

Summer 2020

Contract Design, Default Rules, and Delaware Corporate Law

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Recommended Citation

Jeffrey Manns and Robert Anderson, *Contract Design, Default Rules, and Delaware Corporate Law*, 77 Wash. & Lee L. Rev. 1197 (2020), <https://scholarlycommons.law.wlu.edu/wlulr/vol77/iss3/6>

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Contract Design, Default Rules, and Delaware Corporate Law

Jeffrey Manns* & Robert Anderson**

Abstract

Incomplete contract theory recognizes that contracts cannot be comprehensive and that state law necessarily has to fill in gaps when conflicts arise. The more complex the transaction, the more that lawyers face practical constraints that force them to limit the scope of drafting and broadly rely on legal defaults and open-ended terms to plug holes and address contingencies. In theory Delaware law serves as lawyers' preferred jurisdiction and forum for merger and acquisition (M&A) transactions and other high-end corporate deals because of the state's superior default rules for corporate law and its judiciary's expertise in discerning the "hypothetical bargain" of the parties.

This paper sets out to examine whether lawyers' professed confidence in Delaware defaults actually shows up in the drafting of merger and acquisition agreements. Lawyers may base deals in Delaware law because of their familiarity with its provisions, or Delaware's appeal may reflect the substantive adding of value in filling contractual gaps. Our premise is that the best proxy for examining lawyers' reliance on a jurisdiction's defaults is the extent of brevity in legal drafting, which is closely related to reliance on standards rather than rules. Incomplete contract theory predicts that reliance on defaults should broadly

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translate into implicit (and explicit) references to existing defaults that conserve time and space in drafting, especially through the use of parsimonious standards rather than prolix rules. To the extent to which comparable contracts grounded in different jurisdictions have systematic differences in length, this finding would serve as evidence that lawyers are placing greater reliance on the defaults of one jurisdiction compared to another.

In this paper we compare the length of public company merger and acquisition (M&A) agreements between Delaware transactions and those governed by the law of other jurisdictions. To the extent practitioners regard Delaware law as more comprehensive, more precise, or more settled (due to the Delaware General Corporation law, case law, or the judicial system) compared to other jurisdictions, then we would expect that Delaware M&A agreements would be more concise because of greater reliance on defaults and open-ended terms.

We found agreements governed by Delaware law are no shorter, and in fact are generally longer than agreements governed by the law of other states even when we accounted for a spectrum of control variables including the deal structure, the quality of law firms, deal complexity, and the size of the transaction. This finding held true even when we identified and controlled for the textual source of the precedent documents. Our results challenge the conventional wisdom about contracting parties' placing greater reliance on Delaware law.

Our findings suggest that a gap exists between the Delaware legal system's outsized reputation and the actual practice of lawyers in drafting M&A agreements who appear to place no more reliance on the defaults of Delaware law than on the defaults of other jurisdictions. This finding calls into question why Delaware's statutory and judicial defaults do not appear to matter in the contracting context in which the Delaware difference compared to other states should be the most apparent. Lawyers' confidence in Delaware may be genuine when it comes to steering incorporations and M&A litigation to Delaware. But if lawyers rely on the defaults of Delaware contract law no more (and perhaps less) in contract drafting than that of other jurisdictions, then it suggests that Delaware's reputation for

corporate law exceeds its substance. We conclude that the text is likely influenced far more by fortuitous events in the drafting process, such as the precedent chosen, than by the default rules of the jurisdiction.

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I. Introduction

Every contract is necessarily incomplete.¹ Contracting parties have neither the interest, the time, nor the ability to anticipate and address every contingency. Lawyers must therefore rely extensively on statutory and judicial defaults and open-ended terms, such as “commercially reasonable efforts” or “consent not to be unreasonably withheld.”² Contracting parties invest time in negotiating deal-specific terms, but must weigh the costs and value of contracting around defaults that raise interpretive ambiguities or that the parties perceive to be undesirable.³ The result is that incomplete contract theory predicts a spectrum approach to contracting. The greater the

1. Scott Baker & Kimberly D. Krawiec, *Incomplete Contracts in a Complete Contract World*, 33 FL. ST. U. L. REV. 725, 725 (2006).

2. See, e.g., Ian Ayres & Robert Gertner, *Strategic Contractual Inefficiency and the Optimal Choice of Legal Rules*, 101 YALE L.J. 729, 732–33 (1992) (examining how transaction costs and market power shape contracting parties’ incentives to contract around default rules); Robert E. Scott, *The Law and Economics of Incomplete Contracts*, 2 ANN. REV. L. & SOC. SCI. 279, 280–81 (2006) (discussing how the law and economic theory of incomplete contracts has developed analytic tools to address the problems posed in the contracting process).

3. See, e.g., Baker & Krawiec, *supra* note 1, at 733–34 (discussing the role of statutory and judiciary defaults in “completing” incomplete contracts by filling gaps in contracts or refusing to fill contractual gaps); Richard Craswell, *The Incomplete Contracts Literature and Efficient Precautions*, 56 CASE W. RES. L. REV. 151, 156–57 (2006) (discussing how “the literature on incomplete contracts might just as accurately be referred to as the literature on ‘incomplete courts’” because it recognizes that “the efficiency of key decisions cannot be evaluated perfectly by courts”); OLIVER HART, FIRMS, CONTRACTS, AND FINANCIAL STRUCTURE 37–38 n.15 (1995) (arguing that problems related to vague provisions should push parties to craft alternative provisions that have greater clarity or are more easily verifiable); Charles J. Goetz & Robert E. Scott, *The Limits of Expanded Choice: An Analysis of the Interactions Between Express and Implied Contract Terms*, 73 CALIF. L. REV. 261, 289–98 (1985) (arguing that default rules should be chosen to provide terms that would minimize contracting parties’ cumulative transaction costs); Marcel Kahan & Michael Klausner, *Standardization and Innovation in Corporate Contracting (or “The Economics of Boilerplate”)*, 83 VA. L. REV. 713, 765–67 (1997) (discussing how reliance on defaults enhances contractual drafting efficiency and increases network benefits for contracting parties).

confidence parties have in the defaults of a jurisdiction (and judicial interpretation of those defaults), the more concise contracts will be as parties broadly rely on default rules and open-ended terms to minimize the costs of transactional drafting and other costs associated with detailed rules.⁴

This paper leverages this insight to examine empirically whether Delaware's reputation for comprehensive, precise, and settled corporate law shapes the actions of lawyers when they are drafting merger and acquisition agreements. Delaware has long served as the destination of choice for incorporations and as the most appealing forum for the adjudication of business and finance litigation, such as mergers and acquisition litigation.⁵ Most commentators have attributed Delaware's appeal to its ostensibly superior legal system.⁶ "Race to the top" advocates believe Delaware has won a competition among the states in producing a statutory framework and specialized Court of Chancery that enhance shareholder value.⁷ In contrast, "race to

4. See, e.g., Albert Choi & George Triantis, *Strategic Vagueness in Contract Design: The Case of Corporate Acquisitions*, 119 YALE L.J. 848, 881–95 (2010) (discussing the efficiency enhancing effects from contractual vagueness in the material adverse change clause context); Richard A. Posner, *The Law and Economics of Contract Interpretation*, 83 TEX. L. REV. 1581, 1582–83 (2005) ("[C]ontracts are likely to be shorter the more competent the judges are because lawyers will not have to spell out everything for a dim interpreter."); Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L.J. 541, 594–607 (2003) (providing an overview of the role of defaults in shaping contractual drafting under incomplete contract theory).

5. Approximately 60 percent of publicly traded companies in the United States are incorporated in Delaware including 63 percent of the Fortune 500 companies. See DEL. DEPT OF STATE, DIV. OF CORPS., 2009 ANNUAL REPORT, 1 (2010), <https://perma.cc/XW3Y-B7UY> (PDF). Over 90 percent of publicly-traded companies that are incorporated in a state outside of their principal base of operations are incorporated in Delaware. See Lucian Arye Bebchuk & Alma Cohen, *Firms' Decisions Where to Incorporate*, 46 J.L. & ECON. 383, 391, 420 (2003) ("The choice is thus not among a multitude of competitors for the national market but rather between incorporating in the home state or in Delaware.").

6. See *infra* note 7 and accompanying text.

7. See, e.g., RICHARD POSNER, *ECONOMIC ANALYSIS OF LAW* 306–07 (2d ed. 1977) (arguing that Delaware's appetite for tax revenues from corporate charters incentivized it to develop efficient corporate law rules); RALPH K. WINTER, *GOVERNMENT AND THE CORPORATION* 28–42 (1978) (developing the

the bottom” advocates argue that Delaware statutes and case law merely excel at adding managerial value and entrenching managers at the expense of shareholders.⁸ But both advocates

“race to the top” argument in greater detail); Barry D. Baysinger & Henry N. Butler, *The Role of Corporate Law in the Theory of the Firm*, 28 J.L. & ECON. 179, 184–90 (1985) (arguing that companies “will select their state of incorporation adaptively” leading to a “race to the top” among states); Robert Daines, *Does Delaware Law Improve Firm Value?*, 62 J. FIN. ECON. 525, 527–31 (2001) (analyzing the Tobin’s Q of Delaware corporations versus non-Delaware corporations to argue that incorporation in Delaware adds value); Daniel R. Fischel, *The ‘Race to the Bottom’ Revisited: Reflections on Recent Developments in Delaware’s Corporate Law*, 76 NW. U. L. REV. 913, 919–20 (1982) (pointing to the greater market valuation of Delaware versus non-Delaware firms in arguing that Delaware “has achieved its prominent position because its permissive corporation law maximizes, rather than minimizes, shareholders’ welfare”); Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225, 265–73 (1985) (arguing that the positive market reaction to reincorporations in Delaware suggests that state competition results in a “race to the top”); Guhan Subramanian, *The Disappearing Delaware Effect*, 20 J.L. ECON. & ORG. 32, 35–38 (2004) (applying the Tobin’s Q approach to show that Delaware law adds a modest, though declining amount of value compared to other states); Ralph K. Winter, *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251, 289–92 (1977) (arguing that state competition results in a “race to the top”); Michal Barzuza & David C. Smith, *What Happens in Nevada? Self-Selecting into Lax Law*, 27 REV. FIN. STUD. 3593, 3616–17 (2014) (finding there is a premium for Delaware incorporation based on a comparison of the Tobin’s Q of Delaware and Nevada corporations).

8. See, e.g., *Liggett Co. v. Lee*, 288 U.S. 517, 558–59 (1933) (Brandeis, J., dissenting) (framing the competition among states for incorporation revenues as a race “not of diligence but of laxity”); RALPH NADER, MARK GREEN & JOEL SELIGMAN, *TAMING THE GIANT CORPORATION* 54–61 (1976) (framing Delaware’s preeminence as a product of catering to management rather than shareholders); Oren Bar-Gill, Michal Barzuza & Lucian Arye Bebchuk, *The Market for Corporate Law*, 162 J. INSTITUTIONAL & THEORETICAL ECON. 134, 137–41 (2006) (developing a formal model that suggests that Delaware law systematically favors managers over shareholders in contexts where their interests conflict); Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1437, 1440–45 (1992) (arguing that “state competition produces a race for the top with respect to some corporate issues but a race for the bottom with respect to others” in which managers’ interests conflict with shareholders); Lucian Arye Bebchuk, Alma Cohen & Allen Ferrell, *Does the Evidence Favor State Competition in Corporate Law?*, 90 CALIF. L. REV. 1775, 1820–21 (2002) (providing empirical evidence that state competition results in corporate governance rules that benefit managers but potentially at the expense of

and critics of Delaware have a common theme: Delaware's legal system stands out from other states which creates incentives to rely on Delaware law. Therefore, we would expect that lawyers would place greater confidence in the defaults established by Delaware statutes, case law, and the Court of Chancery to further either shareholder or managerial value, which should be apparent in the drafting of contracts.

In this paper, we subject this ostensible confidence in Delaware to empirical scrutiny to assess whether the actual drafting of merger agreements appears to reflect greater reliance on the statutory and judicial defaults under Delaware law compared to that of other states. In an earlier work, *The Delaware Delusion*, we showed empirically that both the "race to the top" and "race to the bottom" schools of thought may rest on a flawed premise because the decision to incorporate in Delaware does not appear to affect how *financial markets* value publicly traded companies.⁹ We leveraged the fact that every merger of companies in different states constitutes an "acquisition reincorporation" because the target corporation's assets are redeployed from the target corporation's regime of corporate law into the surviving corporation's regime of

shareholders); William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 633, 665–66 (1974) (sparking the debate on the efficiency of Delaware law by arguing Delaware was leading a "race for the bottom"); Melvin Aron Eisenberg, *The Modernization of Corporate Law: An Essay for Bill Cary*, 37 U. MIAMI L. REV. 187, 209–11 (1983) (arguing for the need to reexamine corporate law to remedy rules that favor managers at the expense of shareholders); Richard W. Jennings, *Federalization of Corporation Law: Part Way or All the Way*, 31 BUS. LAW. 991, 993–94 (1976) (arguing Delaware favors managerial over shareholder interests); Stanley A. Kaplan, *Fiduciary Responsibility in the Management of the Corporation*, 31 BUS. LAW. 883, 885–87 (1976) (framing Delaware as leading a "race of leniency" towards management); Donald E. Schwartz, *Federalism and Corporate Governance*, 45 OHIO ST. L.J. 545, 555–57 (1984) (arguing states compete in a "race to the bottom" because corporate law systematically favors management over shareholder interests and that reforms are unlikely because managers will "flee" to other states); Gordon G. Young, *Federal Corporate Law, Federalism, and the Federal Courts*, 41 L. & CONTEMP. PROBS. 146, 151 (1977) (arguing Delaware's appeal lies in its leadership of the "race to the bottom").

9. See Robert Anderson & Jeffrey Manns, *The Delaware Delusion*, 93 N.C. L. REV. 1049, 1077–85 (2015) (presenting the results of our empirical study).

corporate law.¹⁰ By comparing the reaction of capital markets to mergers that reincorporated companies into and out of Delaware, we were able to show that the financial world places no apparent value on the alleged superiority of the Delaware legal system.¹¹

Our previous work left an important issue unresolved: whether *lawyers themselves* perceive value associated with Delaware law and courts. This question is particularly important because lawyers choose Delaware as the locus of jurisdiction and chosen forum for a larger percentage of merger and acquisition agreements.¹² But that fact in itself does not reveal the extent of reliance on Delaware defaults (as it could be explained by path dependence, familiarity with Delaware law, or other non-substantive factors).¹³ In this article we analyze the confidence, or lack thereof, that *lawyers* appear to place in Delaware law in *drafting* merger and acquisition agreements. Our premise is that the best proxy for reliance on defaults and open-ended terms is brevity in legal drafting. Contracts will vary in length due to deal-specific differences, but incomplete contract theory predicts that reliance on defaults should translate into implicit (and explicit) references to existing defaults that conserve time and space in drafting. To the extent to which comparable contracts grounded in different jurisdictions have statistically significant differences in length, this finding would serve as evidence that lawyers are placing greater reliance on the defaults of one jurisdiction compared to another.

Merger and acquisition (M&A) agreements offer an appealing setting to test empirically the extent of lawyers' reliance on Delaware defaults compared to those of other jurisdictions. M&A agreements combine a high degree of time-sensitive negotiation with extensive reliance on statutory

10. *Id.* at 1067–68.

11. *Id.* at 1080–86.

12. *See infra* Tables 2A–2C.

13. *See infra* Part VI.A.

and judicial defaults.¹⁴ M&A agreements are generally based on precedents from earlier deals to lower the costs of contracting, which in theory incentivizes lawyers to rely on preexisting open-ended terms from the earlier agreements and legal defaults.¹⁵ The fact that M&A agreements are generally drafted under tight time constraints also means that the parties and their lawyers must weigh carefully the degree of time and resources to invest in negotiating and crafting terms that deviate from defaults (as well as the risks from failing to do so).¹⁶ The comparable substance and time frames for public company M&A agreements means that it is easier to make apples to apples comparisons to assess the extent of reliance on defaults.

We compare the length of public company merger and acquisition (M&A) agreements between Delaware transactions and those governed by the law of other jurisdictions. Our premise is that if other jurisdictions pose greater uncertainties (compared to Delaware) then we would expect lawyers in comparable non-Delaware agreements to invest more effort in delineating more specific, rule-oriented provisions and in contracting around undesirable defaults. Those specific, rule-oriented provisions would require additional words, which translate into greater length of agreements.

Our results show that agreements governed by Delaware law are no shorter, and are in fact systematically longer than agreements governed by the law of other states even when we

14. See Robert Anderson & Jeffrey Manns, *Engineering Greater Efficiency in Mergers and Acquisitions*, 72 *BUS. LAW.* 657, 690 (2017) (detailing the reasons M&A agreements are time-sensitive).

15. See Robert Anderson & Jeffrey Manns, *Boiling Down Boilerplate in M&A Agreements: A Response to Choi, Gulati, & Scott*, 67 *DUKE L.J. ONLINE* 219, 229 (2019) (explaining how M&A agreements are made); see also STEPHEN J. CHOI, ET AL., *INNOVATION VERSUS ENCRUSTATION: AGENCY COSTS IN CONTRACT REPRODUCTION* 45 (July 18, 2020), <https://perma.cc/FKN5-QRRV> (PDF) (discussing how lawyers in private equity M&A deals engage in higher levels of innovation in drafting compared to corporate and sovereign bond contracts, yet also carry over more obsolete and encrusted terms from previous deals).

16. See Robert Anderson & Jeffrey Manns, *The Inefficient Evolution of Merger Agreements*, 85 *GEO. WASH. L. REV.* 57, 66 (2017) (describing the benefits of beginning contract drafting with defaults).

accounted for a spectrum of control variables including the deal structure, the quality of law firms, deal complexity, and the size of the transaction. This finding held true even when we identified and excluded the Delaware (and other states') jurisdiction-specific language. In fact, the most predictive variable for the length of an agreement turned out to be the length of the precedent agreement from which counsel copied the original draft. This fact suggests that lawyers place little reliance on the statutory and judicial defaults and that Delaware law matters little as an "off-the-rack" default to economize on the costs of drafting.

Our findings suggest that there is a gap between lawyers' professed and actual confidence in Delaware law and courts.¹⁷ Lawyers may simply give lip service to the reputation of Delaware law and its judiciary, but in the context of M&A contract design, lawyers appear to pay less attention to the statutory and judicial defaults than they would to the defaults of any other jurisdiction.¹⁸ These results have important implications for both Delaware corporate law and for contract design, where the tradeoff between *ex ante* drafting costs and *ex post* enforcement costs is paramount.¹⁹

Our finding that lawyers rely on the defaults of Delaware no more (and possibly less) than those of other jurisdictions also suggests that Delaware is living off its past reputation and that the Delaware legislature and courts may need to address the comprehensiveness and precision of Delaware contract law to maintain Delaware's reputation in the long run.

Part II of our paper explains the incomplete nature of contracting and its application to M&A drafting. Part III applies this incomplete contracting framework to our empirical strategy in the M&A context. Part IV describes the dataset we created to test the "Delaware default" hypothesis. Part V presents our

17. See, e.g., William J. Carney, George B. Shepherd, & Joanna Shepherd, *Lawyers, Ignorance, and the Dominance of Delaware Corporate Law*, 2 HARV. BUS. L. REV. 123, 134–42 (pointing to survey data to argue that lawyers' confidence in and reliance on Delaware corporate law is based both on Delaware's reputation and lawyers' ignorance of the alternative corporate law frameworks offered by other states).

18. See *infra* Part VI.

19. See *infra* Part VI.

results. Part VI explains the potential implications of our findings.

II. *Drafting in a World of Incomplete Contracts*

A. *The Incomplete Nature of Contracts*

Explaining the nature and incentive effects of “incomplete contracts” has been a longstanding theme of contracts scholarship.²⁰ Contracts consist of an interplay of statutory and judicially crafted mandates, default rules, and tailored provisions.²¹ The scope and nature of statutory provisions may evolve over time due to legislative changes or exogenous shocks of judicial interpretations of contract-related statutes.²² But in any given drafting context the working assumption is that lawyers are able to anticipate with a high degree of certainty the likely constraints on the parties imposed by statutory mandates because they are grounded in settled law.²³ Similarly, existing judicially created mandates can also be anticipated and addressed by the parties, such as the common law requirement

20. See, e.g., Ayres & Gertner, *supra* note 2, at 732–33 (examining how transaction costs and market power shape contracting parties’ incentives to contract around default rules); Craswell, *supra* note 3, at 1052–61 (providing an overview of the economic literature on incomplete contracts); Scott, *supra* note 2, at 280–81 (discussing how the law and economic theory of incomplete contracts has developed analytic tools to address the problems posed in the contracting process).

21. See Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 87–89 (1989) (describing the legal rules of contracts).

22. See, e.g., Bernard S. Black, *Is Corporate Law Trivial?: A Political and Economic Analysis*, 84 NW. U. L. REV. 542, 553 (1990) (comparing changes in duty of loyalty and duty of care).

23. See Guido Calabresi & Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089, 1093–94 (1972) (discussing the similar notion of immutable entitlements that exist outside of contract law); Stewart J. Schwab, *A Coasean Experiment on Contract Presumptions*, 17 J. LEGAL STUD. 237, 329 (1988) (explaining the differences between inalienable and immutable rules).

of consideration for contracts, which parties can deviate from only under narrow circumstances.²⁴

Academics have debated the extent to which statutory or judicially crafted mandates live up to goals of protecting parties to the contract or parties outside of the contract.²⁵ But it is clear that the bedrock of statutory and judicially crafted mandates provide a starting point for crafting a contract. At the same time legislators leave mandatory provisions for contracts intentionally incomplete.²⁶ Mandatory provisions provide broad rules to the contract negotiating and enforcement process through establishing principles such as the duty of good faith,²⁷ rather than the core substance of the contract itself.²⁸ This is especially true in corporate law, in which mandatory rules are scarce and default rules are much of the substance of the law.²⁹

For this reason most of the debate on incomplete contracts centers on the nature and scope of state-created default rules and the degree of leeway given to the contracting parties.³⁰ Both

24. See, e.g., U.C.C. § 2-203 (AM. LAW. INST. & UNIF. LAW COMM'N 1977) (recognizing an exception from the common-law requirement for consideration in cases in which written agreements under seal serve as a substitute for consideration).

25. See, e.g., Tom Baker & Kyle D. Logue, *Mandatory Rules and Default Rules in Insurance Contracts*, in RESEARCH HANDBOOK ON THE ECONOMICS OF INSURANCE LAW 377, 382–83 (Daniel Schwarcz & Peter Siegelman eds., 2015) (discussing how justifications for mandatory rules are frequently based on claims of market failure); FRANK H. EASTERBROOK & DANIEL R. FISCHER, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 20–32 (1991) (discussing the objectives underpinning statutory mandates for contractual issues related to corporate law).

26. See Katharina Pistor & Chenggang Xu, *Incomplete Law*, 35 N.Y.U. J. INT'L L. & POL. 931, 938–44 (2003) (explaining why legislatures choose to leave “incomplete” laws).

27. See U.C.C. §§ 1-203, 2-209 cmt. 2, 2-305(2), 2-306(1), 2-311(1) (1977).

28. See Sarah Howard Jenkins, *Contracting Out of Article 2: Minimizing the Obligation of Performance and Liability for Breach*, 40 LOY. L.A. L. REV. 401, 403 n.10 (2006) (listing the U.C.C.’s mandatory provisions).

29. See generally Black, *supra* note 22 (arguing corporate law rules that appear mandatory are often trivial or avoidable).

30. See generally Anthony Kronman, *Specific Performance*, 45 U. CHI. L. REV. 351, 370–71 (1978) (arguing that contractual efficiency is furthered by allowing parties to contract around legal rules); Jonathan Macey & Fred McChesney, *Property Rights in Assets and Resistance to Tender Offers*, 73 VA.

the nature of the default rules and the scope for customization form bases for states to differentiate themselves in the “market for contracts.”³¹

Statute-based defaults that contracting parties can opt out of are generally easy to identify through their express language. For example, numerous default rules of corporate law are clearly identified through language such as “unless otherwise

L. REV. 701, 736–37 (1987) (advocating for statutes to allow parties to contract around legal rules when cheaper alternatives are available); Barry E. Adler, *The Questionable Ascent of Hadley v. Baxendale*, 51 STAN. L. REV. 1547 (1999); Ayres & Gertner, *supra* note 2; Randy E. Barnett, *The Sound of Silence: Default Rules and Contractual Consent*, 78 VA. L. REV. 821 (1992); David Charny, *Hypothetical Bargains: The Normative Structure of Contract Interpretation*, 89 MICH. L. REV. 1815 (1991); Richard Craswell, *Contract Law, Default Rules, and the Philosophy of Promising*, 88 MICH. L. REV. 489 (1989); Charles J. Goetz & Robert E. Scott, *Enforcing Promises: An Examination of the Basis of Contract*, 89 YALE L.J. 1261 (1980); Charles J. Goetz & Robert E. Scott, *Liquidated Damages, Penalties and the Just Compensation Principle: Some Notes on an Enforcement Model and a Theory of Efficient Breach*, 77 COLUM. L. REV. 554 (1977); Jason Scott Johnston, *Strategic Bargaining and the Economic Theory of Contract Default Rules*, 100 YALE L.J. 615 (1990); Robert E. Scott, *A Relational Theory of Default Rules for Commercial Contracts*, 19 J. LEGAL STUD. 597 (1990).

31. See, e.g., John C. Coates, *Managing Disputes Through Contract: Evidence from M&A*, 2 HARV. BUS. L. REV. 295, 322–23 (2012) (discussing factors that influence choice of law and choice of forum); Theodore Eisenberg & Geoffrey P. Miller, *The Flight to New York: An Empirical Study of Choice of Law and Choice of Forum Clauses in Publicly-Held Companies' Contracts*, 30 CARDOZO L. REV. 1475, 1481–85 (2009) [hereinafter Eisenberg & Miller, *Flight to New York*] (analyzing New York's efforts to appeal to corporations); Theodore Eisenberg & Geoffrey P. Miller, *Ex Ante Choices of Law and Forum: An Empirical Analysis of Corporate Merger Agreements*, 59 VAND. L. REV. 1973, 1979–83 (2006) [hereinafter Eisenberg & Miller, *Ex Ante Choices of Law and Forum*] (discussing how New York and Delaware are the two states most frequently chosen for both choice of law and choice of forum); Jody S. Kraus & Robert E. Scott, *Contract Design and the Structure of Contractual Intent*, 84 N.Y.U. L. REV. 1023, 1101–03 (2009) (arguing sophisticated parties “prefer a regime that strictly enforces formal contract terms absent an express invitation for judicial intervention”); Sarath Sanga, *Choice of Law: An Empirical Analysis*, 11 J. EMPIRICAL LEGAL STUD. 894, 902–03 (2014) (analyzing choice of law clauses using a machine-coding algorithm). *But see* Kyle Chen et al., *Empirical Study Redux on Choice of Law and Forum in M&A: The Data and Its Limits*, 16 J. BUS. & SEC. L. 1, 4 (2015) (questioning studies that found that Delaware corporations choose contracts subject to New York law).

provided in the certificate of incorporation.”³² Frequently, states incorporate the standards and default rules for contracts by embracing the Uniform Commercial Code and contracts restatements.³³ Judicially created default rules may be more difficult to identify and navigate.³⁴ Some judicial decisions have created default rules that have broad applicability and form the common law of contract.³⁵ But other judicially created default rules have evolved over time in a more patchwork way in response to omissions in contracts.³⁶ The nature of the case by case construction of default rules inherently creates a degree of uncertainty in terms of the breadth and applicability of default rules.³⁷

Although mandatory rules are often unavoidable, the applicability of both statutory and judicially created default rules are a product of both the choice of contracting parties and cost constraints in negotiations.³⁸ The contracting parties rely heavily on defaults and case law because they lack either the economic incentives or the ability to anticipate and address all future contingencies.³⁹ In practice this fact means that default rules established by state law and judicial precedents must

32. See, e.g., DEL. CODE ANN. tit. 8, § 223 (2020).

33. See Alan Schwartz & Robert E. Scott, *The Common Law of Contract and the Default Rule Project*, 102 VA. L. REV. 1523, 1525 (2016) (discussing the role of the American Law Institute and the National Conference of Commissioners on Uniform State Laws in crafting default rules and standards for Article 2 of the Uniform Commercial Code and the contracts restatements).

34. See *id.* at 1530–31 (discussing how common law default rules develop).

35. *Id.* at 1525–26.

36. See *id.* at 1537 (explaining the judicial gap-filling role in contract interpretation).

37. See Einer Elhauge, *Preference-Eliciting Statutory Default Rules*, 102 COLUM. L. REV. 2162, 2253 (2002) (stating judicial default rules and judicial error can “undermine planning”).

38. See Schwartz & Scott, *supra* note 4, at 608 n.144 (discussing the costs of avoiding an unappealing default rule).

39. See *id.* at 544–45 (framing the problem as the inability of the parties to achieve the goals of efficient reliance and efficient trade, i.e. to ensure that their agreement will maximize the expected surplus minus reliance costs).

necessarily serve to fill gaps in contracts.⁴⁰ The debate over incomplete contracts has multiple dimensions in explaining why contracts are incomplete, but the common thread is the centrality of statutes and courts to address the inherent shortcomings of contractual drafting.

Two primary stumbling blocks hinder the ability of contracting parties to anticipate and address contingencies that may affect their contracts.⁴¹ The first issue is the practical problem of *ex ante* transaction costs.⁴² One only needs to look at the Management Discussion & Analysis section of public company 10-Ks to see how it is possible to identify a sweeping range of potential risks affecting companies.⁴³ But the transaction costs of anticipating the range of potential risks to a contract, as well as calculating and agreeing upon how to resolve each contingency in an efficient way, may far outweigh any potential benefits for the parties.⁴⁴

Parties may not be able to anticipate some risks at all, such as the absence of liquidity in the depths of the 2008 financial crisis or the exogenous economic shock caused by the COVID-19 pandemic, which may make it challenging for a contract to cover all contingencies.⁴⁵ The larger problem is the issue of low-probability contingencies, which could be recognized and addressed, but only at a cost that cannot be justified by the

40. See *id.* at 545 (“Parties trade efficiently when, and only when, the value of the exchanged performance to the buyer exceeds the cost of performance to the seller. Parties invest efficiently when their actions maximize a deal’s expected surplus.”).

41. See, e.g., Schwartz & Scott, *supra* note 33, at 1530 n.19 (distinguishing between “front end” costs and “back end costs”); Robert E. Scott & George G. Triantis, *Incomplete Contracts and the Theory of Contract Design*, 56 CASE W. RES. L. REV. 187, 196–97 (2005) (proposing parties balance front end and back end costs to achieve “the efficient optimum”).

42. See Schwartz & Scott, *supra* note 33, at 1530 n.19 (defining the “front end” or *ex ante* costs of “negotiating and drafting a contract term”).

43. See 17 C.F.R. § 229.303 (2019) (detailing instructions for filling out this section of 10-Ks).

44. See Schwartz & Scott, *supra* note 33, at 1558–59 (analyzing contracting costs).

45. See Richard Squire, *Clearinghouses as Liquidity Partitioning*, 99 CORNELL L. REV. 857, 885 (2014) (explaining the importance of illiquidity in the 2008 financial crisis).

expected value of the offsetting benefits to the parties.⁴⁶ These *ex ante* transaction costs make the incomplete nature of contracts virtually inevitable and necessitate at least partial reliance on state defaults.⁴⁷ Parties may also strategically decide not to resolve potential contingencies for fear that disagreement about how to address them could signal negative information or otherwise stymie the deal, which leaves their future resolution in the hands of courts.⁴⁸ When faced with contractual omissions that turn out to be relevant, courts are left with the task of gap filling by trying to identify the *ex ante* intentions of the contracting parties based on extrapolation from the issues the parties did address.⁴⁹ This process entails uncertainty even though courts attempt to view the parties' likely intentions in an objective way with an eye towards how future parties would respond to a judicially created default rule.⁵⁰

The second, related issue is the *ex post* enforcement costs.⁵¹ Contingencies may occur that are not addressed in the contract, but the parties may be concerned that the costs of litigating the issue may outweigh the benefits of enforcing the contract.⁵² If the parties do proceed with litigation, the judicial process for interpreting contracts inherently entails a degree of uncertainty both in terms of the interpretation of facts and application of

46. See Ayres & Gertner, *supra* note 2, at 759 (“Even if a party knows that a particular contingency is possible, the contingency may be considered so unlikely that it would not pay to become informed about the rule of law.”).

47. See *id.* (explaining various situations in which contingencies may not be addressed).

48. See *id.* at 731–33 (discussing how parties negotiate contracting costs).

49. See Schwartz & Scott, *supra* note 33, at 1546–47.

50. See *id.* (proposing common law courts' default rules demonstrate “how courts conceive their role in resolving contract disputes”).

51. See Posner, *supra* note 4, at 1582–84 (discussing the need to analyze both the *ex ante* and *ex post* transaction costs to the completion of contracts).

52. See, e.g., Eric A. Posner, *Economic Analysis of Contract Law After Three Decades: Success or Failure?*, 112 YALE L.J. 829, 857 (2003) (discussing the challenges courts may face in verifying the underlying facts behind a contract and related reliance which may undercut incentives to invest in contract design); see also Alan Schwartz, *Relational Contracts in the Courts: An Analysis of Incomplete Agreements and Judicial Strategies*, 21 J. LEGAL STUD. 271, 277 (1992) (discussing the various types of transaction and litigation costs that motivate contracting parties' decisions).

law.⁵³ It is possible that courts may not be positioned to identify some facts that underpin contractual provisions if they are contested by the contracting parties, yet courts may be able to identify other facts and terms with complete precision.⁵⁴ The challenge is that judicial verification of facts will likely lie somewhere in between because of conflicts between the parties over the underlying facts.⁵⁵ Additionally, the judicial application of the law creates its own set of uncertainties. While some contractual terms may be based on settled law,⁵⁶ the process of interpreting ambiguous contractual provisions and related statutory provisions necessarily entails a degree of uncertainty.⁵⁷

This fact underscores the appeal of choosing a state law and forum with a large body of case law, high-quality statutes, and judges with the credibility and expertise to handle the uncertainties that contractual litigation entails.⁵⁸ Arbitration, settlements, or renegotiations may allow parties to minimize

53. See generally Robert E. Scott & George G. Triantis, *Anticipating Litigation in Contract Design*, 115 YALE L.J. 814 (2006) (discussing how parties design contracts in light of litigation risks).

54. See, e.g., *id.* at 817–18 (discussing the tension between verifiable and non-verifiable provisions).

55. See, e.g., *id.* at 818 (explaining the parties’ ability to “regulate the enforcement process”).

56. The scope of what constitutes settled law in contract may be far narrower than most lawyers appear to believe. See, e.g., Stephen J. Choi, Mitu G. Gulati & Robert E. Scott, *The Black Hole Problem in Commercial Boilerplate*, 67 DUKE L.J. 1, 2–4 (2017) (discussing how boilerplate terms may lose their meaning over time in the context of the *pari passu* clause, a boilerplate provision in sovereign debt contracts); see also Anderson & Manns, *supra* note 15, at 221–23 (discussing how the text of boilerplate terms in M&A transactions rapidly evolve in unintended ways which potentially undercuts the terms’ meaning); Christopher C. French, *Understanding Insurance Policies as Noncontracts: An Alternative Approach to Drafting and Construing These Unique Financial Instruments*, 89 TEMP. L. REV. 535, 537 (2017) (discussing the difficulties of determining the intent of drafters of standard form language in insurance contracts).

57. See Scott & Triantis, *supra* note 53 at, 831–32 (explicating the variables in litigating contracts).

58. See *infra* Part VI.A.

the costs and uncertainties of the legal process.⁵⁹ But the judicial process matters in these contexts too as arbitrations, settlements, and renegotiations would take place in the shadow of the expected judicial outcomes.⁶⁰

B. The Tradeoff Between Precision and Defaults

The challenge parties face is that the tradeoff between *ex ante* transaction costs in drafting contracts and *ex post* enforcement costs is a spectrum question. No party can realistically draft contracts that address every possible contingency and contract away from all undesirable defaults, nor would parties want to because of the time, the costs, and the potential uncertainties created by deviating from defaults.⁶¹ While parties may rely almost exclusively on default contractual agreements in basic standardized contracts (aside from the financial terms), complex contracts, such as merger agreements, necessarily entail some negotiated departures from defaults that may be mutually beneficial for the parties.⁶² For this reason contracting parties rely at least in part on a combination of defaults and open-ended terms that place faith in the courts to resolve disputes.⁶³ We see that empirically as virtually any contract embraces state defaults and includes intentionally open-ended terms to capture a range of conduct and vest courts with a degree of *ex post* discretion in resolving conflicts.⁶⁴

This fact raises the question of how parties decide how to strike this balance. Part of the calculation is a weighing of the costs and benefits of investing time in negotiating and drafting

59. See Scott & Triantis, *supra* note 53, at 856–57 (“It is now common for parties to agree to have disputes resolved by arbitration rather than by litigation or by the court of a specified venue.”).

60. See, e.g., W. Mark C. Weidemaier, *Judging-Lite: How Arbitrators Use and Create Precedent*, 90 N.C. L. REV. 1091, 1096 (2012) (discussing how employment and class arbitrator decisions cite judicial precedents to signal that judicial precedent shape arbitration awards).

61. See *supra* notes 51–57 and accompanying text.

62. See *supra* note 57 and accompanying text.

63. See *supra* notes 20–31 and accompanying text.

64. See *supra* note 17 and accompanying text.

precise provisions, rather than relying on defaults.⁶⁵ But another part of the equation is the degree of (implicit) confidence that lawyers place in a given jurisdiction.⁶⁶ The more parties are concerned about the limitations of a judiciary's ability to verify the underlying intentions or uncertainty costs in judges' application of the law, the more we would expect to see contracts substituting precise terms for contractual defaults and minimizing the extent of open-ended contractual terms such as "commercial reasonableness" or "best efforts."⁶⁷ For example, parties can negotiate their way out of default rules in contracts to minimize the costs of enforcement, such as by requiring arbitration in the event of contractual disputes.⁶⁸ But the more parties have confidence in the clarity of statutory defaults or the ability of courts to resolve disputes in a cost-effective and accurate way, the more we would expect them to reduce the up-front costs of contracting by relying on contractual defaults or opting for vague, rather than precise terms.⁶⁹

It would be difficult to upend all defaults and avoid all open-ended contractual terms entirely because of the extent to which they reduce *ex ante* transaction costs.⁷⁰ But the law and economics literature would suggest that the more comfortable parties are with their choice of law and the related judicial backstop, the more they can minimize *ex ante* transaction costs

65. See *supra* notes 41–57 and accompanying text.

66. See *supra* note 17 and accompanying text.

67. See, e.g., HART, *supra* note 3, at 37–38 n.15 (arguing that problems related to vague provisions should push parties to rely on alternative provisions that have greater clarity or are more easily verifiable).

68. See Christopher R. Drahozal & Keith N. Hylton, *The Economics of Litigation and Arbitration: An Application to Franchise Contracts*, 32 J. LEGAL STUD. 549, 550–51, 554–55 (2003) (arguing that contracting parties may prefer vague provisions if they anticipate addressing potential disputes through an arbitration process).

69. See, e.g., Scott & Triantis, *supra* note 53, at 818 ("A reduction in back-end enforcement costs should lead the parties to substitute more back-end for front-end investment by replacing precise provisions with vague terms.").

70. See *id.* ("[S]ome of the rules governing litigation are default rules that the parties can vary or manipulate in their *ex ante* contract. By doing so, the parties can further reduce the cost of litigation and improve the *ex ante* incentive gains from enforcement.").

by relying on defaults and open-ended contractual terms.⁷¹ Thus, the existing literature suggests a testable comparative static: as the quality of default rules and courts increase, the number and complexity of terms in the negotiated contract should decrease.⁷² This point is a central premise of our paper as we are focusing on the question of whether firms relying on Delaware contract law (in the form of acquisition agreements) rather than the law of another state are more likely to act on that premise in relying on the defaults.

III. Calibrating Legal Terms to Default Rules

A. Background

This article focuses on the degree to which M&A lawyers rely on defaults in drafting acquisition agreements under Delaware law compared to those under the law of other states. One way of assessing the substantive appeal of Delaware to M&A lawyers would be to analyze the degree of movement towards or “flight” of merger agreements away from Delaware choice of law and choice of forum clauses.⁷³ This approach would be straightforward as in theory the more confidence lawyers have in Delaware the less likely they will be to end reliance on Delaware law and to stipulate that any disputes be adjudicated in another jurisdiction.⁷⁴ The shortcoming of this approach is that the choice of law and choice of forum provisions may be tied to many other factors that have little to do with lawyers’ confidence in Delaware or lack thereof.⁷⁵

71. See *supra* notes 67–69 and accompanying text.

72. See *supra* notes 67–69 and accompanying text.

73. See Eisenberg & Miller, *Ex Ante Choices of Law and Forum*, *supra* note 31, at 2001–09 (using data to document the “flight” of merger agreements away from Delaware choice of law and forum).

74. Cf. *id.* at 1988 (“If Delaware’s efficient and skilled judges and procedures are part of the positive attraction of Delaware as a place of incorporation, as some claim, one expects Delaware to attract choice of law clauses disproportionately relative to other states.”).

75. See *id.* at 1994–95 (discussing the effect of various “variables—choice of law, state of incorporation, business locale, and attorney location—on law and forum choices”).

Instead, our premise is that a better way to understand how much lawyers value the default rules and judicial expertise under a state's law would be to analyze the extent to which they (1) embrace the default rules of the state's statutory framework and (2) defer to judicial interpretation of contractual terms based on the state's forum. Lawyers crafting transaction agreements governed by state law with fewer undesirable defaults require less contracting around those defaults.⁷⁶ Lawyers drafting transaction agreements with forum selection clauses that place interpretation of contractual provisions in the hands of an expert judiciary (especially one without juries as in the Delaware Chancery Court) can rely on more open-ended, flexible standards rather than on detailed, rule-based provisions.⁷⁷

This article analyzes the extent to which M&A lawyers calibrate their contractual terms to the default rules of the law and forum selected. Both Delaware and other states are likely to have strengths and weaknesses in their default rules, leading the lawyers to draft different provisions calibrated to the law of each state.⁷⁸ To the extent that there are systematic differences between states, we argue that they may reveal differences that lawyers perceive in default rules from state to state. If the substantive terms in M&A agreements do not appear to differ based on the legal regime governing the contract, then lawyers may perceive all states as having equal default rules (or equally disregarded default rules that they contract around), which would suggest that lawyers' functional confidence in Delaware is no stronger than what they place in other jurisdictions.

B. Empirical Strategy

We are studying the extent of lawyers' reliance on state default rules using the prism of merger agreements for the acquisition of public companies. We chose to analyze merger

76. *See supra* Part II.B.

77. *See supra* Part II.B.

78. *See generally* Michael P. Dooley & Michael D. Goldman, *Some Comparisons Between the Model Business Corporation Act and the Delaware General Corporation Law*, 56 *BUS. LAW.* 737 (2001) (comparing corporate law from several states with Delaware's default rules).

agreements because they are highly negotiated agreements that do not follow standardized forms,⁷⁹ which means lawyers are constantly confronted with the choice of relying on defaults or opting out by drafting precise terms.⁸⁰ We chose public company merger agreements rather than private company agreements because public transactions provide access to richer set of control variables (e.g., transaction size and structure) than do private agreements.⁸¹ Additionally, U.S. Securities and Exchange Commission rules mandate the disclosure of all public company merger agreements, while the only private company merger agreements that the public is privy to typically involve acquisitions of or by public companies which cover only a portion of private company M&A activity.⁸²

We analyze two closely related hypotheses in this paper. The first is that to the extent default rules differ among states, the terms used in merger agreements should differ because the

79. Although academics and practitioners often describe public company M&A agreements as standardized, to the extent that is true it is as to the substance of provision categories, and not their form. Public company M&A agreements vary highly in terms of their form even when the initial draft comes from the same law firm. *See* Anderson & Manns, *supra* note 16, at 61 (“[P]ublic merger agreement terms are not based off a common ‘form’ agreement, but rather are the product of an ‘evolution’ over many generations. This is true even within large law firms where drafts are based on prior agreements rather than standardized form language.”).

80. Public company merger agreements are among the most visible and high-profile documents in all of transactional legal practice, and therefore reflect the investment of considerable legal time and attention. *See Using EDGAR to Research Investments*, SEC. & EXCH. COMM’N, <https://perma.cc/HZ2G-5BUG> (last updated Sept. 5, 2018) (noting that certain mergers and acquisitions must be disclosed when at least one of the companies is subject to SEC disclosure rules); *see also* Ronald J. Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 94 YALE L.J. 239, 243 (1984) (observing that corporate acquisition agreements are “among the highest forms of the business lawyer’s craft”).

81. *See generally* Vojislav Maksimovic et al., *Private and Public Merger Waves*, 68 J. FIN. 2177 (2013) (discussing the various factors that influence the acquisition behaviors of public and private firms).

82. Securities and Exchange Commission (SEC) disclosure rules provide access to over twelve thousand merger agreements from 1994 to 2014, providing a broad set of data to study. *See* SEC. & EXCH. COMM’N, FORM 8-K 4–5, <https://perma.cc/NPB4-P3NB> (PDF) (requiring companies to disclose material definitive agreements outside of the ordinary course of business including merger agreements).

choice of law varies from state to state. The second is that to the extent that lawyers believe courts in different states are more or less sophisticated in addressing business law issues, the terms used in merger agreements should differ because the implications of forum selection vary from state to state because of the differences in the experience and quality of state judiciaries.⁸³ In the majority of merger agreements, however, the forum chosen is the same as the state law chosen, so we have only a limited ability to distinguish between the two concepts.⁸⁴ Therefore, although we present results for both variables, we focus primarily on the choice of law, which is less susceptible to selection bias as we discuss below.⁸⁵

The law and economics literature on contracts generally predicts that better default rules and more expert courts will lead to shorter and more open-ended contracts.⁸⁶ Drafting contracts is costly, and the cost increases with the number of terms in the agreement.⁸⁷ Covering more contingencies results in more terms, meaning that the more complete the contract the more costly it is to draft.⁸⁸ At some point, the cost of addressing

83. The focus of this Article is on the implications of the choice of forum in drafting when choosing between the specialized business court in Delaware—the Court of Chancery—and the non-specialized court systems of most other states. Future research could look at the equally intriguing implications of choice of forum on drafting in considering other differences between state judiciaries, such as elected versus appointed judiciaries. See, e.g., Steven P. Croley, *The Majoritarian Difficulty: Elective Judiciaries and the Rule of Law*, 62 U. CHI. L. REV. 689, 729–48 (1995) (discussing the potential distorting effects of elections for judges in many states on judicial decision-making).

84. See, e.g., Eisenberg & Miller, *Flight to New York*, *supra* note 31, at 1505 (“Contracts overwhelmingly specify the place of choice of law as the choice of forum.”); Eisenberg & Miller, *Ex Ante Choices of Law and Forum*, *supra* note 31, at 1981 (“If a particular state’s law is chosen, that state’s forum is also very likely to be selected.”); Symeon C. Symeonides, *Choice of Law in the American Courts in 2015: Twenty-Ninth Annual Survey*, 64 AM. J. COMP. L. 221, 239 (2016) (observing that choice of law clauses and forum selection clauses “almost always” select the same jurisdiction).

85. See *infra* Part V.

86. See *supra* notes 67–69 and accompanying text.

87. See *supra* Part II.B.

88. See *supra* Part II.B.

farfetched contingencies is no longer worth the benefit, preventing contracts from being completely contingent.⁸⁹

There are many law and economics accounts of costly contract drafting, and almost all of them predict longer, more detailed contracts will result from undesirable default rules or less competent courts.⁹⁰ To make our analysis more concrete, however, we take as our basic starting point the specific model developed by Steven Shavell on contractual completeness.⁹¹ Shavell models the parties' choice among (1) specific terms, (2) general terms, and (3) gaps in writing a contract.⁹² Specific terms express the parties' intended outcome in individual contingencies, and therefore are certain to produce the desired result, but are costly to write.⁹³ General terms express the parties' intent as to a group of contingencies, and are less costly to write but may result in incorrect interpretation.⁹⁴ Gaps in contracts are contingencies not addressed in the contract at all, and are cheapest, yet represent a conscious or unconscious decision to leave interpretation of these issues to the court.⁹⁵

[The model is based on the basic idea that] the more closely the courts' interpreted contracts resemble the parties' true wishes, the more willing the parties are to leave gaps and write fairly general terms, whereas the parties are more willing to take extra pains to write more detailed contracts when courts refrain from interpreting terms or interpret terms in ways that run counter to their true desires.⁹⁶

Because the cost of writing specific terms is higher than gaps or general terms, parties will write more specific terms to

89. The notion that contracts were not completely contingent because of the cost of writing contracts has existed in economics literature for many decades. However, the more recent literature explicitly modeling the cost of contract drafting has developed more recently. *See, e.g.*, Ronald A. Dye, *Optimal Length of Labor Contracts*, 26 INT'L ECON. REV. 251, 251–52 (1985) (presenting one of the first models of the cost of contracting).

90. *See supra* Part II.

91. *See generally* Steven Shavell, *On the Writing and Interpretation of Contracts*, 22 J.L. ECON. & ORG. 289 (2006).

92. *Id.* at 295.

93. *Id.*

94. *Id.*

95. *Id.*

96. *Id.* at 290.

the extent that they are concerned that the courts would reach aberrant interpretations otherwise.⁹⁷ Thus, the stronger the track record and reputation of the state judicial system, the fewer terms one would expect, and the shorter the contract the parties would write to economize on drafting costs.⁹⁸

The analysis above leads to the prediction that contracts will be shorter and more open-ended when the default rules are better and the courts that would enforce the contract are more competent.⁹⁹ This is the specific prediction in other incomplete contract theory papers in the law and economics literature.¹⁰⁰ We combine this prediction from the law and economics literature with the nearly universal consensus among M&A lawyers that Delaware has higher quality law and courts.¹⁰¹ Taken together, we would expect that these two hypotheses would translate into M&A contracts that are shorter and more open-ended when subject to Delaware choice of law or forum than when subject to other states' laws or courts.

To evaluate this hypothesis, we initially determine the number and complexity of the terms in the agreements with a very simple measure—the number of words in the agreements.¹⁰² Although the number of words is a simple proxy for the number of terms, it is strongly correlated with the complexity and detail of the contract.¹⁰³ More detailed and precise instructions covering a greater number of contingencies require more words, even if carefully described in the most parsimonious language.¹⁰⁴ Open-ended standards, rather than rules, are able to economize on words by using phrases such as

97. *Id.*

98. *Id.*

99. *See supra* notes 91–98 and accompanying text.

100. *See, e.g.,* Posner, *supra* note 4, at 1593 (“[C]ontracts are likely to be shorter the more competent the judges are because lawyers will not have to spell out everything for a dim interpreter.”).

101. *See, e.g.,* Marcel Kahan & Ehud Kamar, *Price Discrimination in the Market for Corporate Law*, 86 CORNELL L. REV. 1205, 1212–14 (2001) (discussing broad consensus about perceived advantages of Delaware corporate law and the Delaware judiciary).

102. *See infra* Part IV.

103. *See infra* Part IV.

104. *See supra* Part II.B.

“reasonable,” “good faith,” or “best efforts,” whereas rule-like contract terms require more words.¹⁰⁵ Thus, we posit that the number of words is likely the most intuitive measure for drafting effort intended to overcome undesirable defaults or unskilled judicial interpreters. For example, Alan Schwartz and Joel Watson specifically suggested the number of words as a proposed measure for empirical tests of their theory on contractual interpretation.¹⁰⁶

Our basic prediction, which we test in Part IV, below, is whether parties view Delaware’s law and courts as providing sufficient benefit over those of other states to allow parties to economize on the number of terms, measured by the number of words in the agreements.

IV. *Data and Methods*

A *The Data*

We gathered our dataset of public company mergers from Mergerstat which is available through LexisNexis.¹⁰⁷ The data include mergers involving public company targets announced between 2001 and 2014 inclusive. For each transaction, the Mergerstat data provide information on the announcement date, deal size, type of consideration, SIC codes of the acquirer and target, the type of transaction (tender offer, leveraged buyout, etc.) as well as the law firms involved. We use these variables as controls in the analysis.

The Mergerstat data do not include the text of the relevant agreements, so we then used a computer script to match merger agreements from the EDGAR system with the transactions in

105. See *supra* Part II.B.

106. See Alan Schwartz & Joel Watson, *Conceptualizing Contractual Interpretation*, 42 J. LEG. STUD. 1, 32 (2013) (“One can measure contract length by the number of words.”). Of course, other proxies are possible, such as the number of sections or subsections. However, transactional drafts often combine multiple (identical) sections into one or break single sections into multiple sections, which would give different numbers of terms for the same exact text. Therefore, we consider such divisions somewhat arbitrary compared to the number of words.

107. See generally *Finding Merger and Acquisition Information on Lexis.com and Nexis*, LEXISNEXIS, <https://perma.cc/BQ2K-8LU7>.

the Mergerstat database.¹⁰⁸ This allows us to analyze the detailed text of each agreement and its relationship to transaction variables in the database. We were able to match a total of 1,569 agreements to the approximately 2,869 transactions in the Mergerstat database.¹⁰⁹ We excluded five transactions that involved bankruptcy reorganizations, and another six transactions with missing data, yielding a total of 1,558 observations.

For each transaction, we reviewed the relevant agreement and hand coded the state of incorporation of the acquirer and target, whether the merger involved a triangular merger structure, as well as the states of incorporation of any merger subsidiaries. We also coded the relevant choice of governing law for the agreement and the exclusive forum selected, if any.¹¹⁰ These pieces of data provide the key variables of interest in analyzing the relative effect of choice of law and forum on the text of the agreements.

The dependent variable in the analysis is the number of words in each agreement. We used a computer script to download the 1,558 agreements, remove punctuation and capital letters, remove exhibits and annexes, and remove tables

108. See *Archive Indices of the SEC EDGAR Database*, SEC, <https://perma.cc/KD5E-2Z5G>.

109. The computer program located the agreements using the names and dates in the Mergerstat data. The agreements were then hand-verified to ensure they were correctly matched. In some cases, the script did not locate the agreements, accounting for the difference between the size of the Mergerstat database and our data. We believe the missing agreements are missing at random and would not affect our results.

110. Forum selection clauses commonly come in two types, exclusive (or mandatory) clauses that specify a forum in which the parties must bring actions and non-exclusive (or permissive) clauses that specify a forum in which the parties may bring actions. See, e.g., Patrick J. Borchers, *Forum Selection Agreements in the Federal Courts after Carnival Cruise: A Proposal for Congressional Reform*, 67 WASH. L. REV. 55, 56 n.1 (1992) (defining exclusive clauses as “an agreement to litigate only in a forum or fora, to the exclusion of any other fora” and non-exclusive clauses as “an agreement to litigate in the agreed forum or fora, but not to the exclusion of any other fora that have jurisdiction and venue”). A variety of other terms are also used for these categories. See *id.* (“Some civilian commentators use the term ‘derogation agreement’ to describe exclusive forum agreements, ‘prorogation agreement’ to describe non-exclusive forum agreements.”).

of contents. The script then counted the number of words, and we stored the text of the agreements for further analysis below.

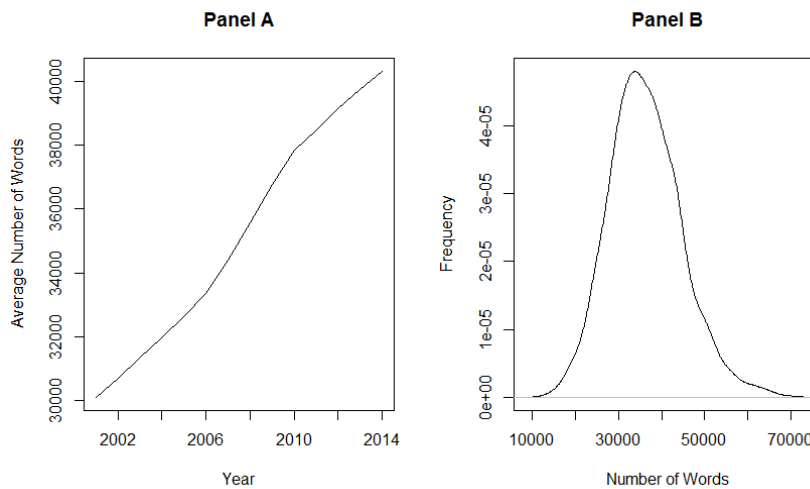
The descriptive statistics for the dataset are displayed in Table 1 below. As suggested by the Table, our analysis will control for various elements of the deal structure, law firms involved, and industry of the target company, as described more fully in the next Part.¹¹¹

Table 1. Descriptive Statistics.			
Variable	Mean	Median	Standard Dev
Number of Words	36,308.6	35,651.5	8,447.0
State of Incorporation of Target = DE	0.627	1	0.484
Choice of Law = DE	0.691	1	0.462
Choice of Forum = DE	0.610	1	0.488
Target Incorporation = DE	0.627	1	0.484
Acquirer Incorporation = DE	0.549	1	0.498
Triangular Merger Structure	0.873	1	0.333
Deal Size	\$2.3 billion	\$702 million	\$5.5 billion
Tender Offer	0.179	0	0.384
Stock Consideration	0.442	0	0.497
LBO	0.111	0	0.314
Top 20 Firm Buyer	0.448	0	0.498
Top 20 Firm Seller	0.671	1	0.470
Banking Industry	0.101	0	0.301
REIT Industry	0.096	0	0.295

The number of words in the merger agreements showed strong evidence of trends over time. The length of M&A agreements increased substantially over our approximately fifteen-year window, adding hundreds of words per year on

111. See *infra* Part V.

average as shown in Panel A of Figure 1, below.¹¹² However, the distribution of the number of words in the agreements was distributed approximately normally with only a slight positive skew, as shown in Panel B of Figure 1. Accordingly, we include a time trend in our analysis below to account for the growth in agreements over time. The approximate normality of the dependent variable (words per agreement) allows us to use ordinary least squares and no transformation is necessary to achieve approximate normality in the dependent variable.¹¹³



112. See Anderson & Manns, *supra* note 15, at 232 (providing an overview of the growth of M&A agreements over time).

113. The dependent variable in this model (words per agreement) is technically a “count” variable and therefore cannot be less than zero and can only assume integer values. In many cases, count variables require special models because they are not normally distributed. Panel B of Figure 1 shows (and our statistical tests confirm) that the number of words per agreement is approximately normally distributed, eliminating the need for a model designed for count data.

Figure 1. The Number of Words in Merger Agreements. Panel A (left) shows the growth over time. Panel B (right) shows the distribution of the number of words in the agreements.

As one might expect, the data confirm that choice of law is correlated strongly with choice of forum. In most cases, the choice of law and choice of forum were the same (and in most cases both choices were Delaware). The association between choice of law and choice of forum is set forth in Table 2A, below. Although all merger agreements contained a choice of law clause, roughly 17 percent of agreements did not contain a choice of forum clause. Similarly, the choice of law was highly correlated with the target's state of incorporation, as shown in Table 2B, below. Table 2C shows that choice of forum is also highly correlated with state of incorporation of the target company. However, choice of forum is not found in all agreements as is choice of law, and Delaware companies are much more likely to choose exclusive forums than are other companies, which creates a possible selection bias discussed in Part V.

Table 2A. Association Between Choice of Law and Choice of Forum.			
	DE Choice of Forum	Other Choice of Forum	No Choice of Forum
DE Choice of Law	933	35	108
Other Choice of Law	17	312	153

Table 2B. Association Between Choice of Law and Target State of Incorporation.		
	Target Incorporated in Delaware	Target Not Incorporated in Delaware
DE Choice of Law	906	71
Other Choice	170	411

of Law		
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Table 2C. Association Between Target State of Incorporation and Choice of Forum.			
	DE Choice of Forum	Other Choice of Forum	No Choice of Forum
DE Incorporation	813	65	99
Other Incorporation	137	282	162

B. Two Approaches to Analyzing Delaware's Defaults

We performed two distinct types of analysis on the merger agreements. First, we modeled the number of terms in the agreement using the length of the agreements in words. As explained above, the more closely parties adhere to default rules, the less text is necessary.¹¹⁴ Similarly, the more predictable and sophisticated the decisions of the tribunal selected in the agreement's forum selection clause are, the less text is necessary to guide the tribunal.¹¹⁵ Therefore, we model the length of the agreement by choice of law and choice of forum with suitable control variables. Because choice of law and choice of forum are closely correlated, we examine them separately initially and then together.¹¹⁶

We then performed a second type of analysis using classification of the agreement text itself. It is possible that the number of words in a document may not reveal all the differences between default rules. Documents may vary based on choice of law or choice of forum in ways that do not systematically translate into longer or shorter documents.¹¹⁷ Therefore, we also use machine-learning techniques to analyze the documents to look for systematic variations by choice of law or choice of forum. Specifically, we use a Random Forest

114. See *supra* Parts II.B, III.B.

115. See *supra* Parts II.B, III.B.

116. See *infra* Part V.

117. See *supra* Part IV.A.

classifier to attempt to predict Delaware choice of law versus non-Delaware choice of law.¹¹⁸ This analysis is designed to reveal the most “important” words that distinguish Delaware from non-Delaware agreements.

We use two very different approaches to analyzing the effect of Delaware law to ensure we have multiple vantage points on the differences in Delaware law and forum. Because each approach uses different methodology (and to some extent different data), we describe the methodology and results together for each result one-by-one in Part V.

V. Analysis and Results

A. Regression Analysis of Document Length

Our regression analysis attempts to analyze the association between the number of words in M&A agreements and our jurisdictional variables and control variables. Accordingly we use the number of words in each agreement as the dependent variable in a linear model and use least squares to estimate the relationship with our variables of interest.¹¹⁹ The key independent variables of interest are the choice of law (dummy variable for Delaware versus non-Delaware) and the choice of forum (dummy variable for Delaware versus non-Delaware). These two (choice of law and choice of forum) are highly correlated,¹²⁰ so we will present separate regressions for each, as well as their connection to the target’s and acquirer’s state(s) of incorporation.

We include a number of control variables in the analysis to account for two types of potentially confounding effects. First, some variables are known to affect the length of merger agreements. In particular, merger agreements where the

118. Random Forests use an ensemble of decision trees to make predictions. *See, e.g.*, David Lehr & Paul Ohm, *Playing with the Data: What Legal Scholars Should Learn About Machine Learning*, 51 U.C. DAVIS L. REV. 653, 681–83 (2017) (discussing how machine-learning algorithms can be used to construct educated guesses about missing values in data sets).

119. *See* DOUGLAS C. MONTGOMERY, ET AL., INTRODUCTION TO LINEAR REGRESSION ANALYSIS 14–16 (3d ed. 2001) (providing an explanation of least squares regression).

120. *See supra* Tables 2A–C.

consideration includes stock are lengthier than those where the consideration is solely cash because of the need for more deal-specific and securities related provisions, so we introduce a variable for whether the transaction is cash only.¹²¹ Banking merger agreements are also often shorter than other merger agreements, in part because of a common practice of the acquirer and target making the same representations and warranties.¹²² In addition, real estate investment trusts often have longer merger agreements because they often have more complex corporate structures including operating partnerships that require multiple layers of mergers.¹²³ Accordingly, we include dummy variables for two industry groups represented in the data, banking (SIC codes beginning with sixty)¹²⁴ and real estate investment trusts (SIC groups beginning with sixty-seven).¹²⁵ Finally, the length of agreements has increased over time.¹²⁶ Some commentators argue this is the result of textual accumulation over time,¹²⁷ while others argue it may relate to rational responses to a changed environment.¹²⁸ In either case, we use year fixed effects to control for this possible confounding variable.

121. The principal reason for the difference is that representations and warranties on the part of the acquirer are much more extensive in a stock transaction than in a cash transaction.

122. See, e.g., *Zions Bancorporation, Agreement and Plan of Merger Dated July 5, 2005*, SEC, <https://perma.cc/9FYZ-V7YB> (setting forth a single Article V on reciprocal representations and warranties of both parties).

123. See *infra* Tables 3–5.

124. Previous work has shown that merger agreements in the banking industry are more closely related to one another than other types of agreements, and as a result are textually different from other agreements. See Anderson & Manns, *supra* note 16, at 73 (noting patterns in use of firm precedent).

125. The results were similar when we incorporated control variables for all two-digit SIC codes.

126. See *supra* Figure 1.

127. See Anderson & Manns, *supra* note 16, at 76 (discussing the growth of the median word count of merger agreements over time).

128. See John C. Coates IV, *Why Have M&A Contracts Grown? Evidence from Twenty Years of Deals 2* (European Corp. Governance Inst., Law Working Paper No. 333, 2016), <https://perma.cc/B2PH-AQRF> (PDF) (describing types of “rational responses”).

The second category of controls relates to “deal complexity.” We include these controls because more complex deals may be correlated with both longer agreements and Delaware choice of law or forum. Accordingly, we include controls for the logged equity value of the deal, on the theory that larger deals might have longer merger agreements.¹²⁹ We also include controls for major deal structure elements, such as whether the transaction involves a tender offer or a leveraged buyout—structures that may introduce drafting complexities.¹³⁰ Finally, we include a dummy variable for whether the seller’s law firm was a “Top 20” M&A firm and the buyer’s law firm was a “Top 20” M&A firm,¹³¹ on the theory that more complex deals may involve more active M&A firms or that more active M&A firms may include more detail in agreements. Finally, we include a control for whether the structure of the merger is triangular or direct, as triangular mergers typically entail extra verbiage in the merger agreement to account for the complexities of the three-party deal structure.¹³²

The first set of results is presented in Table 3, below. In Table 3 we present models for the relevant Delaware variables by themselves in Model 1, then together with transaction controls added in Model 2, then with industry controls added in Model 3. The choice of forum and target state of incorporation

129. For the total value of the deal we used Mergerstat’s “Base Equity Price” data point. See FACTSET MERGERSTAT, MERGERSTAT REVIEW (2020) (on file with author).

130. See *infra* Tables 3–6.

131. We ascertained the “top 20” firms from the most common firms appearing in the dataset. The “top 20” firms were, in order, Skadden, Arps, Slate, Meagher & Flom; Wachtell, Lipton, Rosen & Katz; Latham & Watkins; Simpson Thacher & Bartlett; Sullivan & Cromwell; Cravath, Swaine & Moore; Morris, Nichols, Arsht & Tunnell; Wilson Sonsini Goodrich & Rosati; Cleary Gottlieb Steen & Hamilton; Jones Day; Weil, Gotshal & Manges; Hogan Lovells; Davis Polk & Wardwell; Shearman & Sterling; Baker Botts; Gibson, Dunn & Crutcher; Goodwin Procter; Morgan, Lewis & Bockius; O’Melveny & Myers; and Ropes & Gray. We also ran the regression with individual dummy variables for these firms, which did not change the results materially. We apologize in advance to partners and associates at “Top 20” firms who did not make the cut as we are just focusing on M&A transactions and volume of M&A deals rather than quality or dollar amount of transactions as is often the focus of other M&A law firm rankings.

132. See *infra* Tables 3–6.

are highly correlated with the choice of law. Therefore, the key variable of interest in our analysis (choice of law) is also presented separately in Model 4 without those other variables.

Table 3. Modeling Agreement Length by Choice of Law, Choice of Forum, and Incorporation					
		Model 1	Model 2	Model 3	Model 4
	Constant	36,242.2* ** (483.4)	5653.6* (2612.1)	5485.2 (2615.2)	3998.0 (2565.7)
	Target Incorporated in Delaware	- 2330.3** * (584.8)	-1207.6* (492.4)	-1153.8* (490.7)	
	Acquirer Incorporated in Delaware	276.0 (440.2)	354.2 (376.3)	414.1 (376.3)	
	Delaware Choice of Law	2129.1* (855.2)	2273.1** (710.5)	2102.6** (707.5)	1150.0** (418.8)
	Delaware Choice of Forum	827.6 (869.6)	-753.0 (725.0)	-584.6 (719.2)	
	No Choice of Forum	- 3574.5**	-2071.4 (634.2)	-1885.2** (636.0)	

		*			
		(720.3)			
Direct (Non-Triangular) Merger			- 3265.5** * (621.2)	- 2598.3*** (702.0)	- 2955.1** * (697.5)
Years After 2001			990.1*** (49.4)	965.0*** (49.4)	971.2*** (48.8)
Tender Offer			2460.9** * (502.7)	2481.0*** (500.8)	2404.9** * (500.9)
Stock Consideration			7303.3** * (431.4)	7310.4*** (427.9)	7351.0** * (428.1)
LBO			1998.2** (614.0)	1956.2** (608.9)	2079.5** * (595.1)
Log (Deal Size)			956.2*** (125.7)	967.0*** (125.1)	954.2*** (125.1)
Top 20 Firm Buyer			-57.5 (369.2)	41.1 (366.3)	53.7 (365.9)
Top 20 Firm Seller			343.6 (385.8)	352.4 (382.7)	287.0 (381.6)
Banking Industry				- 2549.9*** (747.2)	- 2491.4** * (744.5)
REIT Industry				1794.5* (719.6)	1914.8** (711.0)
R-Squared	0.049		0.3551	0.3676	0.3642
Adjusted R-Squared	0.046		0.3496	0.3614	0.3593
No. Observations	1558		1558	1558	1558
Standard errors reported in parentheses. *, **, *** indicates significance at the 95%, 99%, and 99.9% levels, respectively.					

The Table reveals some interesting findings regarding the relationship of Delaware law to agreement length. Delaware

choice of law is associated with a statistically significant increase in the length of the agreements, and that is true across all the specifications in Models 1–4, regardless of the controls introduced. In terms of magnitude, the choice of Delaware law is associated with approximately 1000–2000 additional words in the merger agreements, depending on the control variables included in the model. This result is the opposite of the incomplete contract theory prediction that high-quality Delaware law would allow drafters to rely on defaults and economize on detailed terms.¹³³

The control variables offer some expected results and some surprises. As was expected, agreements increase steadily in length as time passes, adding about one thousand words per year.¹³⁴ Stock transactions are very strongly associated with longer agreements, primarily because of the lengthier representations and warranties of the acquirer in a stock transaction. Tender offers and leveraged buyouts (LBO) are associated with longer agreements, as one might expect given the increased complexity. The logged transaction size was strongly positively associated with longer agreements, as drafting effort is proportionately less costly on a larger transaction. Direct (as opposed to triangular) merger structures saved about three thousand words, as the mechanics of these transactions are less complex.

The results for some of the control variables are surprising, however. In particular, the identity of the law firms did not appear to significantly affect the length of the agreements when other variables were controlled. This is surprising because one might expect that more prominent M&A firms would be retained in more complex deals, and that more complex deals would involve longer agreements. Indeed, the coefficients on the “Top 20” M&A firms were positive and significant in an (unreported) model in which transaction size was not controlled. However, controlling for transaction size almost completely neutralized this effect, suggesting that the transaction size control is capable of controlling for almost all “deal complexity”

133. See *supra* note 4 and accompanying text.

134. See *supra* Figure 1.

effects.¹³⁵ The fact that the more prominent M&A firms do not seem independently associated with agreement length helps to alleviate the concern that some other confounding variable related to deal complexity accounts for the main results.

Digging deeper into the key Delaware variables of interest, there are a few broad observations and a few more specific ones. First, the Table makes it clear that the target's state of incorporation, choice of law, and choice of forum coefficients all have relatively small magnitudes compared to some of the other variables. The state of the acquirer's incorporation was not associated with differences in the lengths of the agreements at all.

Second, the Delaware choice of forum variable is not significant and even switches sign as control variables are added. On the one hand, choice of forum and choice of law are correlated. Indeed, the choice of forum is, to a large extent, a subset of the choice of law because all agreements in the dataset selected governing law but not all selected an exclusive forum. As a result, when the choice of forum was included in an unreported regression separately (without choice of law) it had a positive and statistically significant sign (associated with more words). However, as the control variables were added to that regression, the magnitude of that coefficient and its statistical significance declined. This suggests that Delaware choice of forum, to the extent it is associated with anything beyond choice of law, is merely a signal for increased deal complexity. This is further bolstered by the fact in Table 3 that deals that fail to choose a forum are about 3,600 words shorter when deal complexity controls are not included, but only about 1,900 words shorter when those controls are included. In contrast, Delaware choice of law continued to have an association with longer agreements regardless of the control variables added.

A second point about the effect of the choice of Delaware law is that its association with longer agreements is reduced for target companies incorporated in Delaware. Of course, the target's state of incorporation is strongly associated with both Delaware choice of law and Delaware choice of forum. Although

135. See *infra* Part VI.B.2.

an agreement for the acquisition of a Delaware target can (and sometimes does) choose law or forum other than Delaware, in most cases the state of target incorporation and the choice of law are the same, as is the exclusive forum if one is selected.¹³⁶ Although the target state of incorporation, choice of law, and choice of forum are highly correlated, they are not perfectly correlated.

The result that Delaware choice of law is associated with a smaller increase of words for Delaware companies than for non-Delaware companies is a potentially interesting one. Approximately one-third of the transactions in the database are “All Delaware” in the sense that they involved a target and acquirer incorporated in Delaware, a Delaware choice of law, and a Delaware choice of forum. Accordingly, we present a table that compares the results of “All Delaware” merger agreements versus other merger agreements. Table 4 below shows how the length of those merger agreements compares to other merger agreements.

	Model 1	Model 2	Model 3
Constant	36,504.5*** (296.8)	5862.4* (2618.8)	5830.7* (2615.3)
All Delaware (All Legal Variables Are Delaware)	1287.9** (469.6)	414.8 (398.7)	398.2 (400.2)
No Choice of Forum	-3725.5*** (592.4)	-1707.4** (551.4)	-1558.6** (555.7)
Direct (Non-Triangular) Merger		-3516.5*** (615.5)	-2713.4*** (703.6)
Years After 2001		994.0*** (48.9)	971.4*** (49.0)
Tender Offer		2455.5*** (502.2)	2457.1*** (501.4)

136. See generally *supra* note 31 and accompanying text (discussing factors influencing forum choice).

Stock Consideration		7324.6*** (433.1)	7338.6*** (429.6)
LBO		2025.1*** (608.3)	1991.6*** (603.2)
Log (Deal Size)		961.8*** (125.5)	969.4*** (125.2)
Top 20 Firm Buyer		-8.8 (369.2)	89.9 (366.4)
Top 20 Firm Seller		323.7 (385.3)	339.4 (381.8)
Banking Industry			-2813.0*** (733.4)
REIT Industry			1568.8* (697.4)
R-Squared	0.040	0.349	0.362
Adjusted R-Squared	0.039	0.345	0.357
No. Observations	1558	1558	1558
Standard errors reported in parentheses. *, **, *** indicates significance at the 95%, 99%, and 99.9% levels, respectively.			

The “All Delaware” variable is significant only in Model 1, and is positive but not significant in Models 2 and 3. However, even in Model 3 where the effect is not statistically significant and smallest, the confidence interval for the “All Delaware” coefficient is -386.9 to 1,183.2. The fact that the coefficient is not significant means we cannot reject with 95 percent confidence the hypothesis that “All Delaware” has no effect on the number of words in the agreement. However, the standard error is small enough that we can reject with 95 percent confidence the hypothesis that “All Delaware” deals reduce the number of words more than 386.9 (or increase them more than 1,183.2). In other words, although it is possible in this analysis that “All Delaware” deals are associated with slightly shorter agreements, such an effect, *if any*, is small. In other words, this result still supports the notion that Delaware law does not offer any substantial drafting advantage over the law of other states, even in the model most favorable to finding such an advantage.

The above analysis demonstrates that the Delaware choice of law is not associated with shorter agreements, and indeed most of the models associated Delaware choice of law with longer agreements. However, one might still question whether the analysis definitively establishes no drafting advantage to Delaware law. For example, despite the controls used in the above analysis, it is possible the Delaware agreements reflect greater transaction complexity that we have not adequately controlled for. The fact that the most prominent M&A firms do not affect document length tends to minimize this concern. Fortunately, we do not need to rely entirely on that fact, as we have a very powerful additional control variable we can introduce—the length of the precedent agreement on which each deal was likely based.¹³⁷ By controlling for the length of the precedent agreement, we can control for most of the residual factors that might influence agreement length.¹³⁸

We are able to control for the length of the document used as a precedent for each transaction because of a prior analysis we performed on the evolution of merger agreements.¹³⁹ In that study we used computer analysis to identify the most likely precedent agreement for each public company acquisition agreement in a broader 1994–2014 data set and showed that most M&A agreements can be traced to their precedent documents.¹⁴⁰ Using the results from the previous analysis we identified the most likely precedent agreement in our dataset and determined the number of words in each such precedent. In Table 5, below, we add a variable for the number of words in the precedent agreements (where they could be found). Table 5 below presents the full models from Table 3 and Table 4 with the additional variable of precedent length added.

137. See *infra* Table 5.

138. See *infra* Table 5.

139. See, e.g., Anderson & Manns, *supra* note 16, at 66 (showing the high degree of editorial churning on a macro-level for acquisition agreements); Anderson & Manns, *supra* note 15, at 222–25 (highlighting the high degree of textual changes within the micro-level of the text of boilerplate terms in M&A acquisition agreements, which reinforces the editorial churning hypothesis).

140. See *generally* Anderson & Manns, *supra* note 14 (discussing how insights about macro-level agreement drift suggest potential pathways to greater efficiency in M&A drafting).

Table 5. Choice of Law, Forum, and Incorporation with Control for Precedent Length.				
		Model 1 Individual Delaware Variables	Model 2 “All Delaware” versus not “All Delaware”	Model 3 Delaware Choice of Law
	Constant	-665.5 (2209.6)	-585.7 (2208.6)	-1836.4 (2168)
	All Legal Variables Are Delaware		227.6 (334.4)	
	Target Incorporated in Delaware	-1009.0* (411.0)		
	Acquirer Incorporated in Delaware	21.7 (316.0)		
	Delaware Choice of Law	1597.8** (592.9)		776.9* (350.7)
	Delaware Choice of Forum	-356.5 (602.7)		
	No Choice of Forum	-1295.1* (537.4)	-1086.0* (468.4)	
	Direct (Non-Triangular) Merger	-1551.6** (590.8)	-1637.9** (591.6)	-1806.4*** (586.2)
	Years After 2001	440.4*** (46.3)	445.0*** (46.0)	472.5*** (44.4)
	Tender Offer	2068.2*** (418.6)	2042.2*** (418.7)	1994.6*** (419.0)
	Stock Consideration	5530.6*** (366.7)	5528.8*** (368.1)	5444.8*** (365.3)
	LBO	1971.2*** (508.4)	1906.5*** (503.1)	1954.7*** (497.3)
	Log (Deal Size)	657.5*** (105.7)	656.7*** (105.6)	677.8*** (104.9)
	Top 20 Firm Buyer	-3.4 (306.4)	9.3 (306.1)	11.9 (306.1)

Top 20 Firm Seller	285.4 (320.5)	258.8 (319.6)	232.4 (320.0)
Banking Industry	-1450.5* (628.2)	-1637.9** (591.6)	-1573.6* (618.4)
REIT Industry	901.3 (607.3)	832.0 (588.2)	866.8 (593.7)
Words in Precedent Document	0.517*** (0.021)	0.520*** (0.021)	0.521*** (0.020)
R-Squared	0.557	0.554	0.553
Adjusted R-Squared	0.552	0.550	0.550
No. Observations	1542	1542	1542
Standard errors reported in parentheses. *, **, *** indicates significance at the 95%, 99%, and 99.9% levels, respectively.			

The introduction of this variable increases the fit of the model substantially, as the length of the precedent used strongly predicts the length of the agreement. However, the other variables remain largely unchanged. Delaware choice of law continues to be a significant and positive predictor of longer agreements when isolated as a standalone variable (columns 1 and 3). The “All Delaware” agreement variable continues to be positive, although it loses its significance in Model 2. Thus, the key finding of the difference in length for Delaware choice of law remained statistically significant even when we accounted for the differences in the length of the precedent starting points for the drafting of the acquisition agreements.

Next, we turn to another possible objection to our conclusion that Delaware law does not enable shorter agreements. The overall length of agreements is predicted to vary by the quality of law and tribunals in the law and economics literature,¹⁴¹ but it is possible our analysis has not homed in on the “important” aspects of the agreements. Our analysis thus far has documented the overall increases (or at least no decreases) in the length of Delaware acquisition agreements, but it is possible that the important parts of

141. See *supra* Part II.B.

agreements are shorter when Delaware law governs, and that we failed to detect those differences. In particular, it is possible that the superiority of Delaware law allows shorter, more open-ended terms in the important deal terms, but that those important deal terms are swamped by lengthier boilerplate provisions in the Delaware agreements.

In order to address this issue, we now perform the same word-count analysis on one specific provision that is highly negotiated and closely studied in M&A—the material adverse change (MAC) clause (also referred to as material adverse effect—“MAE”) definition.¹⁴² The MAC clause is an important one from the standpoint of the literature on contract design,

142. See generally Choi & Triantis, *supra* note 4 (arguing that before closing the deal, the intentional vagueness of MAC clauses creates more efficient incentives for the seller, rather than more precise and less costly proxies); Yair Y. Galil, *MAC Clauses in a Materially Adversely Changed Economy*, 2002 COLUM. BUS. L. REV. 846 (2002) (discussing how unclear judicial interpretations of the contours of MAC clauses and MAE clauses cast a shadow over merger deals); Ronald J. Gilson & Alan Schwartz, *Understanding MACs: Moral Hazard in Acquisitions*, 21 J.L. ECON. & ORG. 330 (2005) (using economic modeling to analyze the role that MAC and MAE clauses play in the structure of the standard acquisition agreement and the incentive effects for acquirers and targets); Robert T. Miller, *Canceling the Deal: Two Models of Material Adverse Change Clauses in Business Combination Agreements*, 31 CARDOZO L. REV. 99 (2009) (advocating a judicial framework for interpreting MAC clauses that places the burden of material changes on targets and the burden of immaterial changes on acquirers during the closing period); Robert T. Miller, *The Economics of Deal Risk: Allocating Risk Through MAC Clauses in Business Combination Agreements*, 50 WM. & MARY L. REV. 2007 (2009) (arguing that the reciprocal allocations of deal risk in MAC clauses serve to further efficiency in transactions by decreasing the likelihood that parties will exercise termination rights); Alan Schwartz & Robert E. Scott, *Contract Interpretation Redux*, 119 YALE L.J. 926 (2010) (arguing for interpretative default rules in construing MAC clauses); Andrew A. Schwartz, *A “Standard Clause Analysis” of the Frustration Doctrine and the Material Adverse Change Clause*, 57 UCLA L. REV. 789 (2010) (arguing that MAC clauses transform conventional default rules by (1) allowing a contractual exit in cases of frustration of secondary purposes or partial loss of value and (2) shifting exogenous risk from the acquirer to the target); Eric L. Talley, *On Uncertainty, Ambiguity, and Contractual Conditions*, 34 DEL. J. CORP. L. 755 (2009) (arguing that MAE clauses are a tool for allocating the risk of market uncertainty present while negotiating the acquisition agreement).

having been front and center in one of the leading articles.¹⁴³ The clause is uniquely suited for testing these hypotheses, because it is one of the most important moving pieces in the merger agreement, and yet relies to a large extent on the background or default rules of state law.¹⁴⁴

We collected the textual definitions for “material adverse effect” for the 1,382 agreements in our database for which such definitions were available.¹⁴⁵ We then analyzed the word counts for these MAC definitions using the same variables as we used in Tables 3 and 4 above. The MAC definitions were reasonably normally distributed and symmetric like the documents as a whole, with mean of 377.2 words, median of 363, and standard deviation of 167.7.

	Individual Delaware Variables	All Delaware Variables Present	Choice of Delaware Law
Constant	-148.0	-139.7**	-152.2
All Legal Variables Are Delaware		11.7 (8.0)	
Target Incorporated in Delaware	9.1 (9.8)		
Acquirer Incorporated in Delaware	0.9 (7.5)		
Delaware Choice of	19.4		19.0*

143. See, e.g., Choi & Triantis, *supra* note 4, at 852–54 (using the MAC clause as an illustration of the tradeoff between vagueness and drafting costs in the context of contract design).

144. See Gilson & Schwartz, *supra* note 142, at 357–58 (discussing how MAC clauses manage transaction risk without court input).

145. We collected the definitions with a computer script and then checked them manually. In some cases, the outer bounds of the “definition” were unclear, so we used a rule that each definition could consist of one sentence only. In the vast majority of cases, that rule captured the entire definition, but in some cases it excluded text that was arguably part of the definition but contained in a separate sentence.

Law	(14.1)		(8.3)
Delaware Choice of Forum	-9.2 (14.3)		
No Choice of Forum	-10.7 (12.6)	-5.6 (11.0)	
Direct (Non-Triangular) Merger	-5.8 (13.9)	-6.1 (13.9)	
Years After 2001	24.9*** (0.98)	24.7*** (1.0)	
Tender Offer	28.8** (10.1)	29.7** (10.1)	29.1** (10.1)
Stock Consideration	-33.9*** (8.5)	-34.4*** (8.5)	-34.2*** (8.4)
LBO	32.7** (12.1)	30.6* (11.9)	33.2** (11.8)
Log (Deal Size)	16.7*** (12.1)	16.8*** (2.5)	16.8*** (2.5)
Top 20 Firm Buyer	0.03 (7.3)	0.7 (7.3)	0.5 (7.2)
Top 20 Firm Seller	7.7 (7.6)	9.0 (7.6)	8.4 (7.6)
Banking Industry	-35.3* (14.7)	-40.6** (14.5)	-37.7** (14.5)
REIT Industry	-33.9* (14.2)	-40.1** (13.7)	-36.6** (13.8)
R-Squared	0.394	0.392	0.393
Adjusted R-Squared	0.387	0.387	0.388
No. Observations	1382	1382	1382
Standard errors reported in parentheses. *, **, *** indicates significance at the 95%, 99%, and 99.9% levels, respectively.			

The results in this Table, based on the length of MAC clauses, parallel those above based on the length of entire agreements for our key variables of interest.¹⁴⁶ Delaware choice

146. See *supra* Table 6.

of law is positive in all models and significant when the highly correlated other Delaware variables are excluded. In Models 1 and 2 where the Delaware choice of law and “All Delaware” variables are not significant, the confidence intervals reduce any possible “Delaware effect” to a narrow range—literally single digit numbers of words for a definition averaging nearly 400 words. Thus, the analysis on individual MAC definitions parallels that for agreements as a whole. The only interesting difference is that the use of stock consideration in a merger leads to substantially shorter MAC definitions, whereas it leads to substantially longer agreements as a whole.

This analysis of MAC clauses confirms the findings based on entire agreements—that the choices of Delaware law and courts do not enable drafters to economize on contractual language.¹⁴⁷ Both agreements as a whole¹⁴⁸ and MAC clauses in particular do not differ significantly in length based on Delaware choice of law or choice of forum. Indeed, Delaware choice of law in particular is generally associated with an increased number of words in the agreements compared to reliance on the law and courts of other states.

The results of our analysis above suggest that Delaware law or forum is not a substitute for contractual complexity. Our analysis does not necessarily demonstrate, however, that there are no important systematic differences between agreements drafted under Delaware and non-Delaware law. First, it is possible that our analysis based purely on the length of agreements in words may miss systematic differences between Delaware and non-Delaware agreements for a variety of reasons. Second, some of the economic models discussed above predicted that certain types of court sophistication may produce longer agreements, rather than shorter ones.¹⁴⁹ These different types of sophistication could offset one another producing a zero net result.

We therefore also perform some checks to examine the substance of the agreements themselves to determine how

147. See *supra* Tables 3–6.

148. See *supra* Tables 3–6.

149. See *supra* Part IV (discussing collected data and approaches to analyzing Delaware’s default rules).

Delaware agreements differ from agreements governed by the law or forum of other states. We do this in the next section, where we deploy machine-learning techniques to examine how Delaware agreements differ textually from non-Delaware agreements.

B. Classification of Agreements Based on Textual Content

In this section we go beyond word counts to examine the textual content of the merger agreements using computer-based statistical techniques. Our goal in this section is to determine whether there are textual features that differ systematically between Delaware and non-Delaware agreements that may not show up in overall word counts. To conduct this analysis, we use a Random Forest classifier to attempt to differentiate Delaware from non-Delaware agreements.¹⁵⁰ If the classifier is able to reliably distinguish Delaware from non-Delaware agreements based on meaningful textual features, then we may have evidence that lawyers draft differently based on underlying law. If, however, the classifier is unable to distinguish between Delaware and non-Delaware agreements (or can distinguish only based on superficial features), that fact would support the conclusion from the agreement length analysis that lawyers do not draft significantly differently based on Delaware or non-Delaware law.

150. We also examined the documents' content using Latent Dirichlet Allocation (LDA), a statistical technique developed specifically for modeling text documents. See David M. Blei, et al., *Latent Dirichlet Allocation*, 3 J. MACHINE LEARNING RES. 993, 996 (2003) (defining LDA as a "generative probabilistic model of a corpus"). We first perform an unsupervised LDA model on a larger set of merger agreements that include both public company and private company acquisitions. This larger set of documents is drawn from the dataset we developed in a previous article. See Anderson & Manns, *supra* note 16, at 68–70 (collecting merger agreements filed with the SEC between 1994 and 2014). The unsupervised model produced indistinct topics that failed to clearly distinguish between Delaware agreements and non-Delaware agreements. We then perform a supervised LDA model on the public company merger agreement set with Delaware choice of forum as the class. The supervised model has two classes, Delaware choice of law and non-Delaware choice of law. The results were similar when all states were treated as separate classes. The supervised model performed better, but still failed to clearly distinguish between Delaware and non-Delaware agreements.

For the Random Forest analysis, we randomly divided the agreements into a training set of 1,258 agreements and a test set of 300 agreements. We removed terms that existed in substantially all documents and terms that existed in very few documents (fewer than twenty) to eliminate many proper nouns and similar words. We also eliminated stop words and punctuation, as is standard in textual classification.

The Random Forest classifier was able to predict Delaware choice of law with some degree of accuracy, as the following Table indicates. When the choice of law was actually Delaware, the classifier was correct 196 times and incorrect only 9 times. When the choice of law was actually a state other than Delaware, the classifier was correct 64 times and incorrect 31 times. This is a typical result when one class (here Delaware) is more common than the other class (here non-Delaware).

	Delaware Predicted	Non-Delaware Predicted
Delaware Actual	196	9
Non-Delaware Actual	31	64

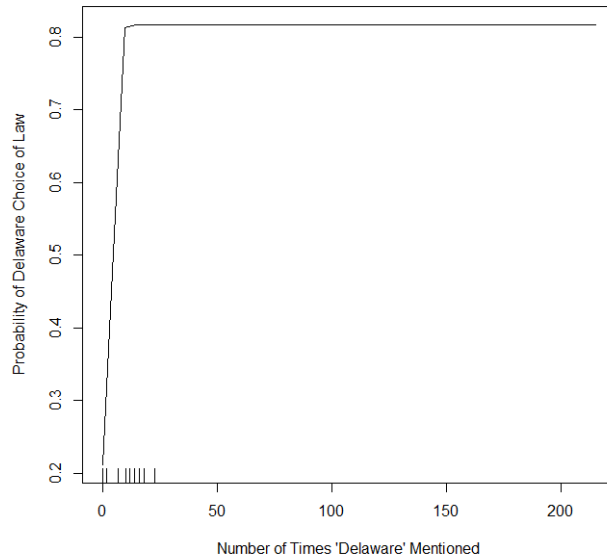
The initial results might suggest differential drafting between Delaware and non-Delaware. However, upon inspection of the individual words that predict Delaware versus non-Delaware, it is apparent that the prediction was largely based on relatively superficial characteristics of the documents. The strongest predictors of Delaware law were words such as “Delaware,” “DGCL” (the Delaware General Corporation Law), and “Chancery.” Below is a Table illustrating the fifteen most important words (in terms of Gini coefficient decrease) in predicting Delaware versus non-Delaware choice of law.

Table 8. Most Important Terms Predicting Delaware or Non-Delaware Incorporation		
Term	Importance	Direction
delaware	19.97	Predicts Delaware
Dgcl	17.56	Predicts Delaware
Articles	9.51	Predicts Non-Delaware
chancery	8.98	Predicts Delaware
stockholder	8.68	Predicts Delaware
stockholders	6.91	Predicts Delaware
shareholder	5.89	Predicts Non-Delaware
shareholders	5.01	Predicts Non-Delaware
appraisal	3.32	Predicts Delaware
Estate	2.76	Predicts Non-Delaware
secretary	2.71	Predicts Delaware
commonwealth	2.43	Predicts Non-Delaware

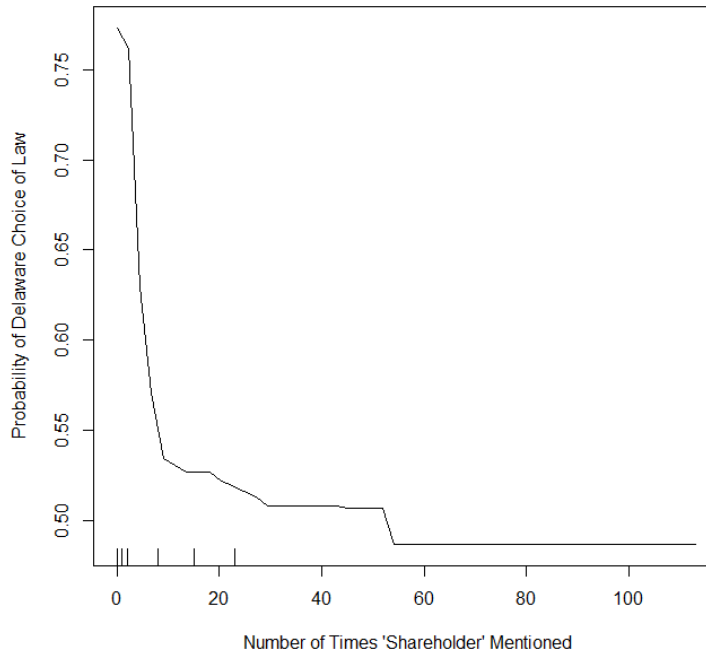
Hsr	2.02	Predicts Delaware
maryland	1.95	Predicts Non-Delaware
Reit	1.84	Predicts Non-Delaware

As an example of the predictive power of these superficial terms, consider the word “Delaware” used in an agreement. Because so few companies are physically located in Delaware,¹⁵¹ the primary reason for that word to appear in an agreement is because the agreement is governed by Delaware law or one of the companies is incorporated in Delaware (in which case the agreement is usually governed by Delaware law). As a result, the number of times the word “Delaware” appears in an agreement dramatically affects the probability the model predicts Delaware governing law, as illustrated in the figure below.

151. See Bebchuk & Cohen, *supra* note 5, at 389–91 (displaying the disparity in the number of publicly traded firms incorporated in Delaware and states with the largest number of publicly traded firms’ corporate headquarters).



Of course, there are also words that strongly predict non-Delaware choice of law. As an example, the following figure shows the predictive effect of the number of times the word “shareholder” appears in an agreement. When “shareholder” does not appear in an agreement, the agreement is governed by Delaware law about 80 percent of the time. When the word “shareholder” appears more than ten times, the probability the agreement is governed by Delaware law drops to about 50 percent. In Delaware, those who own shares of stock are generally referred to under the Delaware General Corporation Law as “stockholders,” while in most other state corporate codes such persons are referred to as “shareholders.”

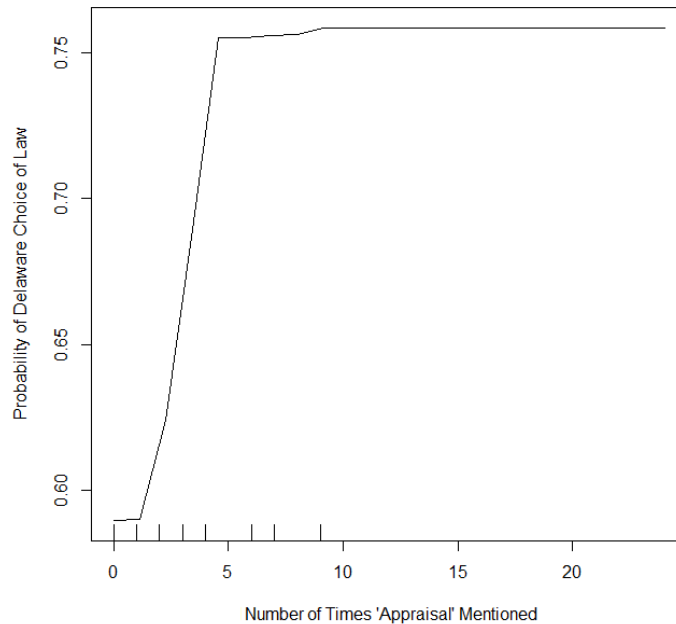


In contrast, the first arguably substantive term in the list of most important terms, “appraisal,” has a much smaller impact as shown in the Figure below.¹⁵² This is telling because the fact of appraisal for cash mergers under Delaware law is not even a default rule that the drafters can contract around; it is a mandatory rule to which the drafters must merely acquiesce.¹⁵³

152. The term “appraisal” tends to predict Delaware law (really Delaware incorporation of the target company), because Delaware provides appraisal rights when cash is the consideration, which many states do not. *See* DEL. CODE ANN. tit. 8, § 262(b)(2) (2019) (detailing stockholder appraisal rights).

153. *But see* Manti Holdings v. Authentix Acquisition Co., No. CV 2017-0887-SG, 2019 WL 3814453, at *3 n.20 (Del. Ch. 2019)

Thus, the word likely does not reflect an effort to contract around or accept default provisions—merely the acceptance of mandatory rules.



Overall, the results show that the Random Forest classifier was effective in distinguishing Delaware choice of law from non-Delaware choice of law, but did so largely based on superficial state-specific terminology, not based in substantive

The [appraisal] right is mandatory, I presume, in that it exists for all stockholders of Delaware corporations by statute. It is not mandatory in that stockholders must pursue appraisal, or that an appraisal action must proceed in every instance in which statutory appraisal is permitted under the DGCL. To the contrary, stockholders must meet certain procedural requirements to invoke appraisal rights, and stockholders are deemed to have waived appraisal rights if those requirements are not satisfied. (citations omitted).

transactional terms. In other words, we found no evidence lawyers drafted different substantive terms under Delaware law, only that they adapted the merger agreements to the different terminology and mandatory terms of Delaware law. Accordingly, we ran another Random Forest classifier after having removed these superficial markers for Delaware or non-Delaware corporate law.¹⁵⁴ The terms removed are listed in Table 9.

Table 9. Superficial Terms Removed.	
Terms Removed	Explanation
delaware, maryland, york, pennsylvania, massachusetts, texas, california, virginia, commonwealth, florida, indiana, nevada, jersey, minnesota, washington, carolina	Names or partial names of states
Articles	The corporate charter is called “articles” of incorporation in most states and a “certificate” of incorporation in Delaware
stockholders, shareholders, stockholder, shareholder	The holders of stock are called “stockholders” in Delaware and “shareholders” in most other states
dgcl, mgcl, bca, pbcl, tbca, sdat, department, cgcl, vsca, nybcl, nrs, fbca	Names, parts of names, or abbreviations for various state corporation code and agencies
chancery	The trial court chosen in most Delaware choice of law provisions is the Court of Chancery
secretary	Delaware Secretary of State

154. See *infra* Table 10.

borough	Common in exclusive forum provisions choosing New York courts
southern	Refers to Southern District of New York, common in provisions choosing New York Courts.
manhattan	Common in exclusive forum provisions choosing New York courts
fdic, reit, hsr, banking, bank, deposits, deposit, banks, bancorp, antitrust, taxable, governors, frb, irs, hart, rodino, bhc, bancshares, leach, bliley, comptroller	Words merely indicating industry or federal regulatory environment unrelated to state corporate law
appraisal, adoption, dissenters	Terms associated with mandatory rules of Delaware law

Once the terms in Table 9 had been removed, we re-ran the Random Forest classifier and obtained the following results in Table 10. Although the classifier still performs better than random,¹⁵⁵ it now predicts Delaware choice of law too often, and even predicts Delaware choice of law more often than not when the actual choice of law is not Delaware.

155. A null model would always predict Delaware choice of law as Delaware choice of law is the most common. It would have been correct 203 times and incorrect 97 times. The actual Random Forest classifier with superficial predictive terms removed was correct 219 times and incorrect 81 times. By way of comparison, before the removal of the superficial predictive terms the Random Forest classifier was correct 260 times and incorrect 40 times, as indicated by Table 7.

Table 10. Random Forest Predictions after Removal of Superficial Terms		
	Delaware Predicted	Non-Delaware Predicted
Delaware Actual	187	16
Non-Delaware Actual	55	42

Our results from this text classification parallel those from our regression analysis above.¹⁵⁶ The selection of Delaware law does not translate into systematic differences in textual patterns relative to agreements selecting non-Delaware law.¹⁵⁷ This finding reinforces the thesis that lawyers do not draft significantly differently based on a reliance on Delaware or non-Delaware law and casts doubt on the claims of the distinctive appeal of Delaware's legal framework and judiciary.¹⁵⁸ Alternatively, as we discuss below, these findings may raise doubt about the completeness of the explanations underpinning incomplete contract theory.¹⁵⁹ We do not see greater reliance on Delaware statutory and judicial defaults in contracting in spite of the confidence that lawyers appear to place in Delaware as the primary locus of incorporations and M&A litigation.¹⁶⁰

VI. Discussion

A. The Results and Their Interpretation

The key results from our analysis are twofold. First, lawyers do not appear to use reliance on Delaware law or Delaware courts as a substitute for detailed contractual terms.¹⁶¹ Delaware-governed agreements are no shorter and

156. See *supra* Part V.A.

157. See *supra* Table 10 (providing results of Random Forest predictions after removal of superficial terms).

158. See *supra* note 17 and accompanying text.

159. See *infra* Part VI.

160. See *infra* note 173 and accompanying text.

161. See *supra* Part V.

generally appear to be longer than agreements governed by the law of other states.¹⁶² Second, to the extent that there are systematic differences between Delaware and non-Delaware agreements, those differences relate primarily to relatively superficial differences in terminology between the states, not to substantive adaptations to different legal rules.¹⁶³

These findings have significant implications for contractual drafting and debates about the value of Delaware law. It suggests that there is a gap between the professed and revealed confidence in Delaware law and courts.¹⁶⁴ Contrary to the praise that M&A lawyers frequently lavish on Delaware, lawyers appear to place no greater reliance on Delaware than non-Delaware defaults when engaged in drafting agreements.¹⁶⁵ The finding that acquisition agreements with Delaware choice of law are statistically significantly longer in most of our models than their non-Delaware counterparts suggests that lawyers' practical confidence in Delaware is no greater than the confidence that they place in other jurisdictions.¹⁶⁶ Otherwise the Delaware agreements would be shorter as parties could rely on statutory provisions, judicial precedents, and reliable court interpretation to a greater extent to fill potential gaps in the agreement.¹⁶⁷ Even the most favorable models for Delaware show that Delaware agreements are no shorter than their non-Delaware counterparts.¹⁶⁸ This conclusion potentially calls into question the extent whether a "Delaware difference" in business law and adjudication exists and raises the issue of whether Delaware's allure preeminence results entirely from

162. See *supra* Table 3 and proceeding discussion summarizing regression analysis results.

163. See *supra* Table 10 (displaying predictions of incorporation state after removal of superficial contract terms).

164. See, e.g., Carney, Shepherd & Shepherd, *supra* note 17, at 134–42 (pointing to survey data to argue that lawyers' confidence in and reliance on Delaware corporate law is based both on Delaware's reputation and lawyers' ignorance of the alternative corporate law frameworks offered by other states).

165. For data underlying this assertion, see *supra* Part V.

166. See *supra* Part V.A.

167. See *supra* Part II.B.

168. See *supra* Part V.A.

substance rather than process—specifically path dependence.¹⁶⁹ The Delaware statutory and judicial defaults do not appear to matter in the contracting context where the added value of Delaware should shape lawyers' decision-making.¹⁷⁰

An alternative, yet complementary conclusion is that the logic of incomplete contract theory may simply not correlate closely to the empirical reality of contractual drafting.¹⁷¹ M&A lawyers may not be calibrating the terms of public M&A contracts to economize on drafting by leveraging the existing statutory and judicial defaults in Delaware (or for the defaults for transactions grounded in other states' law). This finding raises questions about the predictive power of the incomplete contract theory, as it may be that lawyers are either less aware of or responsive to legal defaults than incomplete contract theory expects they would be.¹⁷² Lawyers' confidence in Delaware may be genuine as evidenced by the large extent to which lawyers steer incorporations and M&A litigation towards Delaware.¹⁷³ But lawyers may be focused on other factors when it comes to legal drafting that leads to larger investments of time, money, and words in the drafting process. For example, every lawyer may feel he or she has to leave their mark on the agreement to justify their involvement (and billable hours), and idiosyncratic changes may have little to do with efforts to contract around defaults.¹⁷⁴ This potential interpretation may

169. See *supra* note 164 and accompanying text.

170. See Scott & Triantis, *supra* note 53, at 818 (offering a theory that contract design anticipates adversarial litigation); see also *supra* Part V.B (using data to show that the length of M&A agreements is not meaningfully affected by the selection of Delaware law).

171. See Scott & Triantis, *supra* note 53, at 817 (“Despite its theoretical advances . . . the theory of incomplete contracts has yet to yield predictions that are borne out by the realities of commercial practice.”).

172. See *id.* (discussing a gap between theory and practice).

173. See Bebchuk & Cohen, *supra* note 5, at 391, 420 (presenting data detailing Delaware's dominance as the primary location of incorporation for different types of firms); Irwin A. Kishner, *Market Trends, Legal Developments, and Their Effect on M&A Documentation*, in MERGERS AND ACQUISITIONS LAW 2013: TOP LAWYERS ON TRENDS AND KEY STRATEGIES FOR THE UPCOMING YEAR 5, 5 (2013) (discussing the outsized influence that Delaware courts have because of the large number of M&A suits litigated in Delaware).

174. See generally Anderson & Manns, *supra* note 15 (discussing idiosyncratic drafting in the M&A context).

reveal more about the shortcomings of M&A lawyers and their failures to economize on legal drafting than about the value of Delaware law.

The textual focus of our study means we cannot discount this possibility completely as we cannot directly observe the drafting process and what factors shape lawyers' decision-making in drafting. But given the sophistication of M&A lawyers at elite firms and the concentration of the M&A legal market, it seems very unlikely that lawyers are ignorant of the significance of legal defaults or ignore them amidst the drafting process.¹⁷⁵ To the extent that drafting pathologies exist, it is unclear why they would be more or less likely to arise in Delaware versus non-Delaware deals. But what is clear is that Delaware M&A agreements were at least as long and generally longer than agreements from other states even when we accounted for a spectrum of control variables including the deal structure, the quality of law firms, deal complexity, and the size of the transaction.¹⁷⁶ While it is possible that Delaware statutory and judicial defaults may have significant advantages over the defaults of other jurisdictions, lawyers' failure to place greater reliance on Delaware law in legal drafting (compared to other jurisdictions) suggest that they perceive that there is no advantage to relying on Delaware defaults.¹⁷⁷

Our analysis of the content of the agreements further shows only superficial differences between agreements relying on Delaware law and courts compared to those relying on other states' law and courts.¹⁷⁸ In fact, the most predictive variable for the final product of the agreement's text is the precedent agreement from which counsel copied the original draft.¹⁷⁹ This

175. See Scott & Triantis, *supra* note 53, at 816–18 (suggesting that lawyers are highly aware of the front- and back-end costs of contract drafting).

176. See *supra* Part V.

177. See Scott & Triantis, *supra* note 53, at 818 (implying that lawyers will increasingly rely on defaults if those defaults are advantageous); see also *supra* Part V (using data to illustrate the relative length of M&A agreements relying on Delaware defaults and the defaults of other jurisdictions).

178. See *supra* Table 9 (listing superficial language to remove from the Random Forest predication).

179. See *supra* Table 5 (examining choice of law, forum, and incorporation after controlling for precedent length).

fact reinforces the potential interpretation that reliance on statutory and judicial defaults does not play as significant a factor in legal drafting as incomplete contract theory suggests.¹⁸⁰ The strong influence of the precedent document does reveal, however, the importance of the choice of the precedent on the form and content of the final document. This path-dependent process of textual evolution in turn informs questions about why contracts are incomplete based on lawyers' drafting practices.¹⁸¹ This finding may call for a reassessment of how broadly to construe the implications of incomplete contract theory, and at minimum underscores the need for greater empirical research to examine the potential and limits of this law and economics paradigm and contractual drafting.

An important caveat in analyzing these interpretations of the data is the need to address the possibility that agreements governed by Delaware law are longer because the transactions involved are more complex.¹⁸² It is possible that transactions selecting Delaware law disproportionately involve novel legal issues or other forms of complexity, or simply employ counsel more inclined to create prolix agreements.¹⁸³ In that case, the word savings attributable to Delaware law might be reduced or even negated by these selection effects. Although we have attempted to control for the complexity of the transactions, it is possible our controls failed to control completely for deal complexity. At the same time, that possibility is significantly reduced by several factors discussed in our responses to potential objections in Part VI.B.2.

The centerpiece for our analysis is the construction of models of the lengths of agreements that have the agreements'

180. See Scott & Triantis, *supra* note 53, at 818 (suggesting that in anticipation of litigation, statutory and judicial defaults play an important role).

181. See Robert Anderson IV, *Path Dependence, Information, and Contracting in Business Law and Economics*, 2020 WIS. L. REV. 553, 558–62 (theorizing why the use of precedent documents leads to contract incompleteness).

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

183. See Kishner, *supra* note 173, at 8 (discussing Delaware's influence on M&A transactions).

length in words serve as the dependent variable.¹⁸⁴ We conducted regression analysis of the two key independent variables (choice of law and the choice of forum for Delaware versus non-Delaware) separately, as well as their connection to the target's state of incorporation.¹⁸⁵ We included a broad set of control variables including cash-only mergers (to control for the greater length of cash-only mergers), a date variable (to control for the increase in length over time), logged-enterprise value (to account for the potential impact of transaction size on deal length), and controls for major deal elements (to control for complexities that could potentially affect deal length).¹⁸⁶ We also included dummy variables to analyze "special" industries in the data set (banking firms and REITs) as well as to account for whether the buyer's and seller's counsel were "Top 20" firms to account for any potential impact of elite firms on legal drafting.¹⁸⁷

This set of control variables is not comprehensive, as we could expand on these models to account for a broader range of deal dimensions that could affect the length of agreements as we refine our analysis.¹⁸⁸ That is an objection that can be made for virtually all regression analysis studies as there are always more control variables that could be considered.¹⁸⁹ But the control variables we use do offer statistically significant evidence that the choice of Delaware law is correlated with longer agreements, even when we account for the structure of the deal, the date of the deal, and the size of the industry.¹⁹⁰ Our finding that the choice of Delaware law is associated with at least one thousand more words than agreements that opt for the law of other states suggests that lawyers may place no more confidence in Delaware defaults than those of other jurisdictions

184. See *supra* Part V.A. (detailing the analytical methods used to gather data).

185. See *supra* note 120 and accompanying text.

186. See *supra* note 121 and accompanying text.

187. See *supra* notes 124–127 and accompanying text.

188. See *supra* Part V.A.

189. See MONTGOMERY, ET. AL, *supra* note 119, at 15–16 (discussing residuals and their impact on linear regression model adequacy).

190. See *supra* Table 3 (incorporating control variables for deal structure, complexity, and industry size).

and therefore invest at least as much time and energy (and generally more) in drafting terms for Delaware deals than their non-Delaware counterpart agreements.¹⁹¹

Our modeling of the agreement length by choice of forum (without other Delaware controls) produced similar results to the choice of Delaware law analysis, which we would expect because the choice of forum and choice of law are correlated.¹⁹² However, in models controlling for Delaware governing law, the Delaware choice of forum results were not statistically significant.¹⁹³ While all acquisition agreements in the data set selected Delaware or another state to serve as the governing law for the agreement, not every agreement chose an exclusive forum for the resolution of disputes. This fact may lead to selection bias in the results for Delaware choice of forum, which is consistent with the effect for choice of forum disappearing (and indeed reversing) as deal complexity variables are controlled.¹⁹⁴ But the larger story is that Delaware choice of law and choice of forum are generally correlated, and in the deals in which they go together they are associated with significantly longer agreements than in non-Delaware choice of law and choice of forum agreements.¹⁹⁵ This fact suggests that lawyers do not perceive any less of a need to invest time and energy in drafting Delaware deals than they do in drafting other deals, and in fact generally invest far more effort in drafting Delaware deals.

Our finding in Table 3 that companies incorporated in Delaware who opt for Delaware choice of law are associated with shorter agreements than for non-Delaware companies who opt for Delaware choice of law does suggest a potential caveat and a future research direction for our results. This finding suggests that some of the additional length may be attributable to counsel for non-Delaware incorporated companies having to tailor agreements to fit non-Delaware corporations into the ambit of Delaware law. However, in an unreported regression

191. *See supra* Part V.A.

192. *See supra* Part IV.A.

193. *See supra* Table 3.

194. *See supra* Table 3.

195. *See supra* Table 4.

we analyzed only Delaware-incorporated companies opting for Delaware choice of law or Delaware choice of forum, and we still found that there is a positive (although not statistically significant) increase in length for Delaware agreements compared to agreements in which companies opt for non-Delaware choice of law or forum. This finding suggests that M&A lawyers may not be merely conforming agreements to fit governing Delaware law, but instead may actually be drafting more detailed agreements whose terms are opting out of Delaware defaults.

It is possible that the length of agreements does not completely capture the extent to which jurisdictional differences drive agreement drafting. For this reason we applied a Random Forest classifier approach to the data.¹⁹⁶ The Random Forest approach was able to predict agreements that opted for Delaware choice of law and non-Delaware choice of law.¹⁹⁷ But the distinctions the approach identified were largely superficial terms related to the nomenclature of Delaware compared to other jurisdictions.¹⁹⁸ This point may help to explain the one notable exception that runs counter to our finding of Delaware agreements being systematically longer: why non-Delaware incorporated companies who opted for Delaware choice of law in M&A agreements had marginally longer agreements than their Delaware incorporated counterparts who also opted for Delaware choice of law.¹⁹⁹ There may simply be a certain level of “Delaware overhead” verbiage necessary to translate between jurisdictions. But this analysis did not identify differences in substantive terms that would allow us to say with greater certainty that the difference in length of agreements that opt for Delaware choice of law or Delaware forum are longer because parties are contracting out of Delaware defaults in favor of more precise, substantive provisions.²⁰⁰ The Random Forest analysis therefore lends support to the idea that Delaware agreements are not drafted materially differently from non-Delaware

196. *See supra* Part V.B.

197. *See supra* Table 7.

198. *See supra* Table 8.

199. *See supra* Table 3.

200. *See supra* Table 10.

agreements in their substantive content, a fact which underscores the apparent absence of an advantage to relying on Delaware law.

One limitation of the paper is that we cannot conclusively point towards an explanation for what is shaping lawyers' decisions throughout the contractual drafting process. That, in part, reflects the limitation of engaging in reverse engineering analysis based on observing the merger agreement outcomes. We are neither using survey data to observe what lawyers think they are doing when drafting the agreements, nor do we have access to the detailed drafts that could showcase the give and take of the negotiation and drafting process because of the limits of public company disclosures (and the reluctance of law firms to share work product from the various stages of the drafting process with researchers).

But one plausible interpretation of the results in this paper is that regardless of the perception lawyers have of what they are doing in legal drafting, the strong pull of the precedent document's text dominates the deal-by-deal judgment about client needs.²⁰¹ The results in Table 5 show that the strongest predictor of the number of words in a document is the number of words in its precedent document, a fact that shows a tremendous path-dependency in transactional drafting. We have extensively documented the persistence of vestigial terms and left-over verbiage from precedent agreements in previous work.²⁰² Our results therefore might stand for another proposition, which is that the legal work product that transactional lawyers create may be excessively influenced by the happenstance of which precedent agreement was chosen as the foundation for the drafting process or how the draft evolved, rather than the needs of the specific transaction or the defaults of the underlying choice of law or forum. Either way, our findings suggest that no Delaware advantage in legal drafting

201. See Anderson & Manns, *supra* note 16, at 57 (theorizing that substantive similarities in distinct merger agreements reveal inefficiencies in the drafting process).

202. See *generally id.* (using computer textual analysis to identify precedent documents in the merger agreement context); Anderson & Manns, *supra* note 15 (examining the effect of inefficient drafting on boilerplate language in merger agreements).

exists for M&A agreements based on Delaware choice of law or forum. Instead, we found the opposite to be true empirically as Delaware M&A agreements were generally longer than agreements whose defaults rest on statutory and judicial defaults from non-Delaware jurisdictions.

B. *Objections*

The key finding from our analysis is that reliance on Delaware law does not lead to parties economizing on deal terms, contrary to the prediction we would derive from the standard law and economic analysis of contracting.²⁰³ In fact, in most of the models, Delaware agreements were longer in a statistically significant way.²⁰⁴ This type of “equivalence” finding is subject to a number of common objections, so we address them at some length in this section. Although some of these objections have merit, deeper analysis of the data refutes each of them.

1. *The “Equivalence” Objection*

First, some might argue that because the Delaware variables were not significant in some of the models, the analysis fails to show that Delaware law does not allow drafters to economize on contractual terms.²⁰⁵ There are two responses to this objection. First, in all models where Delaware choice of law was analyzed separately from the highly correlated variables on forum choice and state of incorporation, the coefficient was positive and significant.²⁰⁶ Thus, for those models we can reject the null hypothesis that Delaware choice of law has no effect on agreement length in favor of the alternative hypothesis that it is associated with *increased* agreement length.

Second, even if one focuses on the models in which there is equivalence between Delaware and non-Delaware agreements, the model still tells us quite a bit about the effect of Delaware

203. See *supra* note 4 and accompanying text.

204. See *supra* Part V.

205. See *supra* Part V.A.

206. See *supra* notes 134–136 and accompanying text.

law. In fact, the contrary argument is based on a common misunderstanding of hypothesis testing. It is true that in those models we cannot reject the hypothesis that Delaware has *any* effect on lowering the word count, but we can reject the hypothesis that Delaware has any substantial effect beyond a certain size on agreement length with 95 percent confidence.²⁰⁷ Even in the most unfavorable model for the “no effect” hypothesis (Model 2 of Table 4), the confidence interval for “All Delaware” deals’ effect on word count is -428.4 to 883.6. Thus, we can reject the hypothesis that reliance on Delaware law can substitute for more than 428.4 words, which is a quite narrow margin in an agreement averaging over 36,000 words.²⁰⁸ Even in the least favorable model the confidence intervals are quite compressed which suggests that Delaware law has no impact on legal drafting or is still correlated with a longer length compared to agreements grounded in other jurisdictions.²⁰⁹

2. *The “Confounding Variables” Objection*

The second objection centers on the concern that our results may be influenced by confounding variables.²¹⁰ It is possible that transactions choosing Delaware law may tend to have higher complexity than transactions grounded in other states’ laws, and that our independent variables do not adequately control for that extra complexity. If that premise is true, we may have incompletely controlled for transaction complexity. It is possible that the increased complexity of Delaware transactions is offsetting the savings in word count allowed by reliance on Delaware statutory and judicial defaults.

207. See *supra* Part V.A.

208. See *supra* Table 4.

209. See, e.g., William C. Blackwelder, *Proving the Null Result in Clinical Trials*, 3 CONTROLLED CLINICAL TRIALS 345, 348–50 (1982) (discussing the significance of null results in bioequivalence testing). Although this type of analysis is less common in the social sciences “p-value” world, such analyses are quite common in the scientific literature called “equivalence testing.” *Id.* This approach is especially common in medical research in bioequivalence testing, in which null results with narrow confidence intervals are used to establish the equivalence of two pharmaceutical preparations. *Id.*

210. See MONTGOMERY, ET AL., *supra* note 119, at 15–17.

There are several strong counterarguments to this claim. First, the fact that choice of forum loses significance as control variables are added in Table 3 (and indeed switches sign), while the same does not happen for choice of law is strong support that the choice of law coefficient does not result from confounding (although the choice of forum may). Also, the fact that the “Top 20” variable for the law firms involved is small in magnitude and not significant is telling.²¹¹ The “Top 20” law firms are overwhelmingly used in more complex transactions, and yet they do not predict greater agreement length when the control variables are used.²¹² Indeed, merely removing the logged transaction value and the “Delaware law” variables from the controls made both the “Top 20” seller firm and the “Top 20” buyer firm statistically significant predictors of longer agreements.²¹³ These relationships were reversed by the inclusion of control variables, suggesting we have successfully controlled for the role of “deal complexity” in the process.²¹⁴ Finally, the control for precedent length should incorporate any deal complexity concerns, as the precedent is, at least in theory, chosen for its similarity to the deal at hand (including most complexities).²¹⁵

Indeed, it is possible that confounding variables work the other way. There are some controls we used that have the potential to artificially reduce the effect of the choice of Delaware law or forum on increasing the length of agreements. In particular, the most common category of non-Delaware companies are banks and bank holding companies.²¹⁶ Banking companies have lower rates of Delaware incorporation than do other companies (due to regulatory reasons since state banks are incorporated in the state that they operate and are regulated

211. See *supra* Table 3.

212. See *supra* Table 3.

213. See *supra* Table 3.

214. See *supra* Table 3.

215. See *supra* Table 5 (controlling for length of precedent document).

216. See FED. RES., INSURED U.S.-CHARTERED COMMERCIAL BANKS THAT HAVE CONSOLIDATED ASSETS OF \$300 OR MORE (2020), <https://perma.cc/5NSQ-U7KW> (PDF) (demonstrating through bank location data the small number of banks incorporated in Delaware).

in).²¹⁷ However, they also have shorter agreements because of drafting practices peculiar to the industry and their reliance on stringent regulatory frameworks that are difficult to contract around.²¹⁸ Thus, it is possible that our controls actually suggest even stronger evidence that either reliance on Delaware does not enable lawyers to reduce contract detail and length or that lawyers are not recognizing and taking advantage of the potential value of these statutory and judicial defaults when engaged in legal drafting. Either of these potential conclusions underscore the need for greater scrutiny in future research of both the ostensible value-added of Delaware law and the potential pathologies taking place in the legal drafting process.

3. *The “All the Important Terms Are Included in Every Deal” Objection*

A third objection one might make is that the cost of including additional terms is relatively small compared to the magnitude of M&A deals, which therefore makes it easier for lawyers to justify including all the important terms in every deal. In other words, whether the governing law has desirable default rules or not, parties include all the important terms in every deal, simply duplicating the desirable default rules in some transactions and overriding undesirable default rules in other transactions. Thus, the fact that we find that parties do not economize on terms in deals based on Delaware choice of law and forum may potentially not say as much about the significance of Delaware’s statutory and judicial defaults as about inefficiencies in the drafting process.²¹⁹

This objection has three significant problems. First, the cost of additional drafting effort is not solely the cost of additional

217. See Nicholas Economides et al., *The Political Economy of Branching Restrictions and Deposit Insurance: A Model of Monopolistic Competition Among Small and Large Banks*, 39 J.L. & ECON. 667, 668–69 (1996) (noting that banking regulations place geographical limits on bank branching).

218. See *id.* (discussing how commercial banks are subject to a high degree of regulation in “virtually all countries”).

219. See Anderson & Manns, *supra* note 16, at 64–65 (discussing the use of precedent documents in transaction drafting).

attorney time, which may well be low compared to the magnitude of the transaction.²²⁰ The larger cost is the delay in the drafting process of including additional terms, which grows with the magnitude of the transaction. Spelling out additional terms is costly even if the actual cost of lawyers' time is low in an individual deal because of the time-compressed nature of the merger agreement drafting process.²²¹

The second problem is that if all the important terms are included in every deal (because of the insignificance of costs relative to the magnitude of the deal), why does the length of the agreement vary strongly with the value of the consideration being paid? In the full model of Table 3 the coefficient on the log of deal size is 967.²²² This implies, for example, that a \$20 billion acquisition will have 5,123 additional words compared to a \$100 million acquisition.²²³ Considering that the average number of words of the agreements in the database is about 36,309, that is approximately 14 percent more words based on transaction size. The relationship of transaction size to word count suggests that cost is constraining the expression of at least some of the important terms in smaller transactions. Therefore, at minimum we would expect to see that lawyers in smaller transactions would be seeking to economize on drafting and leveraging the value of statutory and judicial defaults (to the extent to which the defaults truly add value and lawyers are able and willing to recognize this value).

Third, important sections of merger agreements do contain what is likely suboptimal detail, and this produces a significant (and increasing) number of litigated cases (as well as untold interpretive disputes that are settled privately).²²⁴ This fact

220. See *id.* at 90 (“[E]ven though the costs of M&A lawyers appear high, legal bills still constitute only a small fraction of the cost of M&A transactions.”).

221. See Claire A. Hill, *Why Contracts Are Written in “Legalese,”* 77 CHI.-KENT L. REV. 59, 63 (2001) (explaining the motivation to use precedent documents).

222. See *supra* Part V.

223. This is calculated by $967 * \log(10,000,000,000) - 967 * \log(100,000,000)$.

224. See, e.g., Jill E. Fisch, Sean J. Griffith & Steven Davidoff Solomon, *Explaining the Increase in M&A Litigation*, 93 TEX. L. REV. 557, 559–60 (2015)

suggests that parties are, in fact, constrained by costs in spelling out the optimal resolution of all contingencies in the agreement because of the potential to avoid litigation and the resulting uncertainties.

VII. Conclusion

We have shown that M&A agreements that opt for Delaware choice of law or forum are no shorter than agreements based on other jurisdictions' choice of law or forum even when we control for a spectrum of variables, such as the deal structure, time, size of the transaction, and major deal elements. Delaware-governed agreements generally appear to be longer in statistically significant ways, even with other factors fully controlled. These findings support the hypothesis that corporate lawyers do not rely on the perceived superiority of Delaware law and courts, at least in terms of how they design contracts.²²⁵ Lawyers may simply give lip service to the reputation of Delaware law and its judiciary, but when drafting M&A agreements pay no more attention (and possibly less) to the statutory and judicial defaults than they would to the defaults of any other jurisdiction. This conclusion shows that Delaware statutory and judicial defaults do not appear to matter in a context where the Delaware difference in business law and adjudication should be clear. Ultimately, this finding calls into question the durability of Delaware's outsized reputation in corporate law. Lawyers' practices in drafting speak to the degree of their confidence in Delaware and the need for Delaware's legislature and judiciary to enhance the comprehensiveness and precision of Delaware corporate law defaults.

(discussing the increase in number and scale of M&A litigation involving public company mergers, noting that by 2015 over 97.5 percent of public company mergers involving deals over \$100 million faced litigation).

225. See, e.g., Carney, Shepherd & Shepherd, *supra* note 17, at 134–42 (pointing to survey data to argue that lawyers' confidence in and reliance on Delaware corporate law is based both on Delaware's reputation and lawyers' ignorance of the alternative corporate law frameworks offered by other states).