreements. However, these and the other issues raised were all completely resolved by mutual agreement save for two remaining problems. The first, raised by Barwick for the first time, dealt with Barwick's insistence on V'Soske's modification of an exclusive sales agreement with a third party.¹⁴¹ The other involved Barwick's objections over the accounting procedure

138. See *supra* notes 70, 100-01, 115 and accompanying text.

139. 404 F.2d 495 (2d Cir. 1968).

140. *Id.* at 496-98. The correspondence provided for a purchase price equal to "audited net worth" of the V'Soske business plus \$700,000; \$1.2 million was to be paid in cash "within 30 days after an agreement is reached." The balance was to be payable over four years in equal monthly installments; no interest rate was specified. The correspondence required a five-year term for the employment agreements at salaries aggregating \$74,500 per year. *Id.* at 497.

141. *Id.* at 498. The V'Soske business had, apparently for some time, operated under an exclusive sales agreement with a third party under which all V'Soske's products were distributed and sold. Barwick insisted upon a modification of that agreement for the stated reason of permitting the distribution of V'Soske's products through Barwick's sales affiliates. *Id.*

used in calculating the purchase price.¹⁴² V'Soske was apparently unwilling to accede to further modification of the preliminary accord and Barwick thereafter broke off further discussions.

In V'Soske's action for damages against Barwick arising out of Barwick's alleged breach of the preliminary agreement, the trial court granted judgment on the merits for Barwick, observing that the case presented "'almost a classic case of preliminary negotiations which never ripened into a contract.'"¹⁴³ The United States Court of Appeals for the Second Circuit, however, reversed, holding that the correspondence exchanged between the parties, together with the parties' subsequent conduct, provided sufficient evidence of their intent to be bound. The court cited to the same fundamental legal principles cited in the cases discussed above and held that Barwick's insistence, late in the transaction, on the modification of the exclusive sales agreement was merely an unsuccessful attempt to amend the then already binding preliminary agreement "to include new terms."¹⁴⁴ On the issue of the accounting procedure, the court dismissed any problem there as being merely one of definiteness, not binding intent, and held that the issue could easily be resolved with reference to recognized accounting principles.¹⁴⁵

In *V'Soske*, as in *Field*, the transaction was ultimately frustrated by one party's unilateral insistence, at the eleventh hour of the final negotiations, upon material new terms that appeared inconsistent with or clearly beyond the terms contemplated by the preliminary agreement. Had the parties been unable to reach a final agreement on some important issue not provided for in the preliminary agreement, the result might be expected to resemble that reached in *Chromalloy*, *Reprosystem* or *R.G. Group*. The *V'Soske* case may, in addition, be viewed as taking the result reached in *Field* one step further, due to the considerable informality and imprecision of the writing involved in *V'Soske*.¹⁴⁶

The *V'Soske* decision is especially interesting for the further reason that both *V'Soske* and *Reprosystem* are Second Circuit decisions and *V'Soske* formed the basis for the trial court's decision in

142. *Id.* These objections apparently originated from Barwick's accountants, but the nature of these objections is not revealed in the opinion. *Id.* V'Soske's letter, which formed the basis for the preliminary agreement, spelled out in some detail the scope and method for determining the purchase price. *Id.* at 497.

143. *Id.* at 499.

144. *Id.* at 499-500.

145. *Id.* at 500.

146. *Id.* at 497. Compare *Field*, 451 Pa. at —, 305 A.2d at 693 (holding that the letter agreement "by its terms, formality and the extraordinary care in its execution, indicates that the signatories intended to bind themselves to an enforceable contract").

Reprosystem, which was reversed on appeal.¹⁴⁷ This fact both highlights the confusing state of the law in this area and sharpens the distinctions discussed above.¹⁴⁸ As in *Field*, the principal objective distinction between the facts in *V'Soske* and those in *Reprosystem* was the reason for the ultimate failure of the transaction.

The immediately preceding discussion is consistent with the correlation identified earlier between the results reached in these cases and the apparent reason for the failure of the transaction. Observe that in this analysis when the transaction appeared to break down simply as a result of the parties' impasse, the courts consistently refused to enforce the preliminary agreement. However, when the transaction was frustrated *either* by an intervening third party bid *or* by one party's unilateral insistence upon material "new" terms or conditions beyond those contemplated in the preliminary agreement, the courts uniformly reached an opposite conclusion.

While the foregoing analysis shows that the results in these cases may be seen to be both consistent and highly predictable, it does not explain why there should be any connection at all between the reason for the failure of the transaction and the courts' conclusions in these cases. The discussion below will offer some possible explanations for the connection.

SOME REASONABLE HYPOTHESES

The distinctions identified above and the discussion that follows

147. *Reprosystem*, 727 F.2d at 261.

148. Indeed, it appears that the trial court's holding in *Reprosystem* was based very largely upon its conclusion that SCM had, toward the end of the negotiations, and without *Reprosystem's* knowledge, set out to "kill the deal." See *supra* notes 101, 108. On appeal, the Second Circuit reached a distinctly different conclusion, characterizing the negotiations as simply having "stalled." *Reprosystem*, 727 F.2d at 260. This finding, and the balance of the Second Circuit's opinion, leaves a reasonably clear implication of its view that the transaction in the case failed, not due to any ulterior motive or invidious or deceitful conduct on the part of SCM, but simply because the parties were unable to reach an agreement on final terms. *Id.* at 261-65. For present purposes, it is unimportant to determine which court interpreted these facts correctly. Rather, it is sufficient to observe only that opposite conclusions concerning the reason for the failure of the transaction resulted in a correspondingly opposite outcome in the case.

It may be noted that, if the inferences drawn by the trial court in *Reprosystem* were to be accepted, this would illustrate a further distinction as to the reason for the failure of the transaction—that is, one party secretly attempting to "kill the deal" by frustrating an agreement on final terms. This makes the task of fact-finding particularly critical in this class of cases. It should also be observed that these distinctions may simply be examples of what Professor Farnsworth describes generally as "instances of unfair dealing," which include (1) refusal to negotiate, (2) improper tactics, (3) unreasonable proposals, (4) nondisclosure, (5) negotiations with others, (6) reneging, and (8) breaking off negotiations. These variations and the resulting problems are explicated in Farnsworth, *Precontractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations*, 87 COLUM. L. REV. 217, 273-85 (1987).

may be subject to some measure of skepticism.¹⁴⁹ Assuming, for the moment, that this skepticism may be overcome, there are several reasonable hypotheses that can be offered to explain the connection between the reason for the failure of these transactions and the results reached in these cases.

One possible explanation is that, in those decisions that have held the parties bound by their preliminary agreement, the courts may have reached the dubious conclusion that, *but for* the third party bid or the unilateral insistence on additional "new" terms late in the deal, the transaction would have succeeded and the preliminary agreement *would* have or *should* have been fulfilled. This explanation certainly appears to have had some influence in *Mid-Continent Telephone Corp. v. Home Telephone Co.* In that case, the court looked at the status and progress of the transaction at the point when Home had broken off discussions to accept an improved third party bid and, in dicta, actually attempted to predict the probable success of a final

149. Such skepticism is anticipated on two levels. The first relates to the method by which one arrives at the distinctions identified earlier. These distinctions are solely the product of this author's interpretations of the opinions in these cases. However, the preceding analysis requires only two interpretive inquiries: the reason for the failure of these transactions and the results or holdings reached with respect to the recognition of a binding preliminary agreement. The latter should present no serious interpretive problems since, apart from determining the reason for the failure of these transactions, there is no particular concern in this analysis for the expressed rationale of the decisions; however, the magnitude of the distinction in the particular case is affected by whether the decision is one granting summary disposition on the issue; a determination on the merits of the case, or merely a denial of summary disposition. In any event, that point is disclosed in the discussion of the cases. The determination as to the reason for the ultimate disagreement of the parties relies solely upon inferences drawn from the text of the opinions as to the facts in these cases. The primary problem here is that the facts on this issue are not "operative facts," *see supra* note 11, and a specific finding by the courts on that point is not or should not be material to their analyses. Therefore, the criteria for reaching a conclusion on this point consists of inferring from the language of the opinions the identity of the most significant event, following the parties' preliminary agreement, that appeared to contribute to the parties' ultimate disagreement. These interpretations may thus not "hold nontrivially for all possible interpretations." Hoy, *Interpreting the Law: Hermeneutical and Post-structuralist Perspectives*, 58 S. CAL. L. REV. 136, 148 (1985). Accordingly, with respect to each of the cases discussed, some interpretations on these points will be better than others. *See id.* It is submitted, however, that these criteria should be sufficient in the context of this analysis to avoid being self-serving or slipshod. *Id.*

Second, with respect to both the distinctions identified and the hypotheses offered, this Article does not assert that these are the only interpretations or inferences that may be drawn from the decisions in this area. It is, however, assumed that these decisions are, taken as a whole, coherent and capable of being reconciled with reference to the legal principles by which they are held to be governed. Thus, the method and perspective of the analyses proceed from a distinctly formalist premise, and any shortcomings perceived in that regard will be found throughout this Article. *See generally* Trubek, *Where the Action is: Critical Legal Studies and Empiricism*, 36 STAN. L. REV. 575 (1984).

agreement, *but for* the interference.¹⁵⁰ Similarly, in *Field v. Golden Triangle Broadcasting, Inc.*, the court appeared to go some distance out of its way to hold specifically that the collateral security for the purchase price in the transaction, as specified in the preliminary agreement, "[was] *adequate*"¹⁵¹ for Triangle in the deal—thereby seeming to reach a business judgment in the matter, and perhaps implying that it was reasonable to assume that the transaction *should* have proceeded to a successful conclusion. Such attempted predictions and business judgments are not a necessary part of the legal analysis in these cases and operate simply to cast suspicion on the underlying reasoning for the courts' holdings.

Beyond these points, it appears that these decisions may have also been influenced by the connotation of bad faith associated with an abrupt termination of negotiations due to one party obtaining a better deal in secret negotiations with a third party or one party's unilateral insistence upon material "new" terms at the eleventh hour of the negotiations. Examples of such influence are seen in the opinions in *Mid-Continent* and *Field* and in the trial court's opinion in *Reprosystem, B.V. v. SCM Corp.*¹⁵² Other decisions have, interest-

150. See *Mid-Continent Tel. Corp. v. Home Tel. Co.*, 319 F. Supp. 1176, 1195-96 (N.D. Miss. 1970). With reference to the condition of a "mutually satisfactory" employment agreement between *Mid-Continent* and *Rex Darley*, the court noted:

In fact the evidence showed that *Weston* and *Rex* were negotiating within well defined limits and probably headed toward a final understanding [with respect to *Rex's* employment agreement]. As expounded earlier, agreement on *Rex's* contract was a condition precedent to closing the merger and not precedent to the existence of a binding contract of merger.

Id. at 1195.

151. *Field v. Golden Triangle Broadcasting*, 451 Pa. 410, —, 305 A.2d 689, 695-96 (1973) (emphasis added).

152. See *Mid-Continent*, 319 F. Supp. at 1196, wherein the court stated:

Home was under a positive duty to allow *Mid-Continent* a reasonable time to agree upon a reorganization plan and a contract for *Rex Darley*, and it could not flatly repudiate the entire agreement without giving *Mid-Continent* notice of the reasons for its dissatisfaction and a reasonable opportunity to remedy the defects as *Home* saw them. . . . [T]he only impetus for the decision to repudiate the *Mid-Continent* contract was the highly profitable cash offer which *Home's* stockholders received from a third party. On that factual basis, we must hold that *Home's* action was a wrongful repudiation and breach of its contractual obligations and not a justified rescission.

Id. Another example may be drawn from the trial court's decision in *Reprosystem, B.V. v. SCM Corp.*, 522 F. Supp. 1257 (S.D.N.Y. 1981), where the court certainly revealed its views as to *SCM's* motives in the transaction:

On the facts as I have found them, I conclude not only that *SCM* breached the agreements reached at the end of 1976, but that it specifically breached its duty of good faith negotiation and performance required by those agreements. A fundamental obligation to deal in good faith, found in established case law, required *SCM* to act otherwise than to single-mindedly bail out of what it came to see as a bad deal.

Id. at 1279. See also *Field*, 305 A.2d at 695, wherein the court similarly seems to disclose its appraisal of *Triangle's* conduct in the final negotiations.

ingly enough, made more explicit reference to the involvement of bad faith in this context, but only by way of raising the issue for the trial court's consideration on remand.¹⁵³ The problem in such cases lies in trying to determine from the opinion whether the existence of a binding preliminary agreement resulted in a finding of a breach of duty of good faith, or vice versa. This is not often easy to determine, particularly in the context of language in opinions such as that contained in *Mid-Continent*, *Field* and the trial court's opinion in *Reprosystem*.

Another possible explanation for the connection between the reason for the failure of the deal and the outcome of the case may be seen in those situations when the parties simply appear to have been unable to reach a final agreement. Here, the courts sometimes seem to infer an after-the-fact intention of the parties not to be bound by their preliminary agreement from the very fact that they were unable to reach a final agreement. In *Reprosystem*, for example, the court appeared to place more emphasis on the terms in the drafts of the final agreement than on the provisions of the preliminary agreement itself.¹⁵⁴ Moreover, it employed a gap-filler to bolster its conclusion on the contractual intent issue by subsuming a "practical business need to record all the parties' commitments in definitive documents."¹⁵⁵ A similar observation may be made with respect to certain language found in *R.G. Group, Inc. v. The Horn & Hardart Co.*¹⁵⁶

There is, however, yet another explanation for the courts' rationale in these cases that is more plausible, and this is reflected in the fundamental principle underlying the objective theory of contracts that runs throughout the Restatement of Contracts (Second) notion of "manifestation."¹⁵⁷ In each of the cases examined, it appears that

153. See *Arnold Palmer Golf Co. v. Fuqua Indus., Inc.*, 541 F.2d 584, 588 (6th Cir. 1976); *American Cyanamid Co. v. Elizabeth Arden Sales Corp.*, 331 F. Supp. 597, 606-07 (S.D.N.Y. 1971); *Pepsico, Inc. v. W.R. Grace & Co.*, 307 F. Supp. 713, 720 (S.D.N.Y. 1969); *Itek Corp. v. Chicago Aerial Indus.*, 248 A.2d 625, 629 (Del. 1968).

154. See *Reprosystem, B.V. v. SCM Corp.*, 727 F.2d 257, 262 (2d Cir. 1984).

155. *Id.* at 262-63.

156. See *R.G. Group, Inc. v. The Horn & Hardart Co.*, 751 F.2d 69, 77 (2d Cir. 1984).

157. See RESTATEMENT (SECOND) OF CONTRACTS §§ 2, 19, 24, 26, 27 (1981). For example, with respect to preliminary negotiations, section 26 provides: "A manifestation of willingness to enter into a bargain is not an offer if the person to whom it is addressed knows or has reason to know that the person making it does not intend to conclude a bargain until he has made a further manifestation of assent." *Id.* § 26. With respect to agreements contemplating a subsequent written memorial, section 27 provides: "Manifestations of assent that are in themselves sufficient to conclude a contract will not be prevented from so operating by the fact that the parties also manifest an intention to prepare and adopt a written memorial thereof; but the circumstances may show that the agreements are preliminary negotiations." *Id.* § 27. Comment b to section 2 explicates the concept of "manifestation:"

the outcome was determined not so much by the reason for the failure of the transaction, as by whether one of the parties was simply misled by the conduct or "manifestations" of the other. This analysis is recognized explicitly in several of the opinions in the cases discussed¹⁵⁸ and is expressed more subliminally in the dicta of others.¹⁵⁹

In those cases where the parties simply failed or appeared unable to reach a final agreement, the conduct of the parties following their preliminary agreement may have seemed to the court suggestive of the parties subsequent intention to no longer be bound. As the final negotiations deteriorated, the ultimate failure of the deal seemed to come as no surprise, even to the disappointed party. In both *Chromalloy American Corp. v. Universal Housing Systems of America* and *Reprosystem*, the final negotiations faltered over each party's inability or unwillingness to resolve issues of fundamental importance. In

The phrase "manifestation of intention" adopts an external or objective standard for interpreting conduct; it means the external expression of intention is distinguished from undisclosed intention. A promisor manifests an intention if he believes or has reason to believe that the promisee will infer that intention from his words or conduct.

Id. § 2, comment b. See also J. CALAMARI AND J. PERILLO, *CONTRACTS* § 2.7, at 33 (2d ed. 1977), wherein the authors conclude in this context:

The essential point is that under the objective theory of contracts the test is whether a reasonable man in the position of the plaintiff would conclude that the defendant had made a commitment. Under such a test it is not surprising to find that there are often differences of opinion as to the correct result in a concrete case.

Id. (footnotes omitted).

158. See *Reprosystem*, 727 F.2d at 261, and the corresponding trial court opinion, 522 F. Supp. at 1275-80; *V'Soske v. Barwick*, 404 F.2d 495, 499 (2d Cir. 1968); *Field*, 451 Pa. at —, 305 A.2d at 693-95; *Texaco, Inc. v. Pennzoil, Co.*, 729 S.W.2d 768, 788 (Tex. Ct. App. 1987); see also *Arnold Palmer*, 541 F.2d at 587 n.2; *Borg-Warner Corp. v. Anchor Coupling Co.*, 16 Ill. 2d 234, —, 156 N.E.2d 513, 517 (1958).

159. See *R.G. Group*, 751 F.2d at 74-75; *Chromalloy American Corp. v. Universal Housing Systems of America, Inc.*, 495 F. Supp. 544, 549-51 (S.D.N.Y. 1980); *Cyanamid*, 331 F. Supp. at 606; *Mid-Continent*, 319 F. Supp. at 1190-91; see also *Pennsylvania Co. v. Wilmington Trust Co.*, 166 A.2d 726, 732-33 (Del. Ct. 1960); *Interway, Inc. v. Alagna*, 85 Ill. App. 3d 1094, 407 N.E.2d 615, 620-21 (1980). *Interway* involved a letter of intent in a stock-for-stock exchange in Interway's acquisition of a corporation owned by Alagna that was engaged in the business of trailer leasing. The parties executed a "letter of intent" that appeared to contain the basic elements of the transaction and which was also made subject to the execution of a "definitive Purchase and Sale Contract." The business day following Alagna's execution of the letter of intent, he informed Interway that he would not proceed with the transaction. The court affirmed the trial court's dismissal of Interway's breach of contract action. The court reasoned that Interway had not been misled or, if it had been misled, no harm resulted therefrom since there was no "substantial action . . . taken by one party in reliance upon the expressed intention of the parties On the contrary, Alagna's intention to halt the negotiations was communicated to Interway on the first business day following the acceptance of the [l]etter." *Id.* at 620-21. But for the court's conclusion on this point, the facts in *Interway* bear a striking resemblance to those in *Arnold Palmer*. Consistent with the hypothesis suggested, the courts in these two cases reached essentially opposite conclusions. See *supra* note 129.

each of these cases, there also appeared to remain at least one critical problem caused by intervening circumstances that seemed outside the parties' power to control.¹⁶⁰ Even in *R.G. Group*, any surprise by R.G. Group over the denial of its franchise application following the oral "handshake" agreement was a direct consequence of its clear mistake of fact as to what, in fact, had not been agreed to.¹⁶¹ A safer rationale in these cases would simply be that the parties' preliminary agreement did not include the essential elements of the deal since, as long as a final agreement was not frustrated by the introduction of "new" issues or a refusal to negotiate final terms, at least some of the final terms would presumably be essential if the parties' disagreement over them prevented a final agreement. The facts in the particular case may, as was held in *Chromalloy*, *Reprosystem* and *R.G. Group*, also indicate the parties' intention not to be bound until the execution of a final definitive agreement, but an analysis of that issue would seem particularly unnecessary in the presence of the more obvious and compelling "essential elements" rationale.

By contrast, when the transaction was broken off over an intervening and secret third party bid, or because material "new" terms were introduced unilaterally in the final stage of the negotiations, the disappointed party appeared clearly to have been misled by the other's objective conduct in the negotiations, whether that conduct was actually attended by bad faith or motivated by any intent to deceive the other party. Thus, the untoward consequences suffered by the disappointed party in these cases resulted not necessarily from the fact that the conduct involved was tainted with bad faith or even an intention to mislead, but because these "manifestations" did in fact operate to mislead.

For these reasons, one may question whether the results in these cases, or the analysis used to get there, would be improved upon by imposing a precontractual duty of good faith.¹⁶² Without intending to oversimplify the matter, one can certainly contemplate that, depending upon how broadly the concept of good faith is defined in the precontractual context,¹⁶³ conduct undertaken within these parame-

160. In *Chromalloy*, the problem related to the securities law concerns in connection with its completed acquisition of Extrudyne. See *supra* note 70 and accompanying text. In the case of *Reprosystem*, the problem related to the discovered accounting error that resulted in a substantial increase in the purchase price and concern over whether Reprosystem would be able to deliver that increased purchase price at closing. See *supra* note 100 and accompanying text.

161. See *supra* note 115 and accompanying text.

162. See *supra* notes 57-61 and accompanying text.

163. Professor Knapp would seem to apply a good faith standard approaching one of commercial reasonableness. See Knapp, *Enforcing the Contract to Bargain*, 44 N.Y.U. L. REV. 673, 721-23 (1969). Temkin would apply a "foregone opportunities" test

ters may, nevertheless, operate to mislead a reasonable party;¹⁶⁴ conversely, any remedy at all should be inappropriate when conduct, even if undertaken in deliberate bad faith, in fact does not or should not operate to mislead a reasonable party.¹⁶⁵ Thus, in terms of defining the nature of the precontractual *duty* to be applied, the "duty not to mislead," as inferred from these decisions, may be more equitable and reliable in this setting than the imposition of a duty of good faith. The problem as to the appropriate *remedy* for a breach of this duty is another matter, and these decisions may properly be criticized for their readiness to award a remedy based upon the disappointed party's expectation of complete fulfillment of a final bargain, whether measured in terms of damages or specific performance. If the core of the problem lies not so much in characterizing the nature of the underlying duty, but in fashioning an appropriate remedy to protect the legitimate interests of the disappointed party, a resolution of this problem could be achieved without the necessity for reform of the common law of contracts.¹⁶⁶ Whatever the merits of the preced-

advanced by Professor Burton as a general test of contractual good faith. See Temkin, *When Does the "Fat Lady" Sing?: An Analysis of "Agreements in Principle" in Corporate Acquisitions*, 55 *FORDHAM L. REV.* 125, 154 (1986); see generally Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 *HARV. L. REV.* 369 (1980). This test, essentially, would view each party to a contract as having thereby forgone some measure of future opportunity; bad faith would be recognized when, following the bargain, one party attempted to recapture one or more of these opportunities. *Id.* However, this test is based upon the *reasonable expectations of the promisee* as to the nature and extent of the opportunities that the promisor has agreed to forgo. Thus, there appears to be little, if any, difference between the boundaries of this precontractual duty of good faith and the "duty not to mislead" inferred from the decisions examined herein.

164. If the ambit of precontractual good faith stops short of encompassing the promisee's reasonable expectations, it seems clear that conduct of a promisor falling within that circumference of good faith may, nevertheless, operate to disappoint the reasonable expectations of the promisee.

165. Thus, for example, in the third party bid cases, had the original suitor entered into the preliminary negotiations with knowledge or reason to know that the target intended to accept a subsequent better offer, there would seem to be no interest of the original suitor in the bargain worthy of protection—indeed, this would likely be strong evidence of both parties' intention not to be bound exclusively—even if the target had intended to deceive the original suitor in that regard. See *supra* note 51.

166. This conclusion appears consistent with Professor Farnsworth's characterization of the "aleatory view" of the common law in this context. See Farnsworth, *Precontractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations*, 87 *COLUM. L. REV.* 217, 221, 284-87 (1987), wherein the author concludes:

Existing contract law has been criticized for failing to deal adequately with the negotiation of deals and, in particular, for failing to protect the rights of parties if their negotiations fail. An application of basic contract law principles to the negotiation process reveals that the criticism is unwarranted.

* * *

Courts have not imposed a general obligation of fair dealing under the regime of negotiation. The disappointed party may, however, have a claim based on restitution, on misrepresentation, or on a specific promise. Recovery for lost opportunities should be allowed in appropriate cases. But courts should

ing observation, the hypothesis suggested does offer an explanation for the results achieved in these cases that is both plausible and consistent with recognized legal principles.

CONCLUSION

The foregoing analysis suggests a method by which the decisions in this area may be reconciled, both in terms of their relationship with one another and in terms of the controlling legal principles involved. When viewed in this manner, the results reached in these cases are shown to be both consistent with one another and highly predictable. In addition, to the extent that the rationale of these decisions is consistent with the hypothesis recommended, the decisions can also be seen to be analytically sound.

Given the foregoing, one might understandably be curious as to the basis for the confusion in this area. Several explanations can be offered. First, the decisions do conflict directly in their analyses on certain specific points involved in these cases, for example, in construing the "subject to" language that regularly appears in the parties' writings¹⁶⁷ and in the inferences drawn from the brevity or informality of the form of writing involved.¹⁶⁸ Second, on several occasions, the language in the opinions appears to go beyond the boundaries of the stated legal principles applicable in these cases to reach conclusions that are neither necessary nor appropriate to the analysis.¹⁶⁹ Finally, the opinions sometimes seem to lay more emphasis upon the subjective, motivational characteristics of the parties' conduct rather than the objective effect of such conduct upon the parties in the context of the transaction and, in that emphasis, there is occasionally seen a pretextual conclusion as to the bad faith quality of such conduct.¹⁷⁰ All these explanations mean, apart from the remedies sometimes awarded in these cases, is that the courts appear to be reaching correct results, although they do not always do so clearly for all or only the correct reasons.

not impose a general obligation of fair dealing and abandon the aleatory view of negotiations under which each party bears the risk that its efforts will go uncompensated if the negotiations fail.

Id. at 285.

167. See *supra* notes 67, 72, 74, 80, 84, 90, 94, 95, 97, 105, 111, 118, 121, 127, 131, 135 and accompanying text.

168. See *supra* note 47. Compare, for example, the seemingly inconsistent inferences in this regard drawn in *R.G. Group, Inc. v. The Horn & Hardart Co.*, 751 F.2d 69, 77 (2d Cir. 1984) and *Reprosystem, B.V. v. SCM Corp.*, 727 F.2d 257, 262, (2d Cir. 1984), with those found in the trial court's opinion in *Reprosystem*, 552 F. Supp. at 1276-77, and *Texaco, Inc. v. Pennzoil, Co.*, 729 S.W.2d 768, 795 (Tex. Ct. App. 1987).

169. See *supra* notes 150, 151, 154-56 and accompanying text.

170. See *supra* notes 152, 153.

This Article has sought to see through these inconsistencies and "wrong" reasons to arrive at a coherent meaning of these decisions. To the extent that this endeavor has been successful, it should bring a corresponding measure of clarity to this important area.